

## Context & Definition

According to the Global Impact Investing Network (GIIN), impact investment has the potential to unlock significant sums of private investment capital to complement public resources and philanthropy in addressing pressing global challenges.

Impact Investing is intended to attain positive impact beyond financial return by seeking to proactively create positive social or environmental benefit.

***The Global Impact Investing Network** (the GIIN) was conceived in October 2007 in the US. The initiatives launched by the GIIN include the creation of a global network of leading impact investors, the development of a standardized framework for assessing social and environmental impact, and a development of a working group of investors focused on sustainable agriculture in sub-Saharan Africa. Today the GIIN operates as an independent organization under the sponsorship of Rockefeller Philanthropy Advisors.*

### **Investors include :**

- development finance institutions,
- private wealth managers and their clients
- commercial banks,
- pension funds and investment funds,
- private companies

### **They operate across multiple business sectors such as**

- agriculture and timber
- housing and community investing
- education
- health
- renewable energy
- climate change and CO<sup>2</sup>
- financial services

Their **impact objectives** can range from mitigating climate change to increasing incomes and assets for poor and vulnerable people. Impact Investing can take the form of private equity or debt instruments but can also include guarantees and deposits.

### **Impact investing vs SRI**

*Impact Investing needs to be distinguished from socially responsible investments (“SRI”). Both have in common the motivation to take note of the social components of business activities. But where SRI focuses on avoiding harm (essentially through screening processes), impact investing is to do with intentionally, proactively and measurably achieving a significant positive social or environmental return while still operating on a financially self-sustainable basis.*

As several surveys demonstrate, **this market segment has gained strong momentum** over the last years, not least because of the fall-out of the global financial crisis that has clearly demonstrated the limits of traditional ways of value creation with exclusively short-term investment horizons.<sup>1</sup> The GIIN estimates impact investments to be worth USD 50 bn, with a projection growth USD 500 bn by 2014.<sup>2</sup>

<sup>1</sup> Source : « White paper Action proposals » - European Impact Financing Luxembourg – November 2010

<sup>2</sup> Source: “Impact Finance Survey 2010 » - AlphaMundi group for European Impact Financing Luxembourg

## 1. Luxembourg as a European hub for impact investing

Luxembourg's position as a leading private banking centre with a potential to attract HNW clients and foundations to innovative asset classes and a world hub for fund domiciliation and distribution, combined with its private equity expertise and its engagement in development aid matters underlines its ability to play a mediating role in impact investing. Luxembourg is well-positioned to achieve in impact investing what it has already succeeded in microfinance, namely the hosting of 45% of the world's microfinance funds.

More specifically Luxembourg can build on its place as:

*a. a pre-eminent jurisdiction for structuring private equity and impact investment funds and projects*

- Luxembourg **SOPARFI** - financial participation company - are used for private equity acquisitions and financings alike.
- With the introduction of the **SICAR** (investment company in risk capital - société d'investissement en capital à risque) a dedicated private equity and venture capital investment vehicle in 2004 and the **SIF (specialized investment fund)** in 2007, a significant number of international private equity houses started to shift their fund platforms from certain off-shore centres to Luxembourg, thereby opting for product regulation often to the benefit of their fund raising efforts. In the context of increased prudential supervision of financial activities worldwide, this trend is set to amplify in the years to come. The Luxembourg Private Equity Association (LPEA) is an important player defending the interest of both investors and service providers of the private equity industry.  
SIF and SICAR as well as Securitization Vehicles and Structured Products, along with Undertaking for Collective Investment (UCI) Part II funds are used for **structuring for Microfinance Investment Vehicles (MIV)**.
- The proposed Directive regulating alternative investment fund managers (AIFM-D) enables the Luxembourg financial centre to position itself as the **Pan-European hub for alternative investments funds (AIF)** or non-UCITS as the main provisions of the AIFM-D are already in place in Luxembourg, such as the need for a custodian bank, the independent evaluator, the required accounting standards etc.
- The EU framework on Social Investment Funds proposed in December 2011 opens another perspective for Luxembourg to actively participate in this debate, create a new framework for social business and adapt existing frameworks to the needs of impact investing.

**b. an engaged player in development aid matters.**

- Luxembourg provided Official Development Assistance (ODA) worth more than EUR 304 mn in 2010 (or 1.05% of its GNI), which was **the second highest ODA/GNI ratio** after Norway.
- The primary objective of the Luxembourg Development Cooperation is the **eradication of poverty, particularly in the least developed countries**. Its actions and projects are conceived in the spirit of sustainable development, which is reflected in its social, economic and environmental aspects.
- At the same time the Luxembourg Cooperation is actively participating in the discussion on, and the defining of, new standards for the **transparency and increased quality of Microfinance institutions through the Rating initiative launched in 2008**.
- The Luxembourg government is the promoter of the **Luxembourg Microfinance and Development fund**, set up in October 2009 as a part II UCI. This innovative fund structure gathers public, institutional and retail investors and seeks to promote microfinance investments in Tier 2 and 3 MFIs located in less developed countries.
- Moreover the presence of supranational actors in Luxembourg, such as the **European Investment Fund**, which is increasingly investing in impact finance, is an additional indication for the extent of network and the quality of actors present in Luxembourg

**c. a leading service provider for Microfinance Investment Vehicles**

- In 1998, Luxembourg was the chosen domicile of **the first registered Microfinance fund**.
- With **28 out of 65 European based Microfinance investment funds** currently registered in Luxembourg gathering around 45% of worldwide MIVs' assets under management (or nearly USD 3 billion), the Grand-Duchy is the leading centre for the domiciliation of MIVs. Six of the largest 10 MIVs are based in Luxembourg.
- Since 2006, the **LuxFLAG** label is granted for MIVs which invest 50%+ of their assets in microfinance. As of February 2012, LuxFlag numbered 23 MIVs with total assets of EUR 2.2 bn.  
Since end of 2011, LuxFlag has added an environment label to its service range. As of February 2012, 3 funds have been labeled.
- Appropriate initiatives in the field of microfinance are encouraged and supported, both on the conceptual and on the operational level. The Luxembourg authorities as well as private players are pioneering in the field of MIV rating (**the Rating Initiative**) and the launch of the **Luminis initiative** by which the Luxembourg Ministry of Cooperation, together with LuxFlag and MicroRate, aims at greater transparency and objective analysis of microfinance investment vehicles. A web-based platform has been launched in December 2011 enabling professional investors and researchers to identify, assess and monitor MIVs with regards to their fund profile, performance, risk, social impact and ESG criteria.

## 2. Promoting impact investing

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### a. *the European Impact Investing Luxembourg initiative (EILL)*

- **EILL was launched in 2010**, regrouping a number of major actor of the Luxembourg financial place such as ADA-Microfinance-an NGO promoting autonomous development through inclusive finance, the lawfirm Arendt & Medernach, Banque de Luxembourg, Deloitte, the lawfirm Elvinger Hoss & Pruessen, Ernst & Young, European Fund Administration, the European Investment Fund, Innpact-a firm specialized in innovative responsible finance solutions, KPMG, the Luxembourg Microfinance and Development Fund and PWC.
- Its aim is **promote the development of impact investing** as well as **Luxembourg's position as a pole of competence in this field.**
- **Amongst its first initiatives range**
  - the organization of conferences introducing the impact investing concept as well as key aspects, such as the impact measurement
  - the sponsorship of the European Venture Philanthropy Association 2010 Conference
  - the commissioning of an international Impact financing survey amongst fund managers and investors (the AlphaMundi survey)
  - a white paper with action proposals for the Luxembourg Financial Center
- **Liaison with prime actors in the domain**

EILL is actively involved in discussions around impact investing with ALFI, LuxFlag, the Ministry of Cooperation, the Ministry of Finance, the Ministère de l'Economie Solidaire, as well as different international advisors and actors, such as the European Venture Philanthropy Association (EVPA), the GIIN etc.

Regular input is given to the "Haut Comité de la Place Financière".

### b. *EILL initiatives:*

In order to meet the challenge of establishing a center of excellence for impact investing in Luxembourg, EILL has proposed a coherent approach working on three dimensions: **knowledge, framework and products/activities.**

## Luxembourg as leading Financial Centre for Impact Investing

Knowledge	Framework	Products / Activity
<ul style="list-style-type: none"> <li>Establish a University Chair</li> <li>Create Database Platform for Impact Investing</li> <li>Build out European Impact Investing Luxembourg to a European Think Tank for Impact Investment</li> </ul>	<ul style="list-style-type: none"> <li>Tax Treaties with countries with high Impact Investing relevance</li> <li>Streamlined, cost-effective structures for small investment vehicles</li> <li>Mandatory allocation to impact investing for Luxembourg based institutions</li> </ul>	<ul style="list-style-type: none"> <li>Create a Luxembourg Social Equity Fund channeling part of Luxembourg's development aid to social entrepreneurship</li> <li>Create a Luxembourg Impact Investment Platform</li> <li>Set up the European Social Investment Bank for Impact Finance Instruments</li> </ul>

EIIL and other Luxembourg players took action on following points:

- **Elaborate a legal structure suitable for the hosting of social impact projects**

At the level of the target companies, the traditional “for profit” companies need to be adapted in order to host social impact projects generating both a financial and a social return.

Reflections around an “impact company – société d’impact” which would allow “impact first” and “financial first” investors to invest together in the same vehicle are currently undertaken, using the existing legal framework regarding commercial companies while adding a social and environmental impact “label”.

At the level of the investment vehicle investing into target companies, these vehicles are mostly tailor-made and start at a relatively low volume (< € 50 mn). Thus the costs involved in the set-up of these type of vehicles are very high and their inception could significantly be eased by the use of a streamlined vehicle, including the major characteristics which are required. Additional, more complex, features can be added at a later stage once the vehicle will have reached sufficient assets under management.

EIIL closely follows the work currently undertaken by ALFI regarding the “Société en commandite simple” (SCS) in this context.

- **Build a Luxembourg impact investing platform (LIIP)**

In order to help fund managers and promoters start their project out of Luxembourg, a platform benefiting from the expertise of fund specialists, social impact advisors and managers, as well as development specialists is envisaged. This platform could be set up as a public private partnership and provide services in the following areas:

- Facilitation, coordination, networking and advice for projects to be set up in Luxembourg
- Project identification and project readiness together with public and private development actors and deal sources such as NGOs and Foundations
- Advisory regarding choice of project and implementation
- Advisory regarding legal, tax and financial aspects
- Marketing & communication
- Impact measurement and reporting to investors
- Project evaluation and audit

- **Create a University Chair in impact investing**
  - ***Field of Activity of the Chair:***
    - focus on applied research rather than purely theoretical fundamental research.
    - considering the emerging nature of impact investing, there is a need for academic background with regards to the definition, development and implementation of new frameworks related to
      - the regulatory environment
      - the funding structures and instruments available to and offered by asset managers in the financial markets
      - the product offering of the financial services industry supporting main actors in asset management and investment activities
  - ***Focus of the Chair:***
    - definition, characteristics and criteria of this advancing investment field
    - aspects of segmentation of impact finance and the origin and motivation for capital streams in its market segments
    - the integration of impact measures in the investment selection, investment execution and reporting to investors
    - the nature of value added sought by investors in the Impact Finance space and how asset managers can respond to these new customer needs and what characteristics products and services ought to have for such service offering by asset managers.
  
- **Analyze and complete the double tax treaty framework relevant for impact investments**

Impact investing target projects are often located in less developed regions and countries. In order to optimize the flows of repayments from the different projects to the investment vehicles, the losses due to tax regulations have to be minimized through the application of double tax treaties. The Luxembourg Ministry of Finance is constantly extending the network of double tax treaties and the needs of the impact finance sector are currently being integrated in the analysis, according to specific business cases per target country.

A first analysis will focus on Cambodia, Kenya and Peru.

**For any further information:**

**Info@impactfinancing.lu**

