Private Markets Sustainability and Impact Report

2022/23

PRIVATE MARKETS SUSTAINABILITY AND IMPACT REPORT

INTRODUCTION

Rede Partners is delighted to publish our Private Markets Sustainability and Impact Report, looking at institutional investor sentiment towards Sustainability and Impact investment in private equity. Despite a tightening in the general fundraising environment, our research highlights real momentum within Impact, with an increasing quantity and quality of fund options and growing LP appetite. Impact has now “arrived” as an investment theme - underpinned by increasing LP interest in the emerging Sustainability megatrend - with increasing recognition of its potential to deliver at least market rate financial returns alongside non-financial benefits.

While much of the LP landscape is now convinced that Impact and Sustainability can be a source of competitive advantage, there remain corners of the market in which ‘anti-ESG’ views, accusations of greenwashing and de-prioritisation of Impact in the face of macro-economic turbulence threaten the acceptance of the investment theme. Meanwhile, the industry’s approach to assessment, delivery, measurement, and accountability for Impact outcomes is a fast-evolving work in progress. For Impact to capitalise on its rapid recent growth path and build a long-lasting position within LP portfolios, potentially as the second major investment theme of the 21st century alongside digitisation, it will need to demonstrate consistently strong financial performance, a clear and standardised approach to defining what is a sustainable or impactful investment, and measuring and reporting of non-financial returns, as well as strong alignment between GPs and LPs.

SURVEY METHODOLOGY

Over the course of 2022, Rede undertook a survey of over 160 institutional LPs from across the globe, questioning investors on their investment appetite and sentiment, geography and strategy preferences for Impact and Sustainability funds, key challenges and risks surrounding the investment theme, as well as key drivers of success for Impact and Sustainability going forward. The survey was sent to a select group of institutional LPs, chosen to provide diversification by geography and source of capital. This was supplemented by ongoing discussions and structured interviews led by Rede with many of the world’s leading and most sophisticated Impact investing market participants, to add further nuance and understanding to the survey results.

The survey has representation from all over the world. In this more detailed analysis focused on Sustainability and Impact, we have only included categories which had enough respondents to be statistically relevant.

KEY FINDINGS

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1

IMPACT HAS COME OF AGE

A major change in LP attitudes to Impact investment – driven by an increasing belief that the Sustainability megatrend has the potential to drive strong returns – has significantly expanded the size and maturity of the Impact market

2

LPS' (SECOND) MOST WANTED

Sustainability and Impact is now the second most frequently cited sector for LPs seeking to expand allocations

3

CLIMATE LEADS THE WAY

Increasing awareness of the decarbonisation market opportunity and momentum is generating a strong gravitational pull towards climate-related themes across asset classes

4

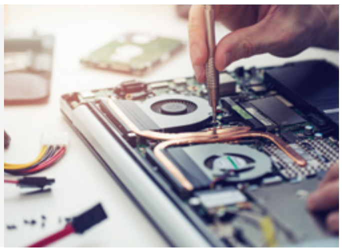
ACTIVE STRATEGIES IN DEVELOPED MARKETS

LPs currently favour Buyouts and Growth Equity strategies in North America and Europe

5

CYNICISM REMAINS THE GREATEST THREAT

Greenwashing, de-prioritisation in light of macro-economic turbulence, and the ‘anti-ESG’ movement threaten the continued success of Impact



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FUTURE ROADMAP

Improvements in methodological rigour, standardised reporting, transparency and alignment will be key to securing the long-term future of Impact

1 IMPACT HAS COME OF AGE

A MAJOR CHANGE IN LP ATTITUDES TO IMPACT – DRIVEN BY AN INCREASING BELIEF THAT THE SUSTAINABILITY MEGATREND HAS THE POTENTIAL TO DRIVE STRONG RETURNS – HAS SIGNIFICANTLY EXPANDED THE SIZE AND MATURITY OF THE IMPACT MARKET

A seismic shift in LP perceptions of Impact investment over recent years has heralded a transformation of the Impact market. Many institutional investors no longer see Impact as a 'nice to have', lower performing bucket within asset allocations, but instead as a strategy that can deliver attractive financial risk-adjusted returns alongside non-financial benefits underpinned by the Sustainability megatrend. As a result, the market has grown significantly across multiple fronts – an expanded universe of GPs, raising larger funds from a broader set of institutional investors who are now investing larger pools of capital into the sector.

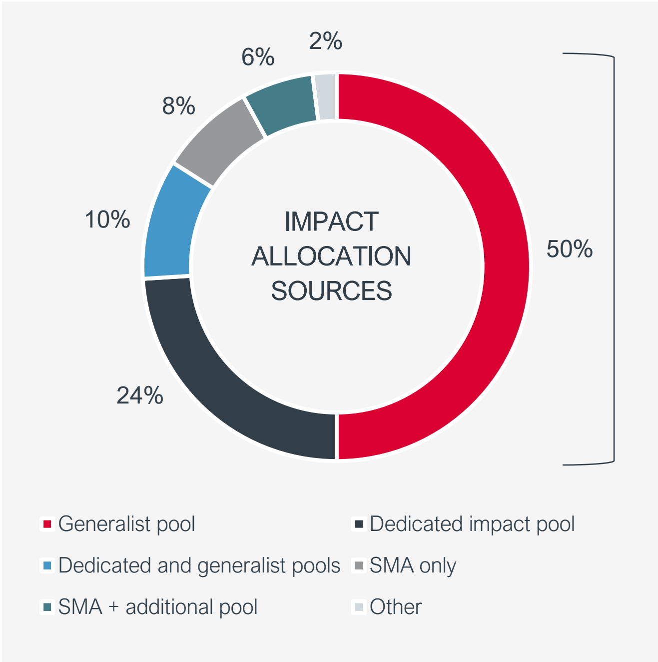
The increased LP acceptance of the performance potential of Impact, in conjunction with the 'mainstreaming' of social and environmental challenges and opportunities, has led to a new recognition that Impact investment is on track to be the second major investment thematic of the 21st century after digitalisation. Indeed, over 350 institutional LPs that Rede is tracking have noted a specific interest in Impact funds, and/or are in the process of building out dedicated Impact programmes.

For many institutional investors, Impact is now a distinct, important segment within their asset allocation strategies. While the size of the Impact investment market is still relatively small compared to the overall size of alternative assets universe, the investment theme's rise in popularity among investors is forecast to continue rapidly over coming years.

As well as driving overall market growth, the change in LP attitudes has also underpinned a rapid evolution of the Impact market as a whole – facilitating the emergence of a thriving ecosystem of differentiated GPs, skilled institutional investment professionals, growing pools of dedicated capital, emerging industry standards, well-regarded trade publications and essential industry events.

The majority of LPs allocating to Impact now have at least one dedicated Impact investment professional, allowing institutions to develop a concentration of knowledge and specialised expertise, as well as a greater ability to monitor and compare performance. This improved expertise is translating into more sophisticated investment programmes, which in turn is enabling the Impact market to mature at an accelerated rate.

Impact is entering the mainstream: 50% of LPs who have invested in Impact funds are now doing so from generalist pools



One important consequence of LPs' changing views on the financial potential of Impact is a growing trend to include Impact strategies within generalist private markets deployment programmes. Rede's survey highlights a significant shift in the way LPs are allocating to Impact funds, with half of investors now stating that they will invest in Impact from their general private markets pools. Rede's experience over recent years suggests this represents a major change from just a few years ago when the majority of Impact funds were being funded from dedicated capital pools. This is noteworthy as it reinforces the view that Impact funds should be viewed as on par with generalist strategies, bringing Impact more firmly into the mainstream within private markets.

1 IMPACT HAS COME OF AGE

The ability to access generalist capital is expected to be highly beneficial to the Impact market as it continues to evolve. It allows Impact GPs to target a significantly broader range of potential investors, and ultimately tap into a vastly expanding pool of liquidity – supporting larger fund sizes and a wider range of investment strategies.

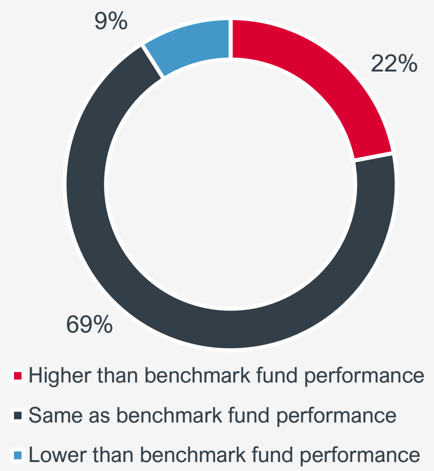
LPs expect Impact funds to perform on par with wider market benchmarks

For Impact to truly break into the private markets mainstream, it must earn its place within LP portfolios by performing on par with generalist strategies. Rede's survey data shows that Impact managers are now mostly benchmarked against generalist private equity managers. Of the 160 LPs surveyed, more than 90% of respondents require an Impact fund to perform in-line with or higher than generalist PE benchmark performance.

Indeed, 22% of LPs are expecting Impact funds to outperform generalist funds in the longer term. Rede's recent conversations with LPs that have allocated or are allocating to Impact funds from generalist pools suggest that many of these investors believe that Impact funds being raised should perform more strongly than similar funds with a non-Impact focus, due to their Sustainability focus providing a competitive advantage and their investment strategies benefiting from strong sectoral tailwinds which will in turn benefit their assets.

On the other hand, in search of incremental impact, a number of Impact pockets surveyed have increasingly focused on emerging managers and emerging themes. Accordingly, these pools of capital tend to have a more flexible approach and can support strategies with less developed track records or newer-formed teams whilst underwriting to achieve a market-rate risk-adjusted return over time.

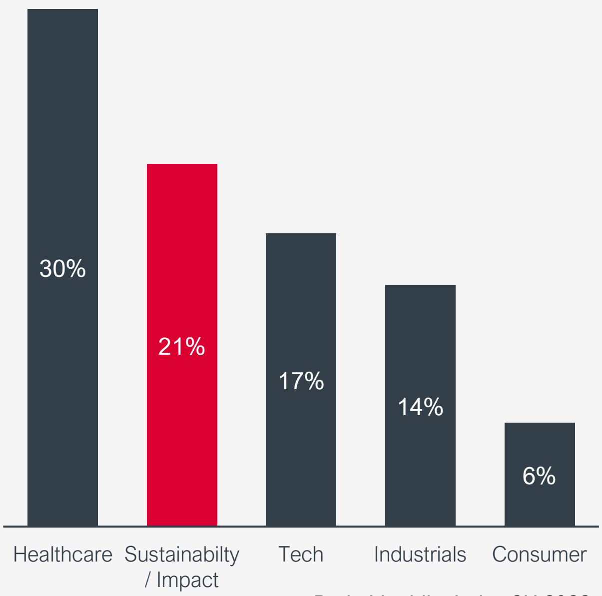
WHEN ASSESSING A POTENTIAL IMPACT FUND INVESTMENT, HOW WOULD YOU DESCRIBE YOUR REQUIREMENTS FOR EXPECTED FINANCIAL PERFORMANCE OF THE FUND?



2 LPS' (SECOND) MOST WANTED

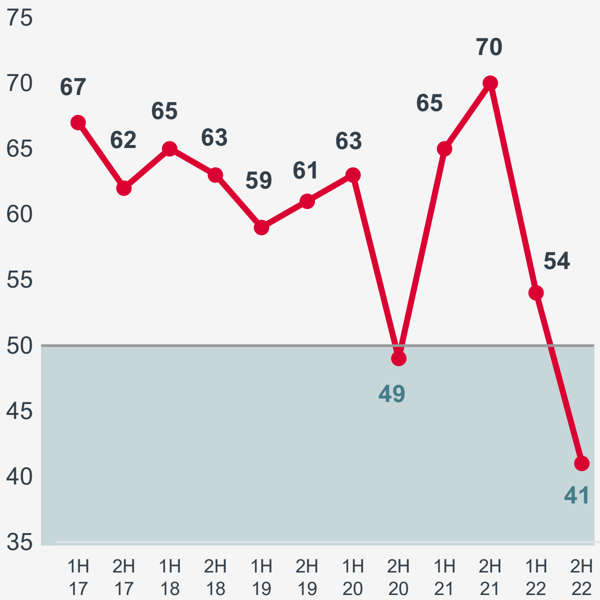
SUSTAINABILITY AND IMPACT IS NOW THE SECOND MOST FREQUENTLY CITED SECTOR FOR LPS SEEKING TO EXPAND ALLOCATIONS

TO WHICH SECTORS DO YOU PLAN TO INCREASE ALLOCATIONS FOR 2023?



Rede Liquidity Index 2H 2022

HISTORICAL RLI DEVELOPMENT



Rede Liquidity Index 2H 2022

While tightening economic conditions over the last few months have caused LP deployment to private markets to lose pace, certain areas remain in higher demand. Rede's research has shown Impact steadily rising up LPs' agendas, with a sustained growth in LP appetite to deploy to Impact or Sustainability-focused funds.

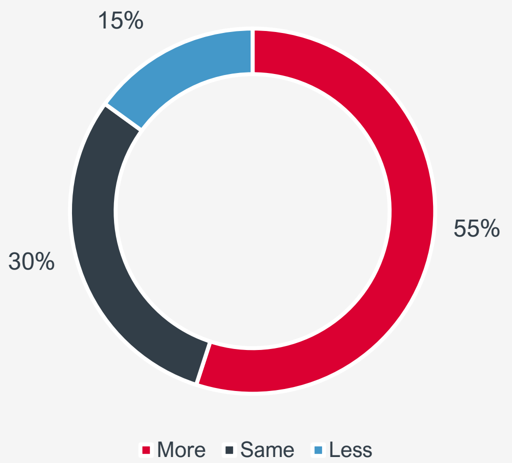
The latest Rede Liquidity Index (RLI) 2H 2022 report, which surveys generalist institutional investor sentiment towards private equity as a whole, found that LP enthusiasm for Sustainability and Impact has now overtaken Technology. 21% of LPs identified Sustainability and Impact-focused funds as a key area to expand exposure in the coming 12 months, placing Impact second only to Healthcare on LPs' most-wanted lists.

The growing appetite for Impact exposure is particularly significant when taken against a context of decreasing LP liquidity overall. In 2H 2022, the RLI reached a record low of 41, indicating that LPs expect a significant reduction in commitments to new private equity funds over the following six months.

2 LPS' (SECOND) MOST WANTED

Over half of LPs who invest in Impact funds plan to increase deployment to Impact in the near-term

HOW MUCH CAPITAL DO YOU EXPECT TO COMMIT TO IMPACT FUNDS OVER THE NEXT 12 MONTHS? (LPS WHO HAVE PREVIOUSLY INVESTED IN IMPACT FUNDS ONLY)



Rede's research shows that 85% of LPs who have previously invested in Impact funds plan to allocate the same or more capital to Impact strategies than they had done in the previous year. The reasons for and potential consequences of the general trend toward acceleration in deployment to the thematic are explored throughout this report.

More specifically, Rede has noted a particularly strong increase in appetite for decarbonisation over recent months. This appears to be linked to the growing recognition that rapid decarbonisation is the only genuine solution to mounting environmental and energy security concerns. In particular, the recent conflict in Ukraine has highlighted the vulnerabilities of economic dependence on imported fossil fuels, while growing evidence of the financial opportunities related to successful decarbonisation has proven increasingly intriguing to investors.

