The LP Impact Primer

The Role of Independent Verification in Sustainable and Impact Investing

Background

- Impact and sustainable investing markets have grown and matured, evolving from a niche approach to a more widely adopted component of global capital markets. As the market matures, so too does the need for credible and objective information about how such strategies are creating value beyond financial returns.

- Investors approach impact in diverse ways, reflecting a spectrum of priorities and objectives. Regardless of where they fall on the spectrum, impact investors share a desire for reliable information about the impact capabilities and results associated with their investments. Independent assessments and verification have emerged as one way for impact investors to gain more confidence in impact claims and protect themselves from impact washing.

- The practices of assurance and verification are standard expectations for financial data and are widely applied across industries as important checks and balances, ensuring that quality standards are met and giving consumers confidence in the claims being made. Verification practices are common in financial reporting and are encouraged in many voluntary standards in the impact and sustainable investing market such as the Operating Principles for Impact Management (OPIM), Principles for Responsible Investment (PRI), and LSTA's Sustainability Linked Loan Principles.

- In an environment that is largely self-regulating and reliant on voluntary standards and frameworks to define what constitutes "good" practice, verification can play a critical role

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This is the third piece in the partnership series ("Exploring Institutional Impact") aimed at providing practical guidance, research insights, and tools related to impact and sustainable investing for the ILPA member community.

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in validating a firm or fund's impact assertions. It provides an additional layer of accountability that helps distinguish genuine impact from marketing narrative.

- However, as the market matures, it is important that verification doesn't become a "one-size-fits-all" requirement. Valid concerns exist that mandating it for every fund could place an undue burden on emerging managers and smaller, niche funds. If treated purely as a rigid compliance exercise, the cost and resource requirements risk becoming a barrier to entry.

- In practice, the role of verification should evolve alongside a manager's maturity. For large, established funds, it can provide the objective assurance that some institutional LPs and regulators now consider a baseline for trust. For emerging or specialized managers, however, the process is less about a "pass/fail" audit and more about supporting the development of impact management systems from the ground up.

- Impact verification is a step that some institutional investