

DVFA Expert Committee Impact

# **DVFA Guide to Impact Investing**

(translation of German Original)

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## Executive Summary

The global economy is currently undergoing a dynamic and diverse process of change, not least in response to resource scarcity, climate change and population growth. Based on the Paris Climate Agreement and the United Nations Sustainable Development Goals (SDGs), initiatives have been launched in all major economic blocs since 2015 to shape this socio-ecological transformation. The financial sector is also set to play a key role in this, thanks to its allocation and multiplier function. With its ambitious sustainable finance agenda, the EU in particular has also assigned an important role to investors. Although the regulatory activity to date has resulted in investors and companies engaging intensively with the transformation, it has not yet had the desired effect on achieving the sustainability goals due to a lack of coherence, a lack of data and an unclear focus. Ultimately, however, it must be about the effect - the "impact" - on these sustainability goals if there is to be real change through investors. However, there is a very wide range of understanding among market players when it comes to the use of the term "impact". Regulatory law does not provide conclusive clarity, and there is no consensus among academics either. It is therefore all the more important to provide investors with guidance. In this context, the DVFA Impact Committee (DVFA-FA Impact) focuses on the question of how investors can generate real "impact" with investments and report on this transparently. With these guidelines, the DVFA-FA Impact aims to provide an assessment of existing definitions of impact investing and its impact channels and to develop a practical guide to measuring impact in order to provide orientation for investments in both the liquid and illiquid sectors.

This DVFA guideline builds on extensive practical preparatory work (see e.g. GIIN, G7 Impact, German Federal Initiative on Impact Investing) and broad academic research conducted in recent years. In addition, the regulatory framework, which is important for investors in the EU, is reflected against the background of the recommendations in this guide. The work of the DVFA Governance & Sustainability Commission also concretises the points presented in the specialist committees "Governance & Stewardship" and "Sustainability Disclosures". Reference is also made to the other DVFA Commissions on Real Estate, Corporate Analysis and Financial Markets.

In this guideline, particular attention is paid to the measurement of impact. In our view, the SDGs and the SDG Impact Standards developed from them, which make it possible to derive impact categories for companies from the global, social priorities, stand out from the large number of standards and systematisations in this regard. The DVFA has already published on [SDG-based impact measurement](#) in 2019 and is planning an update in the near future. With the new DVFA Impact Investing Guidelines, we want to expand corporate impact beyond the SDGs and combine it with investor impact to create a holistic approach. When measuring impact, we therefore differentiate between investor impact and corporate impact in order to enable a comprehensive impact statement.

To summarise, the DVFA FA Impact considers the most important framework conditions for achieving and measuring impact in practice:

- The frequently cited necessity of "additionality" is too abstract a concept that increases measurability problems in practice. It is almost impossible to prove actual additionality in both the liquid and illiquid areas. Additionality should therefore not be seen as a necessary condition for impact investments. Instead, the contribution of an investment to solving environmental and social problems should be presented transparently. Intentionality and verifiability play an important role in achieving a (net) positive impact.
- In a practical context, impact is best identified along the academically proven impact channels. These are primarily capital allocation, engagement and other impact channels, such as signalling. The transformation of companies via these impact channels should be at the centre of impact investing. The legal definition of sustainable investments (in accordance with Article 2 (17) SFDR) and its regulatory interpretation should therefore not be limited to companies that are already very sustainable but should provide sufficient scope for transformative aspects.
- Impact is transferable (fungible) under certain conditions. The DVFA FA Impact has developed a system to differentiate between the impact of investors and companies. Company impact is transferable between investors, whereas investor impact (primarily through engagement) is not. This only arises for the original investor.
- It is necessary to differentiate and quantify the positive and negative impact of investments. The DVFA FA Impact postulates that impact investments must not have a significantly negative impact and at the same time should have an overall positive impact. Here, too, a distinction must be made between the company impact and the investor impact.
- For the first time, different impact and engagement strategies are defined (risk and process-orientated, reporting-orientated, stakeholder- and output-orientated engagement), the results of which can be measured in different ways.
- Collaborative engagement plays a comparatively minor role in Germany. Investors generally consider the legal uncertainty of collaborative engagement to be too high. These uncertainties need to be addressed in regulatory terms and collaborative engagement needs to be promoted in order to strengthen investors' ability to influence companies.

## 1. Definition of impact investing

### Key takeaways: Definition

- Impact investing must have a positive and demonstrable effect.
- Additionality is not a necessary condition for impact investments.
- Differentiation between investor and company impact creates the basis for transparent impact measurement.

### 1.1 Basic definitions

**Impact:** In the context of the capital market, impact is the (positive) change in a sustainability or ESG parameter in companies, organisations or projects as a result of specific activities.

**Impact investing:** Impact-oriented investments are investments that have the *intention of achieving a positive, verifiable* sustainability impact in addition to a financial return.<sup>1</sup>

- **Intentional impact:** The investor's activities must be deliberately aimed at achieving a positive impact.
- **Demonstrable impact:** It should be scientifically proven that the investor's activities can have a positive impact (theoretical causality foundation).
- **(Net) positive impact:** The investor's activities should not have any significant negative impact and should have a clear overall positive impact.

Additionality<sup>2</sup> is a theoretically desirable construct, but it cannot be a necessary prerequisite for impact investing, as it is almost impossible to prove the strict causality required for this in practice. This applies to both liquid and illiquid asset classes. The assessment of whether an investment would only have been made by one investor, regardless of the asset class, is highly speculative and therefore subjective. Rather, it is important that the intentionality and verifiability of the (net) positive impact of impact investments is considered and reported transparently. In this way, the contribution of an investment to global, environmental and social challenges can be validly recorded. This understanding is also supported by GIIN (Global Impact Investing Network).<sup>3</sup>

<sup>1</sup> Based on GIIN: <https://thegiin.org/impact-investing/>.

<sup>2</sup> Definition: Additionality exists if the effect would not have occurred without the activity of one investor.

<sup>3</sup> For example, in a report published in 2023, the GIIN explicitly refers to the concept of contribution through the use of the term "investment".

and investor contribution. Additionality, on the other hand, is not explicitly mentioned in the "Core Characteristics of Impact Investing".

named. Sources: <https://thegiin.org/listed-equities-working-group/>; <https://thegiin.org/characteristics/>

Impact investments should also aim for a financial return, although this can vary from a below-average to an above-average risk-adjusted return. This clearly distinguishes impact investments from philanthropy.

### 1.2 Distinction between "investor impact" and "company impact"

Through their activities, investors can bring about a change in a company's sustainability impact, thereby having an indirect effect on society or the environment, such as reducing CO2 emissions. However, investor activities cannot have a direct sustainability impact on society or the environment. It therefore makes sense to differentiate between the impact of investors and companies in order to provide a clear definition of two types of impact investing<sup>4</sup> :

**Investor impact:** The (positive, sustainable) change in a company brought about by the investor's activities, in particular the sustainable transformation of business models and the promotion of growth of already sustainable business models.

**The impact of companies:** The change in the world caused by the activities of the company in which an investor has an interest. Forms of a company's impact can be:

- Companies enable third parties to improve their environmental or social footprint or to offer products or services to solve social or environmental challenges ("enablers").
- Companies contribute to improving their environmental or social footprint by changing their business model or business processes ("transformers").
- Companies contribute to solving social or environmental challenges with their products or services ("pure plays").

### 1.3 Development of a practice-orientated impact investing framework

Based on the definition of impact investments, the first step in designing an impact investing framework should be to define the impact objective in order to align the activities with it (intentionality). The impact objective should be selected in such a way that there are also impact channels in the relevant asset class that can have a positive impact. Consequently, the second step is to select impact channels that can demonstrably make a positive contribution to the impact objective (verifiability). Once a specific impact objective has been defined and the relevant impact channels have been determined, suitable metrics must be identified in order to document the achievement of the objective (measurability).

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<sup>4</sup> See also G7 Impact Taskforce (2021): Financing a better world requires impact transparency, integrity and harmonisation. Workstream A. <https://www.impact-taskforce.com/workstreams/workstream-a/>

**1) Intentionality** → Definition of an impact goal

- What change is to be achieved through the investment?

**2) Detectability** → Determination of the impact channels

- Which impact channels can make a positive contribution to the impact objective?

**3) Measurability** (net positive effect) → Identification of the measured variables

- Which indicators are best suited to measure the change in the target?

In order to provide practitioners with guidance on the realisation of impact investments, the following chapters [\(2\) on impact channels](#) and [\(3\) on impact measurement](#) will focus on the measurability of impact.

## 2. Impact channels

### Key takeaways: Impact channels

- Impact investments must utilise at least one impact channel in order to achieve a positive effect.
- The relevance and effectiveness of individual channels varies between asset classes.
- There are interactions between the impact channels.

There are various ways for investors to bring about a positive change in sustainability parameters at companies through their activities. The impact should be transparent and comprehensible, regardless of the impact channel addressed, in order to enable a differentiated analysis. The following description of the impact channels of investors and their influence on companies is based on a synthesis of Kölbel et al. (2020)<sup>5</sup>, Caldecott et al. (2022)<sup>6</sup> and Wilkens et al. (2023)<sup>7</sup>.

### 2.1 Capital allocation

Capital allocation can be a significant lever for positively influencing the sustainability of companies. A distinction can be made between targeted (dis)investments and the provision of liquidity, two mechanisms whose relevance varies depending on the asset class.

<sup>5</sup> See Kölbel, J.F., Heeb, F., Paetzold, F., & Busch, T. (2020): Can Sustainable Investing Save the World? Reviewing the Mechanisms of Investor Impact. *Organisation & Environment* 33 (4), 554-574. <https://doi.org/10.1177/1086026620919202>

<sup>6</sup> See Caldecott, B., Clark, A., Harnett, E., Koskelo, K., Wilson, C., & Liu, F. (2022): Sustainable Finance and Transmission Mechanisms to the Real Economy, University of Oxford - Working Paper No. 22-04.

<sup>7</sup> See Wilkens, M., Jacob, S., Rohleder, M., & Zink, J. (2022): The Impact of Sustainable Investment Funds - Impact Channels, Status Quo of Literature, and Practical Applications.

### 2.1.1 (Dis)investment

Definition: Signal (often as a price / share price signal) via the capital market to the company through targeted (dis)investment based on its sustainability.<sup>8</sup>

Description: Capital market-oriented companies are generally not dependent on the financing of a specific investor for an investment. Therefore, the targeted provision of capital or the deliberate refusal of financing does not have a direct effect on the companies in question. Rather, the capital costs of companies can be influenced by targeted (dis)investments, which can affect their orientation and investment behaviour. If this effect materialises, the investor's activity results in a change in the real economy (investor impact). Disinvestment resulting from a company's lack of sustainability sends a clear market signal. However, rising capital costs for non-sustainable companies can also lead to them operating even less sustainably.<sup>9</sup> Disinvestments should therefore be seen as a last resort if other impact channels, such as stewardship, are not (or no longer) effective. Furthermore, the effect of this mechanism varies between asset classes and the size of the companies. For example, bonds (especially sustainability-linked bonds) and smaller companies can have a greater impact.

Examples: Targeted acquisition of companies with a high proportion of taxonomy-compliant business activities or targeted sale of companies with serious violations of the UN Global Compact.

### 2.1.2 Provision of liquidity

Definition: Investment in sustainable companies whose growth is restricted due to limited access to capital.<sup>10</sup>

Description: Companies that do not have direct access to the capital market are often dependent on direct financing from investors in order to finance their growth or specific projects. Accordingly, investors can have a stronger and more direct influence on companies through the targeted provision of capital or the deliberate refusal of financing. This impact channel relates in particular to young, smaller and / or poorly capitalised companies that are already operating sustainably or want to operate more sustainably. Typical asset classes are private equity and private debt.

Examples: Loans with an initial waiver of interest payments to enable a sustainable start-up to tap into new markets.

## 2.2 Stewardship

In line with the [DVFA Stewardship Guidelines](#), we understand stewardship as the responsible allocation and active management of assets with the aim of sustainable, long-term value creation for clients, including the consideration of sustainability factors. In concrete terms, this means (I) monitoring invested

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<sup>8</sup> See for example Zerbib, O. (2019): A Sustainable Capital Asset Pricing Model (S-CAPM): Evidence from Environmental Integration and Sin Stock Exclusion. *Review of Finance*. DOI: 10.1093/rof/rfac045.

<sup>9</sup> Hartzmark, S.M.; Kelly, S. (2023): Counterproductive impact investing: The impact elasticity of brown and green firms. *SSRN Electronic Journal*.

<sup>10</sup> See, for example, Kersten, R.; Harms, J.; Liket, K.; Maas, K. (2017): Small firms, large impact? A systematic review of the SME Finance Literature. *World Development*, 97, p. 330-348.



companies and maintaining an active dialogue with them, (II) exercising shareholder rights in a targeted manner and (III) initiating an exchange with other asset managers within the scope of legal possibilities.

These three aspects can be harmonised through a holistic stewardship strategy. In order to recognise investor impact with the help of these aspects, it is important for investors to document their successes in a meaningful way, particularly through active exchange with target companies ("engagement"), which is described in section [3.2 Measuring investor impact](#). In order to maximise investor impact, it is important to use the investor's resources efficiently, which means that great importance must be attached to prioritising engagement goals and topics and determining any collaborative engagement approach. We will focus on these stewardship aspects in the remainder of this report and briefly introduce all three below:

### 2.2.1 Active dialogue with issuers ("engagement")

Investors can use public or non-public dialogues independent of asset classes (companies, supranational agencies or states) to improve the sustainability of issuers, an impact (e.g. with the aim of decarbonising production processes) ("voicing").<sup>11</sup> A distinction can be made between reasons for dialogue (controversy-based or thematic) or forms of dialogue (independent vs. collaborative dialogue). With regard to sustainability issues, we differentiate between four forms of engagement: risk- or process-oriented engagement; reporting-oriented engagement; stakeholder engagement and output-oriented engagement. The influence of the investor, implementation costs at the issuer and its ex-ante sustainability (as an indicator of willingness to change) are key drivers of engagement success.

When determining the investor impact, it is challenging that the change in the sustainability of issuers is often not clearly attributable to individual exposures or investors. This is due, for example, to the fact that many investments are not made publicly and various investors make investments at the same time. Nevertheless, research shows that engagement can be an effective way to generate impact.<sup>12</sup> If several asset managers pool their resources to exert concerted pressure on an issuer as part of a collaborative engagement, the likelihood of successful engagement with regard to sustainability improvements increases.<sup>13</sup>

How engagement companies can be prioritised, how the success of different types of engagement can be quantified and how collaborative engagement in Germany can be made easier and more legally secure is examined in Chapter [5, In-depth study: Investor impact: Impact through engagement](#).

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<sup>11</sup> See, for example, Barko, T.; Cremers, M.; Renneboog, L. (2021). Shareholder Engagement on Environmental, Social, and Governance Performance. *Journal of Business Ethics*. DOI: 10.1007/s10551-021-04850-z.

<sup>12</sup> Trusteeship is typically even more comprehensive and long-term than engagement (see [Stewardship or trusteeship codes?](#) by Maria Lucia Passador as of March 28<sup>th</sup>, 2022).

<sup>13</sup> See e.g. Slager, R. et al. (2023): Tailor-to-Target: Configuring Collaborative Shareholder Engagements on Climate Change. *Management Science*. DOI: 10.1287/mnsc.2023.4806

### 2.2.2 Active exercise of voting rights

Actively exercising voting rights while taking sustainability aspects into account, including submitting corresponding shareholder proposals, is an effective way for equity investors to have a positive impact on the behaviour of companies ("voting").<sup>14</sup> As with engagement, success depends in particular on the investor's influence on the company, the implementation costs of the sustainability measures and the current sustainability of the company.

### 2.2.3 Exchange with other investors

An exchange with other asset managers can take various forms. In addition to the collaborative engagement described in [2.2.1 Active dialogue with issuers \("Engagement"\)](#), asset managers can also exchange views on general topics without focusing on a specific company. In this context, it is important to note that [BaFin](#) stipulates that asset managers must ensure that they *do not* coordinate the exercise of voting rights or work towards a permanent and significant adjustment of the company's purpose ("acting in concert"), with the exception of agreements in individual cases.

## 2.3 Other impact channels

In the case of other impact channels, the causal link between investor activity and real economic change is usually difficult to prove, as they often have an indirect effect. Two examples of other impact channels are listed and briefly described below:

- **Provision of resources:** Investors can help companies to grow by providing non-financial resources such as expertise. Alternatively, companies can also be supported in their transition to more sustainable business processes or models, for example through the implementation of sustainability-oriented management systems.
- **Generating publicity:** By generating publicity and thus influencing the political and media discourse as well as consumer behaviour, investors can exert an indirect influence on the company in order to bring about a positive change in sustainability.

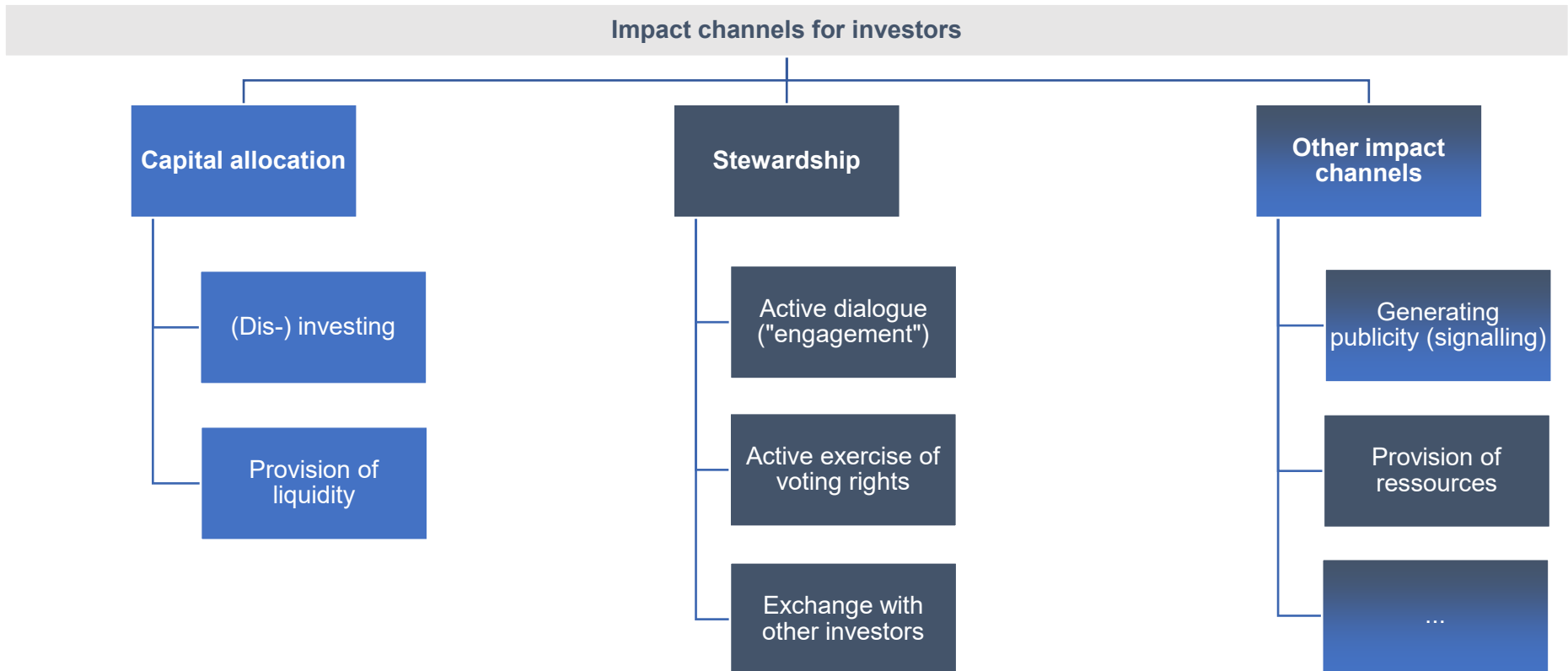
## 2.4 Interaction of the impact channels

It should be noted that the impact channels described are not completely independent of each other. Activity via one impact channel can also influence other impact channels. For example, a targeted disinvestment could have a signalling effect that increases the chances of success of a corporate dialogue with other investors.

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<sup>14</sup> See, for example, Wei, J. (2020): Environmental, Social, and Governance Proposals and Shareholder Activism. *The Journal of Portfolio Management*, 46 (3), 49-64. DOI: 10.3905/jpm.2020.46.3.049.

Figure 1: Illustration of impact channels



**Indirect influence** on corporate behaviour: By directly influencing the cost of capital and/or access to liquidity.

**Direct influence** on corporate behaviour (transformation/growth).

Sources: based on Wilkens, M., Jacob, S., Rohleder, M., & Zink, J. (2022): The Impact of Sustainable Investment Funds - Impact Channels, Status Quo of Literature, and Practical Applications, available on SSRN/ Caldecott, B., Clark, A., Harnett, E., Koskelo, K., Wilson, C., & Liu, F. (2022): Sustainable Finance and Transmission Mechanisms to the Real Economy, University of Oxford - Working Paper No. 22-04, DVFA Technical Committee Impact (2023).

## 2.5 Asset classes for impact realisation

In our view, the "capital allocation" impact channel presented here should be broadly defined. Even if the focus here is more on the impact channel of capital allocation, the other impact channels such as impact or signalling are also relevant in almost all asset classes.

Impact - via capital allocation - can be generated or reduced in and with almost any asset class. The potential **reversibility of the impact is an** important indicator for checking the suitability of the asset class. If, for example, a negative impact can be generated with the capital allocation within the liquid asset class of equities or bonds, this must also be possible in a positive form. Both are two sides of the same coin that belong together and cannot be separated. If a bond invested in by a utility company has a negative impact on the investor because the company still predominantly uses fossil fuels to generate electricity, this must also be possible in a positive sense. For example, through a green bond or an (equity or bond) investment in a company that is predominantly active in renewable energies and thus achieves a net positive effect. The interpretation of what makes a positive contribution varies historically and reflects the current zeitgeist. Therefore, **all asset classes are suitable in principle**, but not at all times and not every instrument. The controversial asset class of "commodities" can also have a positive effect, for example "responsibly sourced gold", as "sustainable timber" or as an investment in CO2 emission rights (e.g. EUAs). **Liquid and illiquid asset classes are equally predestined for** this. However, we see illiquid asset classes as having a relative advantage due to the sometimes clearer cause-and-effect relationship. Primary investments often have a perceived advantage over secondary investments in terms of impact attribution. However, we outline in section 4 that the real economic impact of companies remains even in the event of a partial or complete change of ownership or financing and therefore no impact can be lost. **Secondary investments therefore inherit the impact of the primary investment.**

The **asset class** (e.g. public equities or commodities) and the investment **instrument** (mutual fund or ETC) must be separated. If an instrument covers a large market, it is often referred to as an "asset class" itself, such as "green bonds" (= part of public debt) or "hedge funds" which, like "multi-asset funds", invest in different asset classes. It is not always possible to make a clear distinction, as asset class and instrument are mixed in general investment jargon and capital allocation statistics are often only reported at instrument level.

In the presentation, we focus on the asset classes and exemplary investment instruments and themes that can typically generate a positive impact through capital allocation. The asset classes currently invested in most frequently are shown here.

Table 1: Asset classes and exemplary instruments that are suitable for achieving a positive impact

Asset class	Instruments with a positive impact (examples)	Description of the instruments
<b>Cash &amp; Cash Equivalents</b>	Social Impact Savings/ Deposits	(Short-term) deposits made through socially responsible banks or financial institutions that channel funds into impact-oriented projects
<b>Public Equities</b>	Solution providers, e.g. companies with a high proportion of SDG sales	Investments in listed companies that, for example, have strict ESG practices and make a high contribution to the SDGs
<b>Public Debt</b>	Green bonds, social bonds	(Primary and secondary) investments in fixed-income securities issued to finance environmentally or socially oriented projects
<b>Infrastructure</b>	Green Infrastructure, Social Infrastructure	Investments in ecological or social infrastructure projects and companies
<b>Real assets</b>	Green & Social Real Estate, Sustainable Forestry, Sustainable Agriculture	Investments in properties that focus on high ecological standards or social criteria (e.g. high building efficiency, affordable housing); sustainable forestry, agriculture or land management projects
<b>Private debt</b>	Green & Social Private Debt	Bonds or loans from companies that are placed with a select group of investors and offer solutions to social or environmental challenges
<b>Private Equity</b>	Green & Social Private Equity, Green & Social Venture Capital	Equity investments in illiquid companies (especially start-ups or early-stage companies) that offer solutions to social or environmental challenges
<b>Hybrid Financing</b>	Microfinance	Direct or indirect (e.g. via microfinance institutions) loans or equity investments for individual entrepreneurs and small businesses, primarily in the areas of agriculture, trade, manufacturing and services, especially in emerging markets
<b>Commodities</b>	Sustainable Timber, CO2 emission rights	Raw materials that have a high social benefit and fulfil ecological and social standards

Source: Based on Drexler et al. 2013 (From the Margins to the Mainstream: Assessment of the Impact Investment Sector and Opportunities to Engage Mainstream Investors. World Economic Forum), GIIN 2023: GIIN Insights Series, DVFA Expert Committee Impact (2023)

### 3. Impact measurement

#### Key takeaways: Impact measurement

- Suitable metrics should be selected on the basis of the impact objectives.
- Sustainability data varies in quality, which is why the advantages and disadvantages of the data should be dealt with transparently when measuring impact.
- For transparent impact measurement, a distinction must be made between company impact and investor impact.

Based on the definition of impact investing given at the beginning, the DVFA-FA Impact believes that a distinction should also be made between company impact and investor impact when measuring impact. Therefore, after a generally valid systematisation of possible data for impact measurement, the measurement of company and investor impact is discussed separately.

When measuring the impact of companies, a basic distinction can be made between direct data (e.g. CO2 emissions), derived data (e.g. CO2 intensity) and further processed key figures (e.g. SDG ratings):

- **Direct data**<sup>15</sup> can be divided into sustainability-related (e.g. waste production) and financial data (sustainable turnover or CAPEX). In particular, the use of forward-looking key figures, such as CAPEX, can be a way of assessing the future transformation of the company. The advantage of direct data lies in its objectivity, which makes it easier to compare companies.
- **Derived data**<sup>15</sup> comprise standardised and estimated data. The use of derived data can therefore be useful in order to close data gaps and establish comparability between different companies. However, the quality of the data should be considered, particularly when using estimated values.
- **Further processed key figures** from different data providers are very heterogeneous<sup>16</sup> and therefore difficult to compare. However, aggregated key figures offer the advantage that they paint a more holistic picture of a company, which facilitates the often complex measurement of impact.

Which data is used often depends on the use case - it is important to be transparent about the strengths and weaknesses of the data and models used in order to facilitate an external categorisation of the approach used.

<sup>15</sup> Both direct and derived data are currently reported by companies in a rudimentary and inadequate manner and are therefore often only available as estimated data points from ESG rating agencies. With the expansion of reporting obligations under the CSRD and the underlying "ESRS" reporting standards, companies will report the SFDR data points they classify as material. The availability of data will therefore increase significantly in the future.

<sup>16</sup> Cf. Baukloh et al. (2023), In partnership for the goals? The (dis)agreement of SDG ratings.

Table 2: Exemplary systematisation of the impact measures

Category	Designation	Examples	Availability	Comparability
Further processed data	SDG ratings (activity- and/or output-orientated)	/	+	-
	ESG ratings (asset-orientated)	/	+	-
Derived data	Standardised data	CO2 intensity	+	+
	Estimated values	CO2 emissions Scope 3	+	-
Direct data	Financial data, (past-orientated)	Sustainable sales	+	+
	Financial data (forward-looking)	Sustainable CAPEX and OPEX	0	+
	Sustainability data (output-orientated)	Waste production	0	+
	Sustainability data (activity-orientated)	Accidents at work	0	+

Measuring the actual impact of the investor and the companies invested in is a complex challenge. However, it is necessary in order to be able to communicate the impact transparently and comply with the basic principles of sustainability-related disclosure obligations. For the best possible impact measurement, a differentiation must be made between the impact caused by investors and companies. Regardless of whether an investor or company impact is referred to, the issuer must demonstrate a minimum level of sustainability in order *for* an impact to be recognised and reported by the investor. As "minimum safeguards", we refer to the EU DNSH principles or the minimum exclusion criteria defined as part of the German "[association concept](#)".

### 3.1 Measuring the impact of companies

The following section looks at measuring the impact of companies. In order to show the entire spectrum of companies with a positive impact, these are divided into three categories by way of introduction:

- "Pure Plays": Companies that generate an impact through their products and services.
- "Enablers": Companies that help third parties to improve their environmental and social footprint or offer sustainable products and services.
- "Transformers": Companies that actively improve their business model and / or their upstream and downstream environmental or social footprint.

The focus of possible measurement parameters varies depending on the category:

Pure Plays are characterised by the fact that they provide products and services that have a direct positive impact. The metrics used should therefore also reflect this. For example, a wind farm operator that produces electricity with low greenhouse gas emissions can use the metric of green electricity produced (in mW/h).

Enablers are characterised by the fact that they provide products and services that enable third parties to achieve a positive impact, such as a wind turbine manufacturer that enables the wind farm operator to produce green electricity. One possible metric could be the capacity to produce green electricity (in MW).

Transformation companies or transformers are improving in terms of sustainability. If the improvement relates to the production processes, activity-oriented sustainability indicators are suitable for measuring impact. For example, if a company is aiming to reduce greenhouse gas emissions, greenhouse gas intensity can be used as a metric.

In addition, it is important to capture the impact of a company holistically so that both the negative and positive impact can be recorded. Furthermore, specific metrics/KPIs should be defined that provide a transparent picture of the company's ESG situation. These then also provide a starting point for impact measurement. Ideally, these should be universally applicable metrics/KPIs that can be applied to companies of different sizes, regions and sectors. Examples of indicators for measuring negative and positive impact are listed below:

Measurable *negative* impact can be recorded and documented using the PAI indicators (PAI = principal adverse impact), among other things. The PAI indicators make it possible to identify and assess potential risks and negative impacts of investments and can be used to identify sustainable investments within the meaning of the SFDR as "do no significant harm" (DNSH) factors. Another option is to include the DNSH criteria of the EU taxonomy, which are intended to prevent negative impairment of one or more of the six environmental objectives. In principle, it makes sense to use mandatory regulatory and therefore widely available data (e.g. DNSH, PAI) as the basis for impact measurement. These indicators (with a corresponding reduction) can also be used to measure the success of the commitment (see 3.2 Measuring the impact of investors).

In order for the *positive* impact of individual investments to be measurable, an impact target must first be defined. Appropriate metrics must then be determined in order to transparently assess the achievement of the target. In addition to the six environmental goals of the EU taxonomy, the 17 UN SDGs can also be used to measure impact. For example, "access to clean water" can be defined as an impact goal and then, for example, the number of wells built can be used as a metric. SDG ratings use processed data so that data providers can assess the extent to which and how companies have a positive impact on the achievement of the SDGs through their business activities and/or their products and services.



In view of the large number of established frameworks for impact measurement at companies, we have refrained from further differentiating the measurement methods. A selection of the most important frameworks is listed below:

**IRIS+** (Impact Reporting and Investment Standards+) is a system of indicators developed by GIIN. It seeks to cover a broader range of metrics that meet the evolving needs of impact investing. The framework covers different sectors and industries to assess the social, environmental and financial impact of companies and investments.

PRI launched the "[Impact Investing Market Map](#)" back in 2018. Based on over 450 reports from data providers, universities and UN agencies, it is intended to make it easier for market participants to identify companies that generate an impact based on key topics. The ten key topics identified were largely linked to the 17 SDGs in order to facilitate impact investing reporting. Among other things, sectors were assigned to each thematic focus area in which companies can have a potential positive exposure to the thematic focus area (e.g. sectors such as electric vehicle manufacturing or utilities in the field of renewable energies are assigned to the energy efficiency focus area).

Specific, sometimes asset class or sector-specific frameworks such as [ICMA standards](#) (International Capital Market Association Norms) as standards for the issuance of green or social bonds and the [UNEP FI Principles for Positive Impact Finance](#) (United Nations Environment Programme Finance Initiative) as guidelines for financial institutions and companies supplement generalist frameworks.

Last but not least, with the [EU taxonomy](#) and the [PAIs \(based on the SFDR\)](#), the EU has not only created an identical name, but also defined a set of indicators that is relevant as a basis for all sustainability investors in the EU.

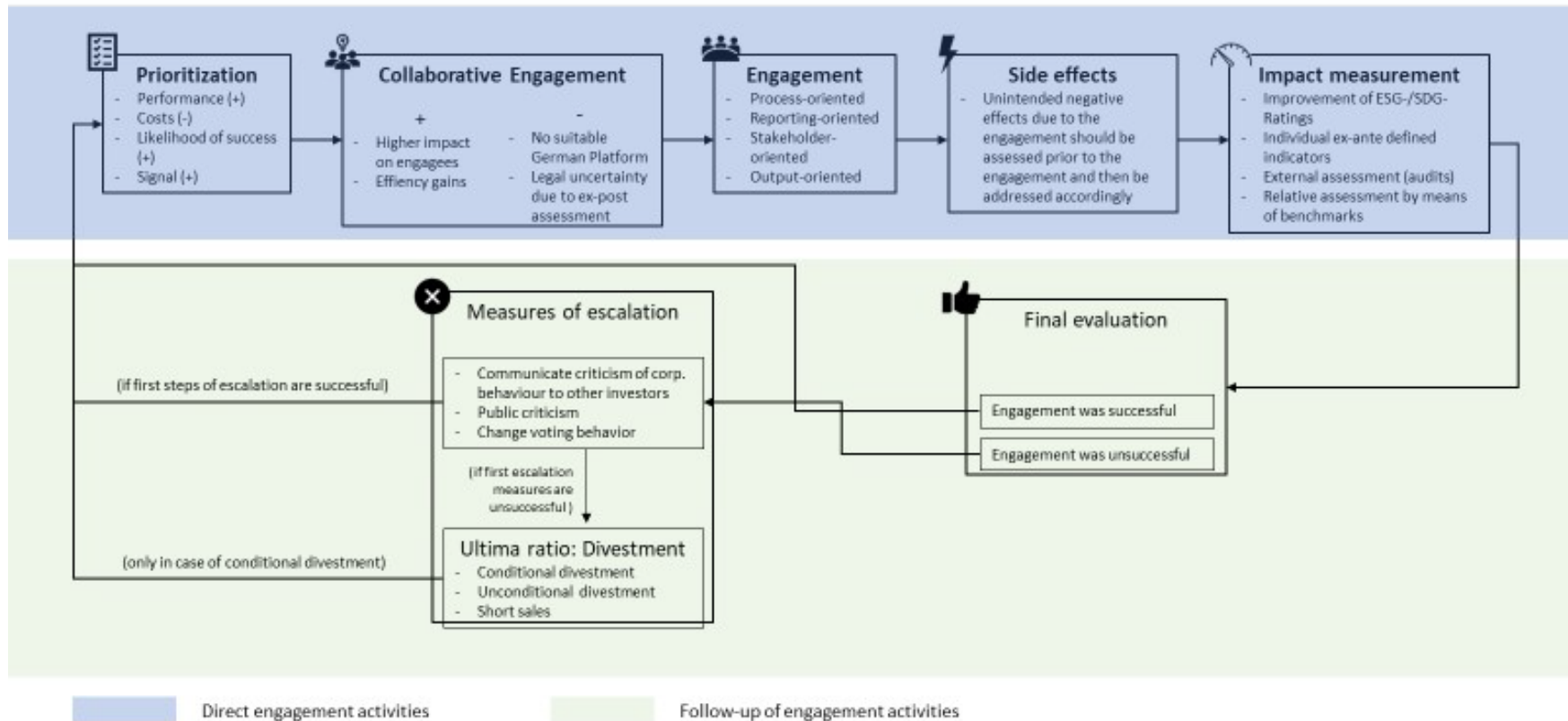
### 3.2 Measuring the impact of investors

As engagement is one of the most established impact channels for generating investor impact in liquid asset classes, this impact channel is focussed on below: Academic research shows that engagement can be an effective impact channel.<sup>17</sup> The impact induced by the engagement is always indirect, as a change must first occur at the target company itself (potential investor impact) before this leads to a real economic change (company impact). The engagement can result in both positive and negative, usually unintended effects, which should be quantified wherever possible. It is important to note that the overall impact must be positive. The aspects along the engagement process analysed in more detail by the DVFA-FA Impact are presented in chronological order in the chart below and examined in more detail in Chapter 5.

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<sup>17</sup> See Kölbel, J.F., Heeb, F., Paetzold, F., & Busch, T. (2020): Can Sustainable Investing Save the World? Reviewing the Mechanisms of Investor Impact. *Organisation & Environment* 33 (4), 554-574. <https://doi.org/10.1177/1086026620919202> Literature review on this: Kölbel, J.F., Heeb, F., Paetzold, F., & Busch, T. (2020): Can Sustainable Investing Save the World? Reviewing the Mechanisms of Investor Impact. *Organisation & Environment* 33 (4), 554-574. <https://doi.org/10.1177/1086026620919202>

Figure 2: Measures and decisions along the engagement process



Whether an engagement is successful depends on the objective of the corporate dialogue and the response of the engagement company. The success of an engagement can be measured based on the objective of the engagement using various metrics, which are analysed in more detail in the section [Engagement implementation & possible metrics for measuring impact](#). Impact can also be measured in absolute and relative terms. In addition to the absolute measurement approach, relative measurement requires benchmarks, the selection of which must meet high quality standards. Firstly, the choice of benchmark for measuring the success of engagement must be justified. In addition, the assessment of the benchmark or the constituents it contains must be based on the same ESG data as the portfolio being assessed. This relative approach can be combined, for example, with the ESAs' idea in the current [Progress Report on Greenwashing](#) of presenting the mandatory PAI indicators of a fund in relation to the fund's benchmark. A distinction can also be made between

- **Internal performance measurement:** Improvement of the ESG and SDG ratings as initial proxy indicators. In addition (e.g. due to time lag in rating improvement), use of own ex-ante defined indicators on the engagement topic and the
- **External performance measurement:** audits (with tracking of whether the target was achieved); number and content of shareholder proposals; proxy voting on a specific shareholder proposal; accepted voting proposals.

In order to avoid double counting and as explained in the section on the [fungibility of impact](#), the impact that investors generate through engagement is never higher than the impact of the target company (company impact). The following therefore always applies: investor impact  $\leq$  company impact.

In a [fund-specific disclosure on the engagement approach](#) and the measurement of investor impact, the following points should ideally be taken into account:

- Proportion of exposures to all (equity) investments (e.g. 10 % of shares).
- Number of topics per engagement and - if possible - weighting of topics in ESG ratings
- Number/scope of successful shareholder proposals
- Number of engagements per year and employee
- Success rates
- Disinvestments and the resulting market signal (was the disinvestment publicised?)

In the "Exemplary stewardship reporting" table below, we build on the previous indicators and a performance measurement proposal from Shareholders for Change and add several elements to it:

- Not only direct involvement, but also the exercise of voting rights (voting) per company.
- Engagement and voting are differentiated per topic
- Possible aggregation of results at portfolio level

Table 3: Exemplary stewardship reporting

Company	First contact	# of contacts	Latest contact	Discussion/voting	Topic 1 (10% of ESG rating)	Topic 2 (15% of ESG rating)	Topic 3 (5% of ESG rating)
A: Engagement	May 30th, 2022	5	July 27th, 2023	Yes	1	2	3
A: Voting			April 30th, 2023	Yes	0	5	
B: Engagement	Feb. 2nd, 2023	3	July 31st, 2023	Yes	3	4	
B: Voting			May 30th, 2023	Yes	5	0	
C: Engagement	July 31st, 2023	1	August 23rd, 2023	Yes	1		1
C: Voting			June 30th, 2023	No			
...							
<b>Number of companies</b>				<b>3</b>	<b>3</b>	<b>2</b>	<b>2</b>
<b>Average</b>					<b>2.0</b>	<b>2.8</b>	<b>2.0</b>

Source: based on Shareholders for Change (2023), DVFA Impact Committee (2023).

The example shown relates to a share portfolio with 50 companies, whereby an engagement was carried out or agreed with 50 % of the portfolio companies. The first contact with company A took place on 30 May 2022, for example. Since then, there have been five contacts in the form of physical/virtual meetings or in writing. Voting rights were also exercised on 30 April 2023. The direct engagement covered three different topics, two of which were also voted on.

For reasons of simplification, the example reporting only uses ESG rating-related topics that can be aggregated relatively easily. It is true that most of the metrics assigned to the four engagement strategies introduced in the chapter on [engagement implementation & possible metrics for impact measurement](#) can also be included, as the number, frequency and scope of relevant company reports for reporting-oriented engagements can also have an influence on the company's ESG rating, for example. However, a direct link to the ESG rating cannot always be established for the proposed metrics, or only to a limited extent. The aim should therefore be to address the aspects listed above under "Fund-specific disclosure on the engagement approach" and to report as fully as possible.

The success of an engagement or a vote is based on the Shareholders for Change system:

Table 4: Evaluation metric for engagement activities

Result of engagement	Result of voting	Engagement points
Company fully implemented recommendation(s)	Company fully implemented recommendation(s)	<b>5</b>
Company largely implemented recommendation(s) or committed to fully implement them	Company committed to fully implement recommendation(s) with timetable	<b>4</b>
Company partly implemented recommendation(s) or committed to largely implement them	Company committed to reduced recommendation(s) with timetable	<b>3</b>
Company communicated the requested information or committed to partly implement the recommendation(s)	Company committed to reduced recommendation(s) without timetable	<b>2</b>
Company partly communicated the requested information	Recommendation voted on but not accepted	<b>1</b>
Company refused recommendation(s)	Voting proposal not accepted for agenda of shareholder meeting	<b>0</b>

Source: based on Shareholders for Change (2023), DVFA Impact Committee (2023).

The assessment is based on six different categories, with a 5 symbolising the achievement of the investor's objectives, as all the requested adjustments have been implemented. A 0, on the other hand, symbolises an issuer's refusal to accept the investor's demands. The incremental gradations are intended to take account of partial implementation on the issuer's side or a future planned implementation with a concrete timetable.

The assessment at individual title level for engagement and voting activities (see "Exemplary stewardship reporting" overview) can also be aggregated at portfolio or entity level. For example, the average success rate for the exemplary investor across all topic areas and individual portfolios is 2.3 out of 5. In addition to the success rate, the "stewardship intensity" can also be presented, for example by comparing the stewardship measures in relation to the number of

Table 5: Stewardship reporting at fund level

Aggregated data on portfolio level (e.g. mutual fund)	Summary
Number of invested stocks	50
Active contacts (companies)	25
Share of active contacts	50%
Number of stewardship	2
Active contacts/specialist	12.5
Average quota of success (see table below)	2.3
Engagement policy	Link to document

Source: DVFA (2023)

of stewardship specialists at an asset manager (in the example: 12.5 contacts/specialist and year). A specific example of how investor impact can be generated through engagement measures and how this relates to company impact is explained in the section entitled [In-depth study: Company, investor and portfolio impact](#).

The reporting can be successively supplemented with additional elements. For example, progress on issues can be measured using more precise metrics such as "reductions in emissions", "improvements in ESG or SDG ratings", etc. in order to check the plausibility of the success rate shown. Escalation levels such as "suspensions of increases in investments" or "divestments" or "increases in investments" can also be added for each company.

Criticism of companies can be voiced across the portfolio for ongoing support or if the commitment does not lead to the desired success by providing information to other (potential) investors, e.g. via investor circles (if permitted; signalling):

- Expressing public criticism of companies ("naming/shaming" or public signalling) through media discussions, open letters, other publications, protest actions, etc. and, based on this, any *uncoordinated*
- change in the voting behaviour of other investors and, as a last resort, a
- Complete or partial divestment<sup>18</sup> (incl. short sale)

In some cases, these approaches can be combined with each other or individual components can have a mutual effect, thereby maximising the impact. For example, a divestment can be publicly justified with

<sup>18</sup> Disinvestment must always be taken into account: Engagement does not have to begin with entry as an investor or end with exit as an investor. A possible (re-)investment promised to the company can incentivise the company to make changes even without current exposure. In principle, a distinction must therefore be made between a conditional or temporary disinvestment, which is cancelled once the change postulated by the investor has been fulfilled, and an unconditional or final disinvestment, which is classified as irreversible by the investor.

a failed engagement attempt or an unsatisfactory sustainability development. It should be noted that some of these measures can lead to significant changes in the price of securities. Such measures can also have an impact on customers, suppliers, employees, supervisory authorities, etc. (direct reputational effects plus indirect effects). Investors can attempt to measure the impact of such actions (public criticism, divestment) using the metrics discussed in the chapter on [Engagement Execution & Possible Metrics for Impact Measurement](#).

#### 4. Fungibility of Impact

##### Key takeaways: Fungibility

- Company-Impact is transferable between investors
- In contrast, investor impact is only attributable to the current investor and is therefore not transferable
- Historical disclosure of the investor impact is possible, but must be clearly labelled.

Impact, in the sense of impact investing, is partially fungible, i.e. transferable. A distinction must be made between investor impact and company impact. The impact of investors (investor impact) is not transferable, whereas the impact of companies (company impact) is transferable and can be extrapolated.

Real economic impact at companies (company impact) remains in place even in the event of a partial or complete change of ownership or financing due to the continuity of the company's entrepreneurial activity. Because new investors, just like previous investors, contribute to the continuation of the impact-generating corporate activity, the current company impact is transferable. The existing company impact can therefore be passed on in a secondary market transaction, as the impact of a company no longer depends on the primary investor. The transferability of impact therefore also follows the transfer of investor rights and obligations. Company impact can therefore not be "lost" through a change of investor. However, the criteria mentioned in 1.3 must be met in order to establish company impact in the case of secondary investments. <sup>19</sup>

The transferability of impact is linear. Negative company impact can therefore also be transferred to new investors. In terms of an overall portfolio view, both "investment" and "disinvestment" can therefore increase (or reduce) the company impact at portfolio level.

Investor impact, on the other hand, which an investor achieves through corporate dialogue (engagement), for example, is absorbed by the company in question. Only the investor who accompanied the

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<sup>19</sup> High-frequency traders, for example, who only hold stocks during the day or fund or index investors without an impact intention who invest in impact companies are therefore excluded, as there is no intentionality.

dialogue can be credited with the investor impact (investor impact). Investor impact is therefore not transferable. If the investor who has achieved investor impact with a company sells his position in the relevant company, the buyer acquires a company with a higher impact (company impact). Accordingly, the investor impact and company impact must always be recognised separately. Furthermore, the investor impact created cannot be greater than the company impact created. The change between company impact in t0 and t1 can therefore be partly investor impact.

However, it is difficult to attribute company and investor impact and ultimately always merges into company impact. We therefore argue in favour of a separate disclosure of key figures for investor impact in order to avoid confusion with company impact and to enable selectivity for the fungibility of company impact. By distinguishing between the investor and company perspective (investor vs. company impact), our definition is compatible with the logic of sustainable investments, e.g. according to the EU SFDR.

**The fungibility of impact extends to all asset classes and instruments, provided they constitute original company impact.** The company impact is transferred pro rata according to the amount of the total capital shares (enterprise value approach). The absolute amount of the company impact achieved is relevant for the planetary impact. For better comparability between companies and investors, however, this consideration should be shown in relative terms. In a comparison between investors, the relative comparison is preferable. Otherwise, for example, investor 1, who invests 1 million (= 10 % of the fund) in a 100 % sustainable company, would have a lower absolute impact than investor 2, who invests 10 million (= 5 % of the fund) in the same company. In relative terms, however, Investor 1 (c.p.) has a higher weighted portfolio impact. For information purposes, the investor and company impact of companies that have already been sold can be shown as "historical" impact. This **"historical impact" should be clearly separated from the currently financed company impact.** The time of impact generation as the primary investor and also the time of sale (transfer of company impact) should therefore be shown.

To clarify, it should be added that overcompensation of historically created impact in the sense of a permanent approach by the original primary investor should be viewed critically. **The compensation of the primary investor in an impact activity takes place in full with the secondary transaction via the sale price.** The fungibility of impact thus follows the economic and legal chain. **However, historical impact can be recognised for information purposes** and should be clearly identifiable as such. Multiple recognition of impact is not permitted.

We also advocate that **impact cannot be traded separately from the underlying investment in order to** avoid the risk of multiple counting of impact. A partial sale of an impact stream is legally possible, but increases the **risk of multiple counting**, which must not occur. This could be relevant in cases such as a sustainably managed forest area, for example, if no trees are felled for a defined period of time and the CO<sub>2</sub> is effectively stored. In this case, the removable CO<sub>2</sub> savings could become fungible. If this is actually relevant in projects, the investor must report on this transparently, including the new owner of the company impact and the investor chain in the event of a resale of the CO<sub>2</sub> rights.



## 5. In-depth: Investor impact: Impact through engagement

### Key takeaways: Engagement

- In order to use resources efficiently, commitments must be prioritised.
- There are various engagement strategies whose success can be measured using specific KPIs
- Collaborative engagement can increase the likelihood of engagement success - but there is still great uncertainty in Germany

The focus of current engagement efforts is often on individual topics that enjoy a high profile in society and/or the media (e.g. CO2 emissions, biodiversity, gender aspects, etc.). As shown in the diagram [under 4.2 Measuring the impact of investors](#) in the "Engagement implementation" section, there are essentially four options for prioritising the content of an engagement and thus generating and measuring investor impact:

- 1. risk or process-orientated engagement:** The primary aim of engagement is to achieve an ESG rating improvement for the target company, i.e. to reduce the ESG risks for the company, which can be achieved primarily through process changes. Consequently, highly weighted indicators are taken up here by rating agencies.
- 2. reporting-orientated commitment:** The target company should in particular improve/expand its reporting and thus become more transparent in order to facilitate commitments by other shareholders.
- 3. stakeholder engagement:** engagement activities that lead to the activation of not only other investors, but also other stakeholders such as employees, customers, suppliers and communities.
- 4. output-oriented commitment:** The commitment is primarily aimed at achieving a change in production or service (output) at the target company, which should lead to better compatibility of the company's activities with the Sustainable Development Goals of the United Nations (e.g. SDG focus).

These four options and proposed metrics for the respective engagement success are presented and discussed in the chapter Engagement implementation & possible metrics for impact measurement.

## 5.1 Engagement prioritisation

Table 6 - Selection of academic studies on the success rates of shareholder engagement

Ver- sion	Study	Number of samp- les	Period ana- lysed	Success rate			
				Total	E	S	G
2015	Dimson et al (2015)	2152	1999-2009	18 %	18 %	11 %	24 %
2022	Hoepner et al. (2016)	682	2005-2014	28 %			
2022	Barko et al (2017)	847	2005-2014	60 %			
2021	Dimson et al (2018)	1671	2007-2017		42 %		
2019	Dyck et al (2019)	147	2004-2013		33 %		
2022	Brav et al. (2022)						
2022	Bauer et al. (2022)				19,9 %		

Even though the success rate of engagements varies between 20 % and 60 % in the scientific literature, the same success factors are often identified in the studies (points 3 and 4 are taken up again in the chapter on [collaborative engagements](#)):

**1. current sustainability of the company:** For companies with higher initial levels of ESG performance, engagement appears to have a higher probability of success - the companies appear to be more open to engagement efforts by investors and more able to address the areas of engagement raised by investors.<sup>20</sup> Collaborative engagements appear to be particularly promising (see section on [collaborative engagements](#)).

**2. implementation costs:** The lower the implementation costs are to fulfil the dialogue objective or the greater the capacity of the issuer to implement the requirements, the more likely it is that they will be implemented<sup>21</sup>. One of the consequences of this is that comparatively complex ecological transformation targets, to which engagements have been led, are implemented less frequently than targets in the area of good corporate governance that are easier to implement. As there are often long-standing

<sup>20</sup> Dimson, E.; Karakaş, O.; and Li, X. (2023): Coordinated Engagements. European Corporate Governance Institute Working Paper Series in Finance.

<sup>21</sup> Dimson, E.; Karakaş, O.; and Li, X. (2023): Active Ownership. The Review of Financial Studies 28.12: 3225-3268. DOI: 10.1093/rfs/hhv044.

relationships between investors and engagement companies, the investor can roughly estimate how complex and costly the implementation of a requirement is.

**3. influence and credibility of the investor:** The more influential and credible the investor is, the more likely it is that the company will implement the dialogue objectives.<sup>22</sup> A simple indicator of the investor's influence is its investment volume. In contrast, the institutional credibility of the investor is more difficult to measure, whereby one factor is a credible and transparent value framework.

Due to the high cost of an engagement, investors can hardly carry out comprehensive engagements for all their portfolio companies (according to MSCI, there are currently only engagements for around a quarter of the largest 9,000 listed companies). Especially as investors are often invested in a large number of companies that show potential for improvement in terms of sustainability. In addition, end customers of financial intermediaries have different interests and preferences that need to be taken into account in the engagement process. It is therefore essential to prioritise engagements.

Following the discussion above, the engagement focus should therefore be on intrinsically motivated issuers as measured by good ex-ante ESG/SDG ratings. However, companies that are particularly unsustainable can be improved the most. It therefore makes sense to engage with issuers that have already improved their ratings and/or have new management that is committed to sustainability (thesis: poor companies with new management are more likely to respond to suggestions).

Possible calculation of engagement prioritisation as a factor from

- Current sustainability of the company ("Performance")
- Implementation costs ("costs")
- Influence and credibility of the investor ("probability of success")
- Signalling character for the market/other companies, including the potential absolute impact of the engagement, which in turn depends on the topic and company ("residual")

**Performance x costs x probability of success + residual**

(+)

(-)

(+)

(+)

*Note:* The sign indicates the effect of the respective factor.