In some quarters, Impact is now viewed as a safe harbour from turbulent market conditions

ADVANTAGES OF IMPACT INVESTMENT

Businesses whose products and services play into the Impact/Sustainability megatrend should deliver superior financial returns

Companies focused on Impact are future-proofed by keeping ahead of regulation and consumer preference

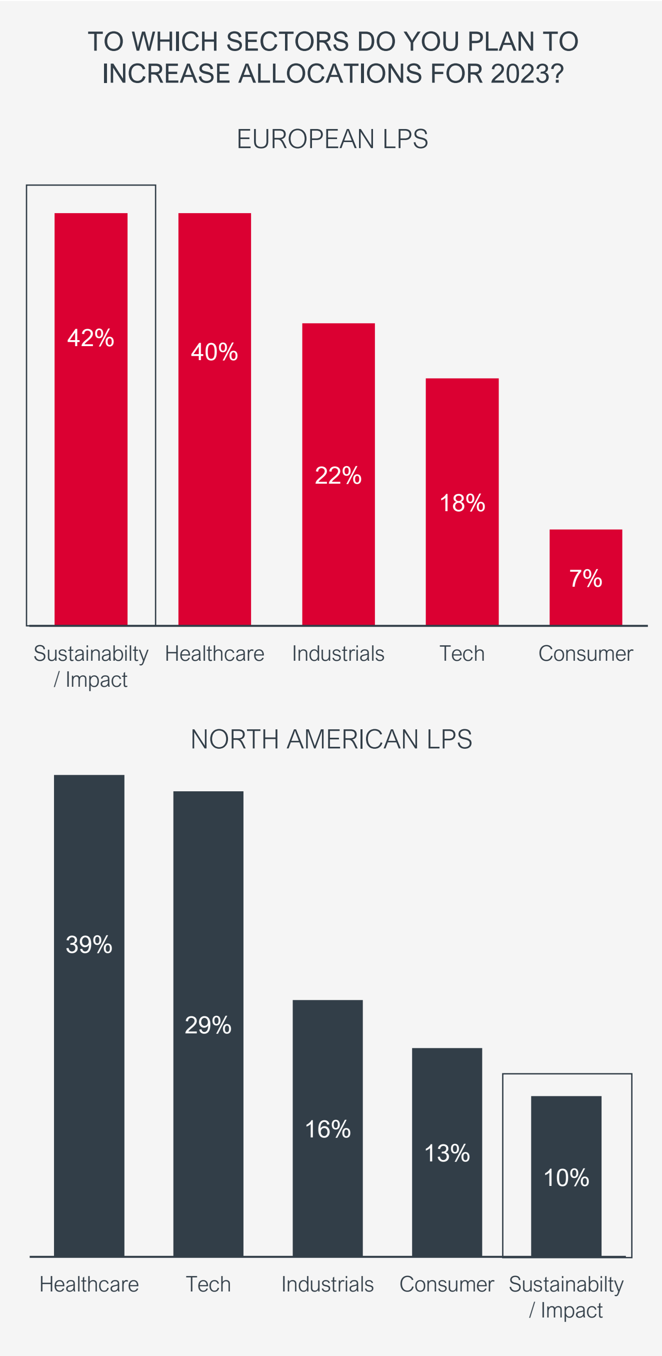
Impact principles are increasingly aligned with LP stakeholder values

As with previous market downturns, the recent tightening in economic conditions has driven a flight to quality across the entire private markets asset class. Anecdotally, we are now seeing some LPs including Impact within their definition of a 'safe-haven'. These LPs typically view Impact as offering advantages that are both 'offensive' (i.e. Sustainability as a source of competitive advantage for portfolio companies) and 'defensive' (i.e. investing in 'future-proofed' businesses in the context of regulation or consumer demand). Businesses benefiting from these twin advantages can, therefore, be expected to outperform even during periods of broader market volatility and economic headwinds.

2

LPS' (SECOND) MOST WANTED

European LPs have a greater focus on Sustainability and Impact than North American LPs



Delving deeper into Rede's RLI data, it is interesting to note that we are seeing a divergence between North American and European LP behaviour and sentiment toward Imact investment. In the current macroeconomic climate, some European LPs are now viewing Sustainability and Impact investment as a more attractive option than other investment themes and doubling down on their Impact commitments, whereas in North America, we are seeing certain LPs deprioritising Impact.

There are a number of potential reasons for this. The hangover from the failed cleantech investment programme of the late 2000s, which was more keenly felt in the US; the oil and gas-rich US economy (versus the more resource-light EU); and the growing anti-ESG sentiment across some states in North America which is in part linked to the importance of its petrochemicals sector. Certain states have recently adopted legislation limiting state business with ESG-related investment funds, partly to protect the energy industry from decarbonisation of investment portfolios by asset managers and funds and partly as a reaction to concerns around the politicisation of ESG. However, the trend toward decarbonisation is strong and hard to stop, driven as it is by global necessity. Furthermore, Impact is not limited to decarbonisation-focused themes as we have seen numerous distinctive more socially oriented Impact strategies develop in areas such as education, healthcare, diviersity and social mobility. As such, we expect that so long as the Impact market continues to deliver strongly, North America could quickly catch up with Europe in both deployment and sophistication, especially given the considerable quantity of large, prominent GPs operating in the space in the region.

Nonetheless, Impact is not limited to decarbonisation-focused themes and therefore, we expect that so long as the Impact market continues to deliver strongly, North America could quickly catch up with Europe in both deployment and sophistication, especially given the considerable quantity of large, prominent GPs operating in the space in the region.

Ultimately, the lag in adoption between Europe and North America should be viewed as an attractive opportunity for high quality Impact managers seeking to increase their assets under management. As new North American LP programmes come onstream, there will likely be an increased availability of capital to build relationships with new GPs.

3

CLIMATE LEADS THE WAY

INCREASING AWARENESS OF THE DECARBONISATION MARKET OPPORTUNITY AND MOMENTUM IS GENERATING A STRONG GRAVITATIONAL PULL TOWARDS CLIMATE-RELATED THEMES ACROSS ASSET CLASSES

51% of LPs identified climate-related strategies as a core focus for their Impact programme

As part of Rede's Impact Survey, LPs were asked about their specific interests and focuses within the broader Impact universe. When selecting Impact managers, LPs noted that investment theme is typically their primary focus, with geography and stage being secondary considerations. Rede's data highlights a notable concentration of LP appetite around environment- and climate-focused funds. 51% of LPs identified climate change mitigation as a core focus for their programme and a further 32% said it was an emerging focus. Other Impact themes related to environment/climate that were also frequently cited as a core or emerging focus were food and agriculture (61%) and the circular economy/resource efficiency (46%).

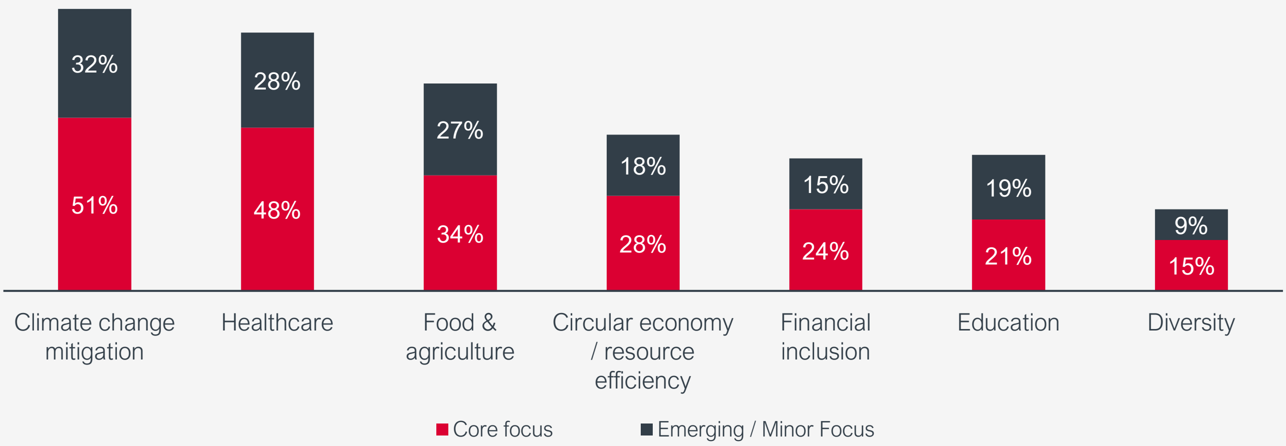
In the first decade of the 21st Century, environmentally focused equity investing became known as "clean-tech," an area within which high profile underperformance ultimately caused damage to both LP portfolios and the reputation of Impact as a whole. In the 2010s, most environmentally focused equity investing focused on renewable energy or sustainable infrastructure, driving a very rapid shift down the cost curve (c.95%) and re-igniting private equity interest in energy transition or environmental opportunities. The 2020s have heralded a shift toward a much more diverse "decarbonisation" opportunity set, encompassing industrial and materials transition, the circular economy, resource efficiency and food and agriculture, to name but a few. The business models and technologies that underpin these segments are now much more proven and competitively priced.

Meanwhile, this focus on decarbonisation has been further amplified in recent years by the increasingly widespread adoption of Net Zero targets by corporates and governments, in turn underpinned by a meaningful rise in awareness of the scale and urgency of the climate change investment opportunity. Pension funds in particular have become increasingly interested in backing Impact funds that have specific Net Zero-related targets. These funds can offer a more holistic way to taking environmental and social themes into consideration en route to achieving Net Zero goals.

Proliferation of strategies highlights the increasing sophistication of Impact

Against this background, a rich ecosystem of specialist Impact investment managers has now emerged, providing a wealth of choice for LPs seeking to build a sophisticated Impact portfolio. The market is no longer dominated by generalist Impact funds: we now see a proliferation of strategies with thematic and sub-thematic approaches to Impact across Venture, Growth and Buyouts. These strategies are being launched by a growing number of spin-outs and independent players that are positioning themselves as specialist Impact funds, seeking to gain greater investor attention.

ON WHICH IMPACT THEMES DO YOU EXPECT TO FOCUS YOUR ALLOCATIONS?



3 CLIMATE LEADS THE WAY

Where once asset-light funds tended to dominate environmental strategies, we are now seeing LPs becoming more comfortable with the integration of asset-heavy businesses in environmental strategies across Growth and Buyouts. This is indicative of a broader recognition that while digital strategies are an important tool in reducing GHGs, ultimately you cannot 'digitise your way to Net Zero', and that asset-heavy strategies will be critical to achieving climate goals.

The Sustainability megatrend appears to be following a similar trajectory to that of digitalisation before it – and it may present a long-term value creation opportunity of the same, or even greater, size. The digitalisation revolution of the early 21st century resulted in a seismic shift within the private equity investment universe, with technology-focused investment representing c.30% of the Buyout market according to a 2022 report by Bain[1]. We are now seeing Sustainability and Impact moving along a similar arc – with high value placed on climate solutions and sustainable products, services and business models across multiple Impact themes and investment asset classes.

While environmental themes garner global interest and social themes are typically more localised, we expect a blurring of the two in future

Beyond climate, healthcare Impact is high on LPs' agendas – 48% of LPs cited healthcare as a key focus of their Impact programmes going forward. This mirrors a strong uptick in LP interest in healthcare in general recorded by Rede's RLI surveys since the onset of the Covid-19 pandemic.

However, Rede's survey data shows a much weaker level of investor appetite for other social themes: financial inclusion, education and diversity were ranked lowest by LPs in terms of core or emerging focus. In discussions with investors, some noted that social Impact tends to be more fragmented and localised in nature. LPs often invest in social Impact funds specific to their own geographies, tackling the themes and issues of most relevance to their local communities.

Interestingly, although social themes were not commonly cited as a standalone core focus, in conversation, many LPs noted an increasing nuance and blurring between environmental and social Impact. As climate change continues to dominate agendas, awareness is growing that efforts to mitigate it may also trigger a variety of social ramifications. Examples discussed ranged from the need to re-skill workers affected by the decline of emission-intensive industries, to increased cyber-security risks as industries and individuals alike strive to become paperless. Beyond this, a variety of social ramifications were noted as being of interest due to their ability to offer a holistic solution to both environmental and social issues, key themes included FoodAg, Sustainable Cities, Natural Capital, and Biodiversity. Looking ahead, we expect to see a decline of emission-intensive industries, sensitivity to climate adaption issues within emerging markets or lower-income segments of society, to increased overlap between the environmental and social and more nuanced investment strategies that take a spectrum of Impact objectives into account.

[1] *How Private Equity Keeps Winning in Software, Bain, 2022,* https://www.bain.com/insights/software-global-private-equity-report-2022/

4 ACTIVE STRATEGIES IN DEVELOPED MARKETS

LPS CURRENTLY FAVOUR BUYOUTS AND GROWTH EQUITY STRATEGIES IN NORTH AMERICA AND EUROPE

Buyouts and Growth Equity strategies remain the most popular strategies for LPs seeking to allocate to Impact strategies

Growth Equity (65%) and Buyout funds (57%) are comfortably the top picks for investors when choosing to invest in Impact. Control-oriented strategies such as Buyouts and Growth Equity (particularly significant minority growth investing) allow GPs to drive their own Impact agenda and drive outcomes, in a way that is much more difficult to achieve in strategies such as Private Credit or Venture, where funds typically have limited rights and depend on their ability to influence, rather than directly manage a business, to implement change.

Given the rapid expansion and disruptive nature of the market, it is unsurprising that at present LPs are favouring Growth Equity over Buyouts. Growth offers investors an attractive combination of benefits: an ability to invest at scale in businesses that have reached certain proof-points and are de-risked to some extent, without compromising the opportunity for home-run style wins if companies succeed. Indeed, investors can add transformative value to these businesses via earlier stage capital injections, which can be significantly more impactful than investing in more established businesses for which much of the investment is likely to be used as replacement capital.

Meanwhile, many LPs believe that the smaller end of the Buyout market represents a good bet for aligning Impact with financial returns, via the value-building operational influence a GP can exert on these types of businesses during the holding period. LPs are focused on managers' Impact 'additionality': seeking to allocate to GPs who can create real impact within businesses, rather than just investing behind trends or backing already sustainable businesses. As the Impact market matures and the number of operational, profitable Impact-oriented businesses increases, we expect to see a parallel rise in LP appetite for Impact Buyout strategies.

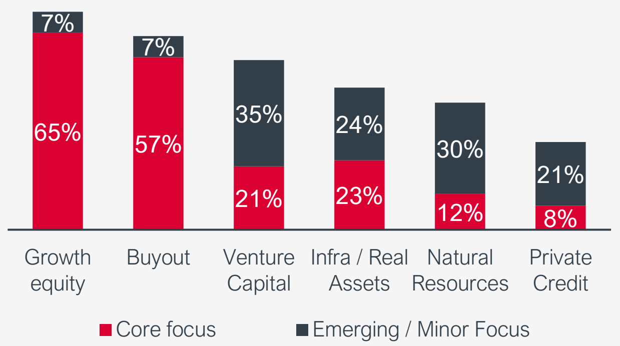
Developed markets continue to be the most popular beneficiaries of Impact capital

Our data highlights a clear preference for investors to deploy to Impact funds in Western markets. When asked about their core geographic focus for their Impact investment programme, 60% of LPs mentioned North America and 45% noted Europe. A far smaller proportion of investors view Asia-Pacific (15%) or the Rest of the World (9%) as a core focus.

