IMPACT INVESTMENT IN INSURANCE INDUSTRY

- A SYMBIOTIC RELATIONSHIP (THROUGH PAR FUNDS)

Author: Poonam Tandon- Chief Investment Officer- IndiaFirst Life Insurance Co Ltd
Mentor- Mr Wole Oshin, Group Managing Director of the Custodian Group

1. Introduction

We have seen that the insurance industry has been instrumental in insuring lives and building savings and paying out annuities for people at large. However, in a new age, we need the insurance industry to expand its scope of service towards impact investment which will change the landscape of the world economy by helping the 'bottom of the pyramid' progress to the next level. Since Insurance industry has long term liabilities and therefore matching long term assets, it is proposed that we use this factor to leverage the investment from insurance companies to uplift the people through impact investment (which can take some time to fructify). This will create a different service stream for the insurance industry to help the 'lower strata' increase their standard of living which will in turn increase the GDP for the country/world and also create a new customer segment for the insurance companies.

Global Multidimensional Poverty Index (MPI) is a key international resource that measures (annually) acute multidimensional poverty across more than 100 developing countries. 1.1 billion people out of 6.1 billion people are in poverty across 110 countries. 534 million people are in sub–Saharan Africa, 389 million in South Asia. According to global MPI 2023[1], a total of 415 million people moved out of poverty in India within just 15 years from 2005/2006 to 2019/2021.

Therefore, the impact investment for this significant population size of 1.1 billion people will be beneficial not only to them but also to the investors. With assets under management (AUM) of USD 36 trillion, the global insurance industry has enormous power to control where investments are made across the world[2] **The insurance industry can help plug the gap**.

1.1 Definition:

The Global Impact Investors Network (GIIN) define Impact Investments as "investments made with the intention to generate positive, measurable, social and environmental impact alongside a financial return." Impact Investing brings into account a concept of blended value which refers to creating social, environmental and financial value while investing in promising projects. It takes into account not only the social cause but also at par returns on the investments so made (Bugg-Levine & Emerson, 2011).

[1] https://niti.gov.in/sites/default/files/2023-07/National-Multidimentional-Poverty-Index-2023-Final-17th-July.pdf

[2] https://www.statista.com/statistics/421217/assets-of-global-insurance-companies/

The social and commercial community together can make more difference than each of them can do separately. Impact Investing can be one platform where huge sums of private capital come into social platform give market rate returns while creating a blended value. Governments various parts of the world are also showing interest in promoting Impact Investing to address problems like affordable housing, poverty reduction, job creation, public transportation, financial inclusion, healthcare etc. Empirical evidence suggests that firms with private ownership perform more efficiently than their government counterparts as there is an expectation of better performance, value creation and financial returns.

Industrial reports from IBEF (2019) give an insightful vision into the industrial segregation on various industries of Impact Investing in India. Industries so analysed were healthcare, pharmaceuticals, transport (roads and railways), textiles, real estate, affordable housing and renewable energy. Government policies are also taken into account while analysing the industries.

We are now feeling effects of climate change on a global scale. High growth consumer capitalism have pushed the planet to breaking point. Inequality is rising. Add to this the challenges of a COVID-19-related recovery at a time when governments have a higher debt/GDP ratio, and it becomes clear that the private sector must become part of the solution rather than the problem.

1.2 Impact investment in different parts of the world

Several reputed investors, including TPG, BlackRock, and Bain Capital, have launched impact investments products. Goldman Sachs Asset Management acquired an impact investment advisor Imprint Capital1and institutional investors such as Zurich Insurance, the AXA Group, and Australian superannuation fund, HESTA,

With growing activity and demand for investments, regulators are stepping up to recognise its importance in development and ease the flow of capital. The US government has made amendments to allow capital from foundations and pension funds to participate in impact investments They are asking for more transparency different ways to measure the impact. Enterprises with a dual purpose of social good and financial returns are being recognised as a separate legal entity by regulators, like benefit corporations in the United States

Emerging markets need impact investments as 86% of the world`s population lives there and 9 out of 10 cities of the world which are vulnerable to climate change are in these parts of the world. This paper focuses on the Indian environment due to the reasons as enumerated in the following paragraph. However, it can be replicated elsewhere in the rest of the world as a measure to uplift the people through impact investment.

1.3 Indian impact investment environment

According to the Impact Investors Council (IIC) India needs to spend roughly ~$170 Bn annually to finance United Nations Sustainable Development Goals (SDGs) by 2030. The amount invested in 2019 in impact investments was $2.7 billion while cumulative amount from 2010 to 2019 was 10.8 billion[3]. This is a huge financial gap and the limited public sector resources means that private capital providers have to play a greater role in plugging this gap.
There were an estimated 137 million people in extreme poverty before the pandemic, and as many as 56 million more were pushed into poverty due to the impacts of Covid-19.[4]
The Covid-19 pandemic saw India experience the sharpest economic contraction in its history. Activity plunged by 24 per cent year-on-year in the second quarter of 2020, with large contractions across all sectors except for agricultural production[5] The pandemic also increased the vulnerability of women's employment – women were seven times more likely to lose work during the nationwide lockdown, and eleven times more likely to not return to work subsequently, compared to men.[6]
India's financing gap – after accounting for government spending – is estimated at $565 billion annually. Approximately 50% of this need stems from 3 SDGs – SDG 8 (jobs and economic growth), SDG 11 (sustainable cities) and SDG 5 (gender equality). Impact investing is particularly well suited to help mobilise this much needed private capital as it is extremely well aligned with the SDG priorities.[7]

- Among the emerging markets, India is a big investment destination with high investor confidence. However, many early stage impact investment solutions are not being able to scale up. Therefore now, in India impact investments are now expanding beyond financial inclusion into emerging sectors such as agriculture, technology for good, healthcare, education, infrastructure which will make a great 'impact' to the lives of the people – (like bridges, metros etc) and livelihoods

---

[3] https://aspirecircle.org/wp-content/uploads/2020/07/The-India-Impact-Investing-Story-June-2020.pdf pg 11
[4] https://openknowledge.worldbank.org/bitstream/handle/10986/37739/9781464818936.pdf
[5] IMF (2020). Navigating the Pandemic: A Multispeed Recovery in Asia
[6] Abraham, R., Basole, A. & Kesar, S. (2022) "Down and out? The gendered impact of the Covid-19 pandemic on India's labour market". Econ Polit 39, 101–128
[7] https://iiic.in/wp-content/uploads/2021/01/India-Impact-Investing-Story-June-2020.pdf pg 19

- Most populous country: India is now the most populous country in the world. The country has a large pool of skilled, young and English speaking population. The internet penetration has offered a chance for low cost products to the bottom of the pyramid – which is a large base and is fast growing in India. The fact that India is home to a considerable number of poor in the world at 228.9 million as per an estimate by the UNDP suggests a significant opportunity for Indian businesses and startups. Almost 5 out of 6 Indians are at the BoP which need to be uplifted according to a survey done by the IIC.
- Digital penetration and affordable data download rates have allowed tech enabled business to scale up faster. This has helped diversify away from microfinance into other areas of Small and Medium sized enterprises (SME)
- The Indian market presents substantial opportunity for social entrepreneurs to create impact at scale and generate returns for investors. An analysis of IIC has shown that equity impact investments in India, with an average holding period of around 5.2 years, have generated an internal rate of return of around 30% over the past decade while impacting more than 500 million lives across the country[8]
- In last few years, there are many measures & reforms undertaken by Government of India in creating world-class Digital Public Infrastructure consisting of three different layers unique identity (Aadhaar), complimentary payments systems (Unified Payments Interface, Aadhaar Payments Bridge, Aadhaar Enabled Payment Service), and data exchange (DigiLocker and Account Aggregator). Together they enable online, paperless, cashless, and privacy-respecting digital access to a variety of public and private services. These benefits were felt & served across in India during & post pandemic. These measures have been used as a platform to foster innovation and competition; expand markets; close gaps in financial inclusion; boost government revenue collection; and improve public expenditure efficiency.