## 5.2 Collaborative engagements

Investors with high assets under management or those with large stakes in individual companies have a higher chance of engagement success due to the greater influence of the engagement company. However, even the largest investors only hold relatively small stakes in individual companies. The pressure that individual investors can exert on engagement companies is therefore limited. As can be seen from

<sup>22</sup> Ibid.

the above discussion, serious and credible engagement also involves a high investment of time and personnel, and even large investors have limited capacities. Conversely, resources in capital market-oriented companies are also limited, meaning that they too are guided by the shares held by investors in engagement discussions and prioritise accordingly.

Empirical evidence shows that this problem can be solved by pooling resources and influence and that the resulting efficiency gains can lead to greater success of engagement measures. The most important factors here are the number of collaborating asset managers, their share of the company and their previous experience with collaborative engagement.<sup>23</sup> These economies of scale show that collaborative engagement should be used to jointly achieve engagement goals. Numerous platforms have been launched in recent years to facilitate and incentivise collaborative engagement, such as the UN PRI's Collaboration Platform, ShareAction (UK), As You Sow (US) and Shareholders for Change (Europe). As early as 2021, the DVFA Governance & Stewardship Commission published a [position paper](#) highlighting the importance and opportunities of collaborative engagement, which remain largely untapped in the German market.

Empirical evidence shows that investors tend to focus their engagement efforts on companies that are geographically closer to them, e.g. listed in their home market.<sup>23</sup> Among other things, this can be attributed to the lower transaction costs in the context of engagement, the greater influence on companies due to their stronger local ties or the greater benefit for investors if poor environmental and social practices are addressed in the engagement company and, for example, negative externalities are internalised. A higher level of credibility is derived from the local expertise of the investor, which has a significant influence on the engagement result.

This pattern also applies to collaborative engagement. If the "lead investor" is geographically and culturally close to the engagement company, this typically leads to better engagement success<sup>24</sup>. In line with this idea, some European countries have already launched national engagement platforms, including Eumedion (Netherlands), Assogestioni (Italy) and Ethos (Switzerland). There is still no platform in Germany, which can be attributed to the legal uncertainty of a collaborative engagement approach, among other things: <sup>25</sup>[BaFin's case-by-case review](#) acts as a deterrent in investor circles and is therefore criticised - as in the above-mentioned position paper of the DVFA Commission on Governance & Stewardship or an [interview by the Sustainable Finance Advisory Board of the German Federal Government \(SFB\)](#). With regard to this ex-post case-by-case assessment, primarily output-orientated collaborative commitments should be viewed critically, as they are intended to bring about a very long-term and far-reaching change in the company. The current aim of the SFB is to address the legal uncertainties and

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<sup>23</sup> Slager, R. et al. (2023): Tailor-to-Target: Configuring Collaborative Shareholder Engagements on Climate Change. Management Science. DOI: 10.1287/mnsc.2023.4806

<sup>24</sup> Dimson, E.; Karakaş, O.; and Li, X. (2023): Coordinated Engagements. European Corporate Governance Institute Working Paper Series in Finance.

<sup>25</sup> Mülbart, P.; and Sajnovits, A. (2022): Emerging ESG-Driven Models of Shareholder Collaborative Engagement. ECGI Working Paper Series in Law.

establish a German engagement platform: it is to be called GEPSI (German Engagement Platform for Sustainable Impact).

With regard to the topic of impact measurement, it is already becoming apparent that the differentiation between engagement leaders and followers means that the leader who devotes more resources to engagement makes a higher impact contribution, but also wants to communicate this. Although collaborative engagement should be labelled as such in the external presentation, we believe that differentiating the impact contribution is currently difficult to implement in terms of technology and content. This aspect needs to be addressed in future contributions.

### 5.3 Engagement implementation & possible metrics for impact measurement

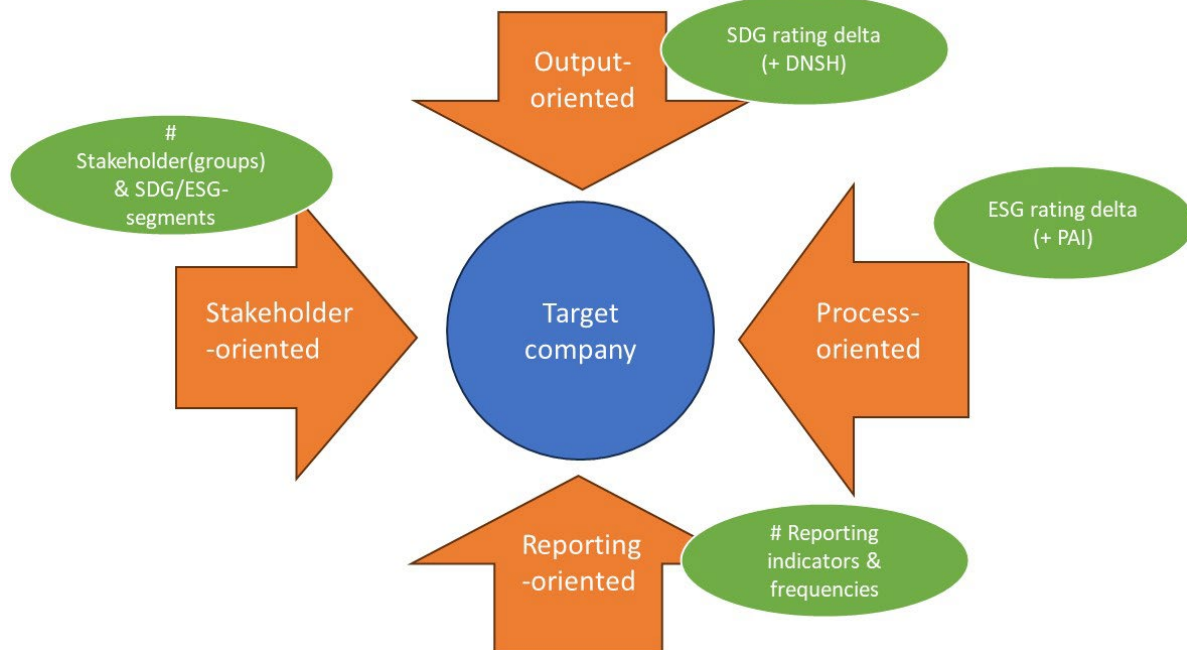
Process- and risk-oriented strategies can be measured with the help of ESG ratings. The focus of the engagement is on the question of how companies organise their production process. ESG ratings are primarily driven by the environmental, social and governance risks to which a company is exposed. social or corporate governance risks to which a company is exposed. PAI indicators can be used as a further measure, as lower ESG risks typically lead to better PAI scores.

**Reporting-orientated strategies** can best be measured by the number of reported ESG indicators and their publication frequency. In particular, engagement should therefore lead to greater transparency in ESG indicators. For example, one-off reporting of greenhouse gas emissions at Scope 1 level should be rated lower than annual reporting of Scope 1, 2 and 3 emissions. When measuring performance, key figures can also be assessed in terms of their significance for the company's respective business model.

**Stakeholder-orientated strategies** can be measured in terms of the stakeholders (groups) addressed and the topics addressed. For example, a strategy focussing on a specific group of employees should be evaluated differently to one that addresses all employees as well as customers, suppliers and relevant communities.

**Output-oriented strategies** can be measured with the help of improvements in SDG ratings. This type of engagement primarily targets a company's products and/or services. SDG ratings typically improve the more a company's sales, investments and operating expenses are compatible with the SDGs. Do No Significant Harm (DNSH) criteria can be used as a supplementary metric. This is because the less harm a company causes through its products and services, the more compatible its output typically is with the SDGs.

One challenge when using the metrics presented is that the disclosure standards for ESG issues that apply in the real economy still fall short. For example, providers of sustainability ratings often have to rely on discretionary company publications, which reduces the reliability of their sustainability ratings. As companies' existing non-financial reporting is often (still) unaudited, companies are inclined to present aspects in a more positive light. (Inter-)national reporting standards are therefore extremely important, whereby attention should be paid to standardised publications. If the publication of individual aspects is left to the discretion of a company, the problem of preparing ESG and/or SDG ratings remains.



## 5.4 Further aspects

### *Possible negative (side) effects*

As already described in [4.1 Measuring the impact of companies](#), an investment can have both positive and negative effects. The same applies to engagements, as even with the best of intentions, unwanted negative (side) effects can occur. These must be identified as far as possible ex ante to the engagement and minimised by formulating the dialogue objectives as precisely as possible. For example, many engagements require ESG issues to be included in management remuneration models.<sup>26</sup> However, this can widen the pay gap between management and employees. With the introduction of variable remuneration components that are linked to ESG issues, the difference in remuneration between management and employees should therefore at least be published on a regular basis.

### *Regulatory aspects*

The role of engagement and voting has so far been neglected by regulations such as SFDR and MiFID II. Only the possibility of influencing the so-called PAIs via active ownership has been addressed. However, with the [Progress Report on Greenwashing](#), the ESAs are focussing on the topic of engagement for the first time and suggest that it should be addressed in more detail in future publications.