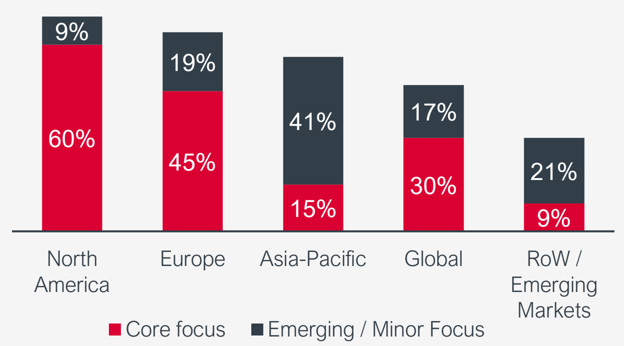
Our discussions with LPs suggest that the key drivers for the current focus on Western markets is that these geographies simply offer a much wider selection of Impact managers for LPs to select from. This is partly due to the Sustainability megatrend being typically more progressed and viewed as more developed, with a greater availability of talent, and better understood within developed markets.

However, our LP interviews highlight that many investors view the Emerging Markets as a major source of opportunity for Impact in the future. Indeed, it is these geographies in which investors could potentially create the greatest social impact, given the sheer number of people inhabiting the "bottom of the pyramid," as well as significant climate impact, as new generation technology and infrastructure is urgently required. At present they are held back by the limited universe of Emerging Markets-focused Impact managers, which chiefly stems from a greater perceived risk of achieving an appropriate risk-adjusted return in these markets across the entire spectrum of private markets investment. For these reasons it may be some time until the true potential for Impact investment in Emerging Markets is unleashed.

ON WHICH IMPACT ASSET CLASSES DO YOU EXPECT TO FOCUS YOUR ALLOCATIONS?



ON WHICH GEOGRAPHIES DO YOU EXPECT TO FOCUS YOUR IMPACT ALLOCATIONS?



5 CYNICISM REMAINS THE GREATEST THREAT

GREENWASHING, DE-PRIORITISATION IN LIGHT OF MACRO-ECONOMIC TURBULENCE AND THE ‘ANTI-ESG’ MOVEMENT THREATEN THE CONTINUED SUCCESS OF IMPACT

60% of LPs cite ‘greenwashing’ as their key concern when looking to the future of Impact

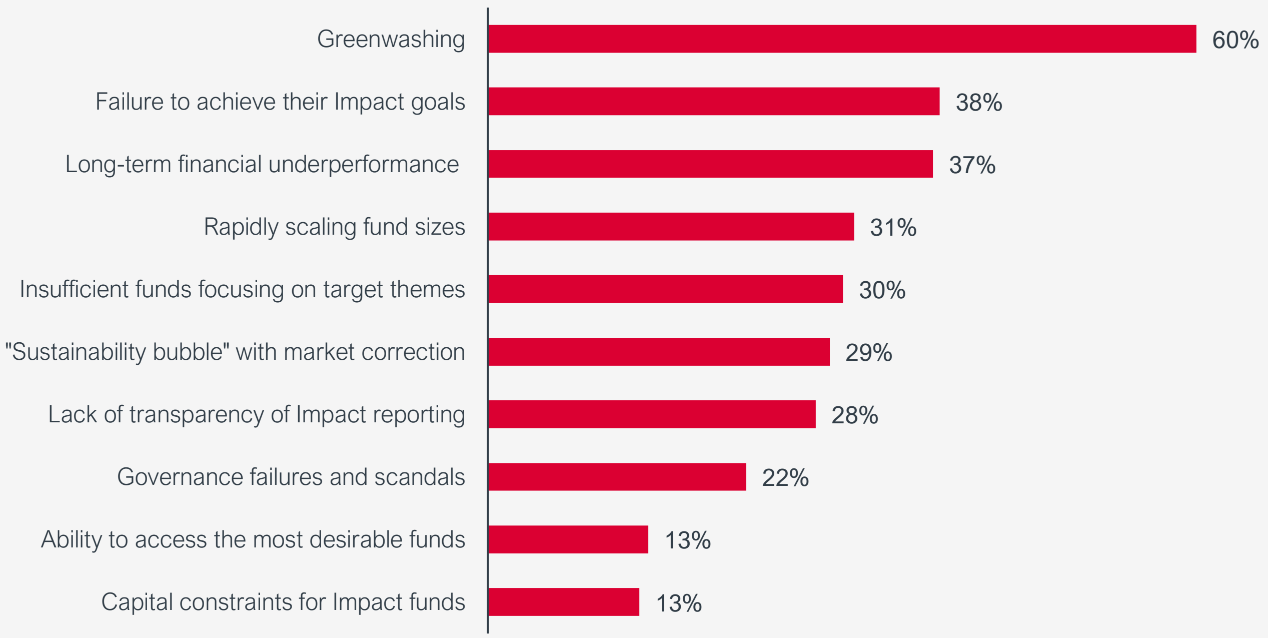
When asked about potential threats to the development of Impact investment, the most frequently cited is ‘greenwashing’, mentioned by 60% of LPs surveyed. ‘Greenwashing’ is typically used as a shorthand term describing an organisation overstating their Impact credentials in public while maintaining environmentally or socially harmful practices behind the scenes. Several high-profile cases of greenwashing-related malpractice across the financial industry have raised concerns about the potential for a major greenwashing scandal to seriously damage the reputation of Impact as a whole.

At a more micro level, LPs’ fears around greenwashing also relate to the potential for inauthentic labelling of funds, which risks reducing overall trust in the industry. In today’s heavily populated private markets landscape, GPs must fight hard to differentiate themselves to rise above the fray and attract LP attention. Rising LP appetite for Impact and Sustainability-focused funds brings with it a temptation for managers to jump on the Impact bandwagon, rebranding themselves as Impact managers and mislabelling their fundamentally generalist funds as “impactful” for marketing purposes.

> *There is a great distinction between companies that contribute towards a climate transition and those that benefit from it.*
>
> *– Swedish Investor*

The risk of mislabelling is an important one that the industry is addressing proactively through regulatory frameworks and reporting standards. It is critical that managers provide a clear Impact thesis substantiating why potential investments qualify for their fund, grounded, as much as possible, in accurate non-financial measures. As one Swedish investor noted, ‘there is a great distinction between companies that contribute towards a climate transition and those that benefit from it’. Furthermore, it is not only GPs who are vulnerable to accusations of greenwashing – LPs can fall into this trap too. LPs can protect themselves by ensuring rigorous diligence standards for their Impact programmes, ensuring that every investment is backed by genuine Impact deliverables and methodologies.

WHAT ARE THE POTENTIAL THREATS TO THE DEVELOPMENT OF IMPACT INVESTING?



5 CYNICISM REMAINS THE GREATEST THREAT

Macro-economic turbulence may threaten Impact if investors are not fully convinced of the financial opportunity

Over a third (37%) of LPs identified long-term financial underperformance of Impact funds as a key concern when looking to the future of the Impact market. To establish its permanent position within LP portfolios, the Impact market must continue to demonstrate that it is able to deliver strong, long-term financial returns, and that these are achievable across economic cycles.

Despite rapid progress made over recent years, the Impact market remains nascent, with a limited evidence base of financial performance from exited investments. Herein lies a critical risk to the credibility and longevity of the Impact market. As one Swiss LP noted, "If the GPs who have raised [Impact funds] in the last two years don't deliver returns then it undermines the whole market." For a young sector with a lot to prove, the recent macro-economic turbulence represents a real threat to its survival – if Impact funds do not provide clear evidence of strong financial returns throughout this bear market, LPs may deprioritise Impact as a 'nice-to-have' in favour of doubling down on more traditional investments with stronger evidence of the ability to perform well across economic cycles.