2. Criteria for impact investment

The following inclusion criteria was applied to the IIC database to identify impact enterprises:

[8] https://www.weforum.org/agenda/2023/03/impact-investors-india-new-research/

- Mass market focus: key stakeholders (client suppliers) belonging to low or lower-middle income segments.
- For profit businesses focused on innovation and scalability - no not profit or hybrid models. Focus on basic service delivery to underserved populations (access and affordability)
- Focus on providing livelihoods for income enhancement for low income clients or suppliers.
- Impact intentionally: Impact as stated objective and/or measured by firm or impact investor.
- For-profit enterprises with a sustainability lens i.e positive environmental and/or climate impact stated as one of their core objectives.

2.1 Objective of the investment is not only risk vs return by risk/return and outcome
Awareness of impact is low among those in the private finance market as well as in public policy circles, despite its usefulness to both groups.

Capitalism needs to change if it is to remain sustainable and greater impact awareness is a key tool for doing so- especially as we are looking at bottom of the pyramid where majority of the population is.

Investors have the opportunity to lead this process of company-led change. There is no future for anyone on a broken planet, investors included. The problem is not the lack of money, There is more than enough capital tied up in the impact market to generate the changes we need. **The problem is directing that capital effectively to where it can bring the greatest improvement.**

We need to keep in mind, the difference between 'having an impact' and 'maximising impact'. It depends on whom the money goes to. A dollar in extra daily income is likely to have more of an impact on the life of a poor household than a well to do household, because the extra food (or other goods and services) it enables that household to buy is likely to make more of a difference.

If one earns $1 per day, another $1 is a 100 per cent increase in income, compared with just a 1 per cent increase when earning $100 a day. Similarly, reaching or empowering otherwise excluded groups, like women and ethnic minorities, also enhances impact. These are the groups that are less likely to have alternative opportunities and the benefits of that investment will thus make more of a difference.

3. Insurance and Impact investments in India

Impact investment in Indian insurance can have a significant impact on the country's economy and society. India is one of the fastest-growing economies in the world, and the insurance sector is a critical component of its financial system. Impact investment in Indian insurance can help to promote sustainable development, social responsibility, and financial inclusion.

One of the primary advantages of impact investment in Indian insurance is that it can help to address the significant protection gap in the country. According to a report by Swiss Re, India's insurance penetration rate is only 3.7%, which is significantly lower than the global average of 6.3%. Impact investment can help to increase access to insurance products and services, particularly for low-income households and underserved communities.

Another advantage of impact investment in Indian insurance is that it can promote sustainable development. Insurance companies that prioritize sustainability and social responsibility can help to mitigate risks associated with climate change and other environmental factor Impact investment can help to support these companies and promote sustainable development Finally, impact investment in Indian insurance can provide financial returns while also making a positive impact on society. According to a report published by the GIIN in January this year, nearly nine in ten impact investors find that their portfolios are either meeting or exceeding their financial performance expectations.[9] Impact investors can invest in companies that prioritize social responsibility and sustainability, which can help to generate long-term financial returns while also making a positive impact on society.

3.1 What are the key impact instruments

i) Private debt/equity in the form of Alternate Investment Funds
ii) Fixed income allocations investors are choosing green or social bonds with key performance indicators (KPIs), meant to hold companies accountable to achieve specific goals
iii) Equity – Listed and unlisted
iv) Infrastructure Bonds which are long term in nature – this will be helpful for the insurance industry to match their long term liability and will help the country with sustainability.
v) Green Bonds and sustainable themes in the form AIFs or equity as well
vi) Blended Finance Bond Funds

[9] https://thegiin.org/assets/Impact%20Investing%20Decision%20making_Insights%20on%20Financial%20Performance.pdf

Indian debt capital markets are shallow and are skewed towards larger and higher rated enterprises. the mid-market segment comprises of more than 15,000 companies which carry an investment grade rating but are overly reliant on bank financing as the access to capital markets remains low. This space has historically seen very low default rates and the current spreads over risk free more than compensates for the incremental risk.

3.2 Which Funds to invest in

The approach should be to use the most appropriate tools that employ funds which create the greatest impact where it is most needed.