## 6. Specialisation: Company, investor and portfolio impact

A central point of our understanding of impact in these guidelines is the distinction between company and investor impact. Furthermore, the transferability (fungibility) of the company impact has also been introduced. In contrast to the company impact, the investor impact cannot be transferred. However, it

<sup>26</sup> See e.g. Bebchuk, L.A., and Tallarita, R. (2022): The Perils and Questionable Promise of ESG-Based Compensation. ECGI Working Paper Series in Law.

can be recognised for information purposes. These points will now be summarised and illustrated in a practical example. As there is no known approach to date as to how different impact figures can be offset, we assume that the respective company impact is comparable and can be offset. To simplify matters, we assume a determinable SDG revenue share that represents the company impact and that can be influenced by the investor's engagement activities. If revenue is generated by products that have a negative impact on the SDGs, the revenue share is shown with a negative sign in the table.

Table 1 shows companies A, B and C at eight different points in time. We assume a dynamic two-company portfolio that is invested equally in companies A and B at the start. In the initial situation, company A has a negative impact of 10 %, whereas company B has a positive impact of 5 %. As the portfolio impact is calculated from the weighted sum of all company impacts, it is -2.5 % in the starting portfolio.

In addition, the change in portfolio impact due to transactions is also shown separately in order to illustrate its transferability: Company Impact (sale) and Company Impact (purchase).

The investor impact shows the effect of the investor's activities in the various time periods, e.g. through an investment. Investor impact is therefore defined as the change in the impact of a company caused by its activities. To measure investor impact, the extent to which the investor's involvement was decisive for the change in the company should be defined. It is assumed that half of the changing company impact is attributed to the investor as investor impact, provided that the investor was involved. This investor impact attribution will often not be realistic in practice and is determined, for example, by the intensity of the engagement and the demonstrable unique position in the engagement for a topic. However, there should be no doubt that the owners play a decisive role in determining the direction of a company through engagement and have a share in positive corporate change. They finance this change through the allocation of capital. This investor commitment effect (IW) can therefore assume values between 0 (no share in the change of the company) and 1 (change based exclusively on the commitment of an investor). Since ultimately the creation of the positive (company) impact always takes place at company level, we argue that the IW should be a maximum of 0.5 if the investor alone has influenced the positive direction of the company, but the company naturally does the implementation. The IW is therefore made up of the investor share within all investors (0-1) and the investor/company ratio, which is capped at 0.5. The investor share of the change in company impact can therefore be a maximum of 50 %. The investor impact can therefore be represented as follows:

$$\text{Portfoliogewicht} * (\text{Company Impact}_{t_1} - \text{Company Impact}_{t_0}) * \text{IW} = \text{Investor Impact}$$

The investor starts in  $t_0$  one commitment each with (E1 and E4) with the companies: One engagement promotes the coal phase-out of company A (E1). The other commitment is aimed at increasing the SDG-relevant sales of company B (E4). However, both commitments only show an impact from  $t_1$  an impact, meaning that the investor impact in  $t_0$  is 0.

As Company B increases its SDG-relevant sales at the investor's request, its company impact increases. As the engagement with Company B is a collaborative engagement with another investor, the investor impact is attributed proportionately. Overall, the investor can report an investor impact of 2.5% ( $\Delta$



company impact = 10%, portfolio weight = 50%, IW = 50%). In  $t_2$  and  $t_3$  further successes from the investment materialise, which is why the company impact increases and new investor impact is generated.

In addition, there are  $t_2$  initial successes from the engagement with Company A, which is beginning to phase out coal. In  $t_3$  the remaining coal production is then ended completely. The company also starts to build up renewable energies and increases the share to +10 % in  $t_3$  (E2). As a result, the company impact has risen continuously.

In  $t_4$  Company A is sold, as no further progress is made in the switch to renewable energies. In  $t_4$  there is a complete reallocation of funds from company A to B. The table shows how the portfolio impact changes through the purchase and sale of the position - i.e. the "company impact" is passed on through the purchase and sale. The positive company impact of A is sold pro rata (-5 %) and positive company impact in B is bought (+25 %). The reduction of company A and the increase in the portfolio share in B in  $t_4$  with a higher proportion of sustainable investments, the portfolio impact increases from 30 % to 50 %.

In  $t_5$  a partial sale of company B takes place. The liquidity released is invested in company C. Company C has a negative company impact, which is why there is a higher transformation potential. The partial sale of B results in a pro rata 30 % positive company impact, while the company impact at C dilutes the portfolio impact from 60 % to 25 %. An investment is made in company C in order to initiate a positive transformation. In  $t_6$ , the rapid transformation of company C changes its company impact by 35 % from -10 % to +25 %, which is also reflected in a positive investor impact.

In  $t_7$ , B is then sold again and reinvested in C, as B only shows low positive rates of change and the investor is not only interested in a high compact impact in the portfolio, but also wants to accompany a positive transformation through commitment. The portfolio impact decreases slightly as a result of this transaction.



Table 7: Overview of company impact, investor impact and portfolio impact, assuming an IW of 0.5

		t0 <sup>1</sup>	t1	t2	t3	t4	t5	t6	t7
Company A	Company Impact	-10 %	-10 %	-5 %	10 %	10 %			
	Investor Impact (IW 0.5)	0 % (E1)	0 % (E1)	2.5 % (E2)	7.5 % (E2)	0.0 %			
	Portfolio weight	50 %	50 %	50 %	50 %	0 % (E3)			
Company B	Company Impact	5 %	15 %	25 %	50 %	50 %	60 %	70 %	75 %
	Investor Impact (IW 0.5)	0 % (E4)	5 % (E4)	5 % (E4)	12.5 % (E4)	0.0 %	5 % (E5)	5 % (E5)	2.5 %
	Portfolio weight	50 %	50 %	50 %	50 %	100 % (E3)	50 %	50 %	0 % (E6)
Company C	Company Impact						-10 %	25 %	50 %
	Investor Impact (IW 0.5)						0 % (E5)	17.5 % (E5)	12.5 %
	Portfolio weight						50 %	50 %	100 % (E6)
Weighted total	<b>Company Impact (without transactions)</b>	-2.5 %	2.5 %	10.0 %	30.0 %	30.0 %	60.0 %	47.5 %	62.5 %
	Company Impact (sales), ( - )	0 %	0 %	0 %	0 %	-5 %	-30.0 %	0 %	-37.5 %
	Company Impact (purchases), ( + )	0 %	0 %	0 %	0 %	25 %	-5.0 %	0 %	25 %
	<b>Company Impact (portfolio)</b>	-2.5 %	0 %	0 %	0 %	20 %	-35.0 %	0 %	-12.5 %
	<b>Portfolio Company Impact*</b>	-2.5 %	2.5 %	10.0 %	30.0 %	50.0 %	25.0 %	47.5 %	50.0 %
	*thereof <b>proportionate investor impact</b>	0.0 %	2.5 %	3.75 %	10.00 %	0.00 %	2.50 %	11.25 %	12.50 %

<sup>1</sup> For the sake of simplicity, it is assumed that the portfolio in t0 consists of no transactions

E1 Commitment to stopping coal at A

E2

Phaseout coal t2 after successful commitment, full recognition of the coal phaseout as investor impact, half recognition of the increases as investor impact for development of renewable energies in t3 + development of renewables +10 % in t3

E3

Disposal A in t3 as progress too slow and reinvestment of position in B with increase in exposure

E4

Investor engagement with B to increase the share of SDG-relevant sales, half of the increases recognised as investor impact

E5

Partial divestment B and reinvestment in C where relatively more investor impact can be created, half of the engagement success recognised as investor impact in t6 and t7

E6

Disposal of B and reinvestment in C

## 7. Outlook

With this guide, we would like to encourage investment professionals to integrate impact holistically into their investment analyses and view it as an integral investment objective. Impact investing is not for the niche of illiquid investments, but a topic for the entire capital market. As the field appears complex due to sometimes competing understandings of impact, our guide aims to show how impact can be achieved via various impact channels. Impact can be achieved in both the liquid and illiquid areas. In our view, the current regulatory framework in the EU only partially reflects the assessment and promotion of impact.

We provide guidance on how impact can be achieved in all asset classes and reported on transparently. In the view of the DVFA-FA Impact, this is increasingly relevant for the legitimisation of sustainable investments, in addition to the regulatory framework in the EU. The current framework is not always suitable for this or the data situation is not always ready for it - especially in the area of investor impact proposed by us.

Therefore, for an effective further development of impact approaches, the better determination of investor impact in a real portfolio is necessary and thus the evaluation of engagement activities in relation to other investors is also relevant. The investor, as part owner or lender, has a significant influence on the direction of a company through its stewardship activities. This view of impact should also become more important in the regulatory assessment of impact in the coming years.

Can this guide address all the current question marks of impact investing? And do we already have "really good data" to define investor impact? No. But that is precisely why we are stimulating the debate in order to facilitate further discussion and research on how investor impact can be more reliably determined, delineated and presented in the future.

We also encourage more research on impact in the various asset classes and the respective instruments. There is a large gap in data and understanding here. In order to be able to generate and measure impact, practice and theory must be able to provide answers as to how impact can be offset between different activities and instruments. The approaches here are still in their infancy. There are also major fields of research in the area of transferability of impact. Last but not least, the understanding of how to measure impact should also be standardised and it should be clarified whether existing standardisations such as the SDGs or the EU PAI are actually sufficiently useful for this purpose.

The current views on impact achievement are complex. In our view, standardisation is needed in the foreseeable future in order to avoid "impact washing" and to support social and environmental objectives with appropriate regulation.

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