With some investors still bearing the scars of the 'clean-tech bubble', the Impact world must act fast to mitigate this risk. It will need to prove definitively that the market has not only learnt from the past, but also that its current risk-return profile is a highly attractive one. The good news is that with the rise of the Sustainability megatrend, evidence for this is now mounting. Consumer demand for sustainable solutions is now robust and tangibly affecting business demand; while the cost of sustainable solutions has reduced, meaning that choosing sustainable options no longer needs to come at an additional expense. Furthermore, markets and government support of the green transition, in addition to shareholder pressure and expectations are driving meaningful, substantive change at the highest levels.

> *If the GPs who have raised [Impact funds] in the last two years don't deliver returns then it undermines the whole market.*
>
> *– Swiss Consultant*

The Anti-ESG movement represents a new threat to Impact that should be mitigated through broader engagement with people across the political spectrum

There has been a recent movement, particularly in the US, that argues against the prioritisation of ESG and Impact, believing that it comes at the expense of financial performance or is biased toward promoting elitist political beliefs that are not shared by the entire population. This movement believes that corporates who prioritise ESG factors are in turn deprioritising the financial interests of these businesses and their own employees, and that boards who allow ESG initiatives to take precedence over profitability concerns are in breach of their governance responsibilities.

From a PE investing perspective, the equivalent argument is that institutional investors prioritising Impact investment could be breaching their fiduciary duties to stakeholders. This is of particular relevance to public pension funds, which manage capital for a broad range of scheme members and may be subject to political appointments and direction-setting.

To mitigate the risk of an anti-ESG backlash against Impact fund investment by large institutions, the Impact market will need to be front footed in addressing concerns; transparent about the overall aims and objectives of their Impact strategies; and ready to engage with people across the political spectrum to convince them of the strong financial return potential for Impact investment. ESG should be seen as a key driver for competitive advantage and financial outperformance, rather than a hindrance.

6 FUTURE ROADMAP

METHODOLOGICAL RIGOUR, STANDARDISED REPORTING, TRANSPARENCY AND ALIGNMENT ARE KEY TO SECURING THE LONG-TERM FUTURE OF IMPACT

A third of LPs identified more rigorous Impact methodology as vital to Impact's continued success

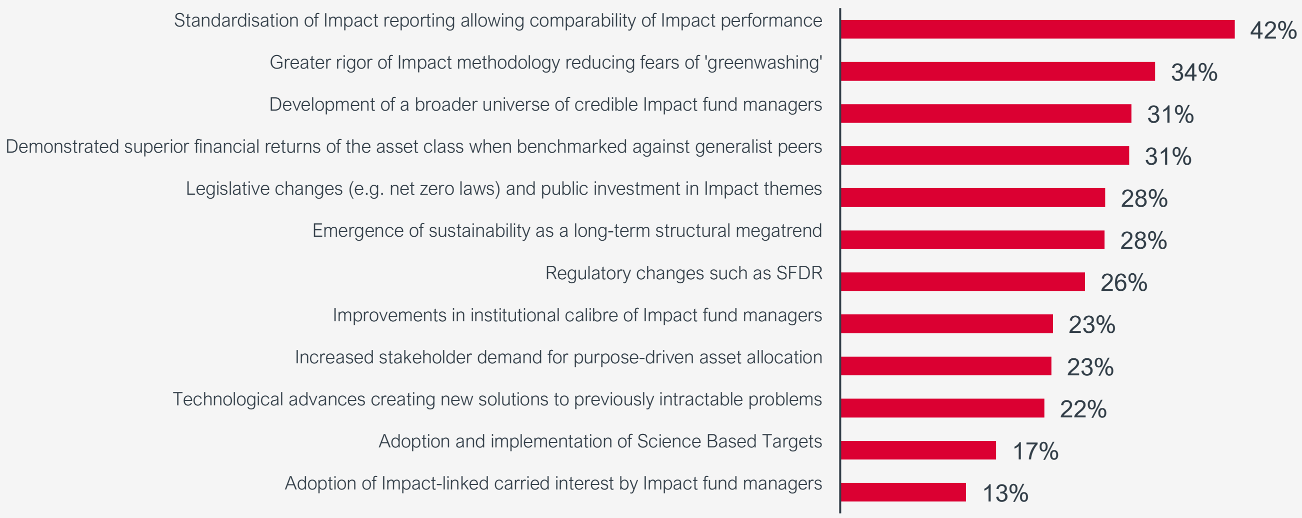
To achieve strong Impact outcomes, GPs need a clear framework for selecting investments, setting targets and monitoring progress – a system commonly referred to as an Impact methodology. Impact methodologies allow managers to select portfolio investments that will deliver the strongest Impact outcomes and can also provide protection against greenwashing claims through evidence-based sustainability credentials. LPs are clear that the quality of Impact methodology is critical to an Impact GP's overall calibre. When asked to identify key drivers of future success for the Impact sector, 33% of LPs cited the development of greater rigour in Impact methodologies.

How might this be achieved? There are a number of core characteristics that are already common to many Impact methodologies: a minimum threshold of Impact (established by assessing the positive, negative, intended and unintended Impact), setting measurable Impact KPIs, and underwriting and tracking the KPIs across the lifetime of an investment. It is likely that a key stepping stone toward raising standards in Impact methodology will be GPs gravitating towards a group of rigorous core methodology frameworks that are currently becoming established within the industry. These include the Impact Management Principles (IMP) which defines Five Dimensions of Impact for managers to comprehensively assess a business' Impact thesis, and Operating Principles for Impact Management (OPIM), which ensures that Impact considerations are integrated throughout the investment lifecycle.

We will likely see Impact methodologies coalescing around a standardised set of underlying metrics and toolkits, while each GP will continue to set their own specific hurdles, targets, and scorecards in accordance with their unique strategies. This will allow LPs to have confidence in the comparability and rigour of the underlying metrics used, while still enabling GPs to differentiate themselves and tailor their Impact requirements to their investment approach.

Beyond the accountability and reassurance that Impact methodologies provide, they also offer GPs a broader and more nuanced understanding of a business' true value. Where a manager's investment strategy is based on the underlying assets' sustainability credentials creating competitive advantage, the ability to articulate and evidence measurable impact can create value even before an investment is made. For example, businesses with strong Impact credentials for their products and services can establish and embed their position within the supply chains of companies who have publicly committed to Net Zero climate goals or who have annual ESG reporting requirements.

AS YOU LOOK TO THE FUTURE OF IMPACT INVESTING, WHAT DO YOU BELIEVE WILL BE THE MOST IMPORTANT DRIVERS OF SUCCESS FOR THE SECTOR?



6 FUTURE ROADMAP

42% of LPs believe that standardisation of Impact reporting will be key to future success

While LPs are calling for methodologies to become more rigorous, when it comes to the output of the methodology, reporting, LPs most frequently point to standardisation as the goal. Investors often express frustration with the fragmented nature of the Impact reporting landscape, which can cause difficulties in objectively comparing Impact quality between managers. A more standardised approach would enable investors to feel more confident in their manager selection process, as well as offering greater scope to benchmark Impact performance of existing investments.

While a universal framework for reporting would be desirable, the difficulties of developing and agreeing such a system remain manifold. Many types of Impact are challenging to quantify, and standardisation of qualitative or subjective evidence is notoriously difficult to implement. For these reasons, we may see standardisation take place faster within certain Impact themes than others. In particular, environment-related Impact is easier to quantify than social Impact, with more readily available metrics and less subjective assessment required. While the ideal situation would be to achieve full standardisation across the whole Impact landscape, it may be more pragmatic to drive toward a suite of standardised approaches to each key Impact theme, with sequential adoption of these standards over time.