- High-impact funds which focus on inclusion and sustainability, These funds invest in companies with an SDG impact focus, capital-starved sectors and types of businesses that have high development potential.
- Larger companies who are expanding by making capital-intensive investments which offer huge potential for job creation and development impact. In these cases, debt is often a more appropriate instrument than equity through customised project loans.
- Impact via the financial sector through multiple ways:
    - **-Improving cost structures**, making financing more affordable for firms and
    - **-Increasing the volume of capital** to underserved or high-growth segments;
    - **-Designing relevant products**, diversifying what is offered by the market

- Banks and non-bank financial institutions (NBFIs) in India have aimed to support a **more developed and inclusive** financial system by:
    - Supporting the **broad development** of the overall sector to enhance the scale of lending; and
    - Encouraging banks for financial inclusion and small- and medium-sized enterprise (SME) and corporate lending to **increase the productive, sustainable and inclusive allocation of capital**
- Investing in solutions is another category of activity which is popular. This often occurs alongside or as part of alignment. For example, companies and investors are increasingly setting targets to spend a certain amount on solutions as part of their wider support for a net zero transition. Thematic funds (which often invest on the hypothesis that these solutions will generate significant returns) are one example

3.3 Who can invest:

- Private wealth clients (High Net worth individuals) through the rise of impact investing can implement a dual-pronged sustainability strategy in which these investors deploy their capital to generate financial returns and measurable societal change simultaneously
- Foundations and charities
- Banks and Institutions- The contribution from these especially banks can be classified as 'Priority Sector Lending" which will help in fulfilling the sustainability with priority sector lending fulfilment
- CSR Funding by companies- This can be made eligible for CSR investment which will help pool in money for the insurance industry to on lend in a big way to make an impact to society.
- Individuals – even those who cannot afford to invest in Angel Funds or AIFs as the require a much higher threshold.

4. Additional Benefits/Permissions sought from the Government/Regulator which can accelerate impact investment in the insurance sector:

- Tax benefits can be extended to the individual policyholders who invest in the impact investment Funds
- The Impact investments Funds can be a part of the PAR Funds so that the investors can benefit from the upside of the investment returns.
- The investment pattern can be tweaked to include majority of impact investment and at 25% of government securities instead of the mandatory 50%. Special rules for this Fund to declare returns like an AIF -instead of yearly bonuses.
- The regulator can give some extra leeway for Solvency margins so that it reduces cost of capital to encourage impact investment in insurance companies.
- The corporates who are contributing towards the impact investment Funds, should get CSR recognition for the same and will therefore encourage the corporates to invest in the impact investment Funds of the insurance companies instead of searching for CSR initiatives or going through the process of setting up CSR initiatives.

- The regulator can permit the corporates and individuals to invest in the same Fund, so that a bigger pool of money is collected faster and deployed in an effective manner.
- Insurance companies can be given a tax holiday on the impact investment portion which will encourage investment in this segment.
- Indian Banks have mandatorily to lend under 'Priority sector lending (PSL)'. Impact investing can be clubbed under PSL, which will give the Banks an incentive to invest in these Funds.

5. Symbiotic relationship- Win win for all stakeholders

- The insurance industry invests for the long term basis and to the bottom of the pyramid section of the population. This will help the insurance companies to sell their products to this section of the population- the micro insurance and other such products through these impact investments who are reaching out to the bottom of the pyramid section
- The direct selling by the insurance company can give better deals to this poor section and also save commissions for itself
- Making impact investments or making these types of investments available to policyholders would send a strong message to the public about the company's core values. The reputational benefits could potentially attract and retain talent as well as increasing the customer base.
- Developing new products for customer segments that have been ignored by traditional businesses, creating new delivery models to lower costs while maintaining product quality, and using technology for value chain disruption has enabled impact investment to have a multiplier effect on development as also give handsome returns to the investors. In this case the shareholders and policyholders.
- Contribution to the nation's development goals – Impact investing is almost perfectly aligned with national development priorities and can help India achieve its SDGs by focusing attention on the collaboration required between the public sector, private capital, and social service providers to achieve the best possible socio-economic outcomes. Therefore it also satisfies CSR commitments.
- The upliftment of the 'impact strata' can create a new customer base segment for the insurance company to cater to.

6. Conclusion:

The impact investments (in any part of the world) as one of the focus areas for investment companies will increase the social impact of the insurance industry apart from creating wealth for the policyholders and upliftment of the bottom of the pyramid strata of society and thereby contributing to nation building in a major way.