In the meantime, there is considerable regulatory and voluntary momentum seeking to support delivery of comparable and actionable non-financial return data within Impact. One important initiative is the Sustainable Finance Disclosure Regulation (SFDR), a legislative programme driven by the EU. SFDR aims to make Sustainability a more important focus for financial services from a regulatory perspective. Importantly, the regulation looks to assist with the classification of funds as either Article 6, 8 or 9 depending on their level of Sustainability. Most Impact funds classified as Article 9 – also referred to as 'dark green' – are defined by the regulation as funds that have sustainable investment as their objective. Comparatively, those labelled as Article 8 are funds that promote environmental or social improvements and characteristics. The SFDR also involves website disclosures, pre-contractual disclosures (dependant on categorisation) and periodic reporting disclosures to investors/clients, which will begin in 2023.

A second initiative is Impact Weighted Accounts (IWA), which are currently being developed by Harvard Business School. These enable cost-analysis of organisations by affixing a price to a range of clearly defined harmful effects to nature and human health. IWA are then added as line items to financial statements of the business, in an attempt to quantify a company's positive and negative impacts on employees and enable cross-company comparisons.

> *"We are concerned about the focus on measurement as it could easily become a box-ticking exercise. For example, we could get a 50-page KPI report, but look back at the actual portfolio and note that it doesn't feel impactful."*
>
> *– US Consultant*

Further, Iris+ by Global Impact Investing Network (GIIN), SASB and the UN Sustainable Development Goals (SDGs), all provide specific KPIs for Impact-related activities to allow organisations and GPs to measure Impact along the same dimension.

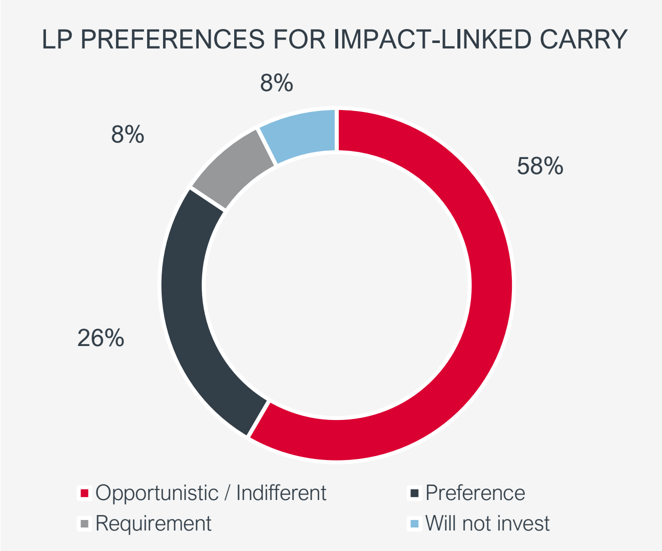
In Rede's experience, while LPs are keen to realise the benefits of standardisation and regulatory rigour, we are seeing limited requirement by LPs for GPs to use these frameworks. If they are to achieve widespread acceptance, more needs to be done by regulatory bodies to both standardise and personalise reporting requirements to specific financial industry segments (such as private markets), avoiding generic reporting and ensuring that collated data is relevant and easily interpretable. As one US-based institutional investor expressed: "We are concerned about the focus on measurement as it could easily become a box-ticking exercise. For example, we could get a 50-page KPI report, but look back at the actual portfolio and note that it doesn't feel impactful."

6 FUTURE ROADMAP

Transparency is vital to LP confidence in both Impact methodology and Impact reporting

However Impact is assessed, LPs need to feel confident that the managers they invest in will deliver on their stated Impact goals – and that the information they receive about Impact minimum thresholds and subsequent outcomes is accurate and trustworthy. Best-in-class Impact GPs are highly transparent with their LPs around their Impact calculations, goals and performance against targets, allowing LPs to engage directly with their data and feel satisfied that their claims are valid. They typically report frequently to LPs, continually seeking to upgrade their measurement procedures and improve the way they communicate developments to investors.

In the long term, many LPs cite the goal of being able to benchmark Impact performance easily and to compare and contrast returns across managers. In discussions with Rede, some LPs voiced concerns around "GPs marking their own homework". Top rated managers set themselves ambitious targets, but these must be underwritten with transparent and reasonable assumptions. An external body or third-party advisor that can audit Impact performance can provide an additional guarantee to investors. As the Impact market continues to evolve, we expect to see the development of an ecosystem of trusted external watchdogs who will underpin a major step-change in transparency and auditability of Impact measurement.



Impact-linked carried interest: the final frontier?

Despite widespread agreement that LP-GP alignment is key to achieving Impact objectives, LPs currently have conflicting views on Impact-linked carried interest as a credible solution.

Supporters of Impact-linked carry (34% of surveyed LPs) appreciate the benefits of additional intensity and rigour regarding Impact performance, as well as increased alignment between financial and non-financial returns. In contrast, 58% of surveyed LPs are indifferent to the concept, while a further 8% are actively opposed to it.

These LPs broadly fall into two camps. The first view the mechanism as over-complicated, opaque and not workable in the long term, while the second believe that Impact-linked carry is unnecessary because the co-linearity of financial and non-financial returns should mean that alignment with financial returns will automatically bring along with it an indirect alignment with Impact outcomes. More broadly, many LPs remain somewhat cynical as to how 'fair' Impact-linked carry schemes will be. When questioned on this, they typically cite the risk that opportunities for personal gain could affect the way that GPs set their internal Impact targets (which are often not independently verified) and may result in targets that are skewed or lacking in ambition.

Overall, it appears that the industry still has some way to go in regard to reaching a consensus on the use of Impact-linked carried interest. At present it is viewed at best as a 'nice to have.' However, there is real potential for this to become an important part of the Impact toolkit if target-setting and reporting becomes more standardised to enable true LP-GP alignment.

CONCLUSION

THE DATA FROM REDE'S SURVEY HIGHLIGHTS THAT SUSTAINABILITY AND IMPACT INVESTING HAS GROWN AND MATURED TO SUCH AN EXTENT THAT IT HAS BECOME A DISTINCT AND SIZEABLE MARKET OCCUPYING AN IMPORTANT NICHE WITHIN ASSET ALLOCATION STRATEGIES.

There has been a palpable shift in LP appetite and sentiment in favour of this segment of the market, second only to healthcare, which is particularly notable when considering the market backdrop and depressed LP sentiment towards private equity investing more generally in the current macroeconomic climate. This shift in LP attitudes towards Impact investing is evidenced by real structural changes seen across the LP universe, including the development of investment roles dedicated to Impact, an emergence and acceptance of Impact within generalist pockets, and an acknowledgement of the broader financial and non-financial benefits of investing behind the Sustainability megatrend.

Rede's survey shows that the long-term success of the 'second megatrend of the 21st century' will depend on consistent delivery of strong financial returns and will be supported by the development of standardised reporting, enabling LPs to make better informed manager selection choices. 'Greenwashing' is viewed as the biggest risk to future success of Impact investing, but the industry can mitigate this risk through adopting more rigorous methodologies and transparent reporting. The enormous potential of Impact investment will only be realised through close collaboration and strong alignment between LPs and GPs, and ultimately through the delivery of strong, long-term financial returns and clearly quantifiable Impact.

What is to come in the next 5-10 years?

Sustainability and Impact now finds itself at an inflection point in its development. With significant momentum behind it, the market is emerging into the mainstream and will need to prove its long-term viability to withstand market forces and embed its position within private markets. Over the next five to 10 years, Rede expects the Impact and Sustainability megatrend to continue to accelerate, bringing with it a broadening and deepening in the offering of Impact propositions available to LPs. We may see certain strategies that are currently viewed as niche, such as Ocean and Education coming to the fore and more interest across asset classes, including real assets, VC, and asset heavier strategies. We should expect to see specialist Impact funds gradually overtaking generalist funds as the default option, with a parallel shift from platform extensions toward fully independent Impact GPs.

With rapid expansion often comes creative destruction. We should expect to see GPs rise and fall in the estimation of LPs according to their ability to keep up with the pace of change within the industry, with spin-out activity and new strategies formed from the ashes of those that do not make it. Those that establish themselves as leaders in the space in coming years - underpinned by consistent financial performance that is in line with or greater than benchmark PE performance – have a unique opportunity to cement a highly valuable position within Impact for the longer term.

Similarly, we may see new methodologies come and go, with assessments potentially becoming more complex before they are simplified and defined. While GPs' Impact methodologies will continue to become more sophisticated, it will be those that differentiate themselves through greater transparency and value-add that will create the greatest momentum for themselves, as well as the Impact market more generally. Together, these changes will continue to propel Impact into the mainstream.

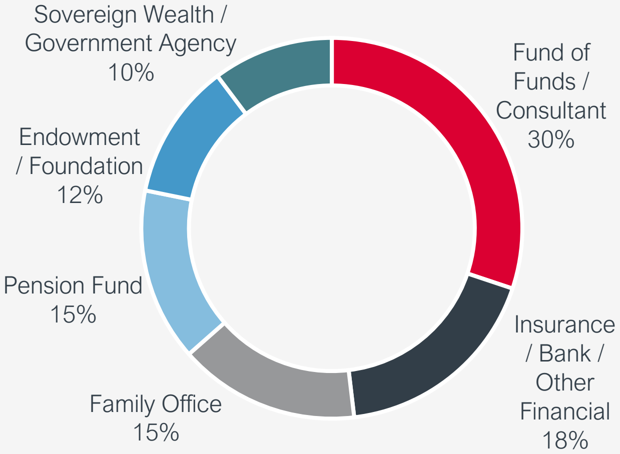
SURVEY METHODOLOGY

During the course of 2022, Rede undertook a survey of over 160 institutional LPs from across the globe, which questioned investors on Impact investment appetite and sentiment, geography and strategy preferences for Impact and Sustainability funds, key challenges and risks surrounding the investment theme, as well as key drivers of success for Impact and Sustainability going forward. This was supplemented by ongoing discussions and structured interviews led by Rede with many of the world's leading and most sophisticated impact investing market participants, to add further nuance and understanding to the survey results and allow us to dig deeper.

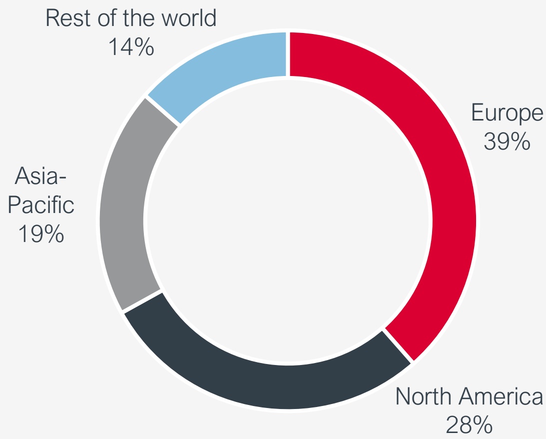
The survey was sent out to a select group of global institutional LPs, chosen to provide geographic and source of capital diversification. The overall report has representation from all over the world. In the more detailed analysis, we have only included the categories which had enough respondents to be statistically relevant.

We surveyed 160 institutional LPs from across the globe, representing a range of investor categories, geographic locations and allocation sizes

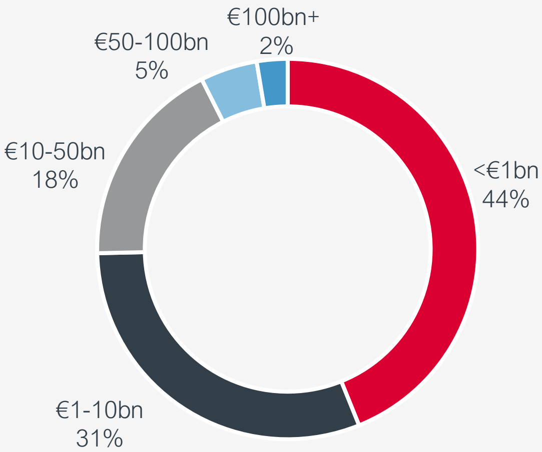
LP CATEGORY



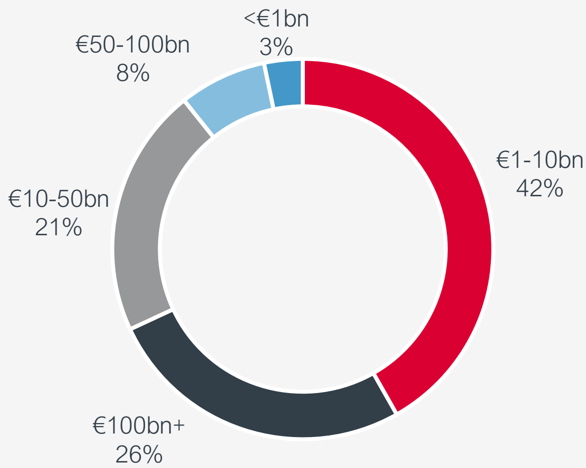
LP REGION



PRIVATE EQUITY: ALLOCATION SIZE



TOTAL AUM:



ABOUT REDE IMPACT

Rede Partners is a leading independent fundraising advisor to the private markets industry. Founded in 2011, Rede has raised over €100 billion in total across primary fundraising and GP-led transactions, as well as completing multiple high-value strategic advisory assignments.

With a well-resourced 100-strong team based in London, New York, Hong Kong and Amsterdam, Rede has a rigorously implemented, focused approach combining a comprehensive service offering across the entire spectrum of investor-facing activities, and a long-term business development perspective. The Firm's business model is underpinned by an unwavering commitment to delivering against its clients' objectives, helping them tackle the challenges and seize the opportunities of today's capital raising environment. Focusing on quality over quantity, Rede engages only with firms after establishing strong conviction in the manager's calibre, values and future potential. Institutional investors around the globe trust Rede to seek out and bring them the market's most compelling investment opportunities.

Since the launch of its first Sustainability-oriented fundraise on behalf of a specialist GP in 2013, Rede's dedicated Impact business has rapidly established itself as a leader in this emerging field. To date, Rede Impact has advised on 16 Impact-focused engagements, and closed €5.4 billion of capital for Impact funds from more than 200 LPs globally.

In line with increasing LP demand for Impact-focused strategies, the Rede Impact team has grown to comprise nine professionals, each with specialist Impact and fundraising expertise. Rede Impact is led by Jeremy Smith, who brings over 20 years' experience of investment and capital raising focused on Sustainability and Impact.

Rede Impact prides itself on its advisory-focused model, working with the world's leading Impact GPs and with outstanding generalist GPs seeking to launch new Impact strategies. Rede's rigorous in-house due diligence function ensures that Rede Impact offers investors the highest quality Impact investment opportunities. To become a Rede Impact fund, the opportunity must demonstrate clear Impact additivity whilst delivering exceptional financial and non-financial returns. Each Rede Impact fund has a clearly differentiated investment strategy focused on businesses that will help drive, and in turn will benefit from the tailwinds of, the global Sustainability megatrend.

The Rede Impact team are experts in positioning Impact Funds within their competitive landscape, developing compelling messaging to bring the proposition to life. The team offers market-leading strategic advice in designing and structuring Impact investment frameworks and vehicles, and also benefits from access to the broader Rede Partners platform offering Rede Impact clients outstanding advice on platform development, fundraising strategy and market insights.

SELECTED REDE IMPACT CLIENTS

actis · Apax · Ara Partners · Circularity Capital · Leapfrog Investments · Miura Partners · Summa Equity · verdane · VIDIA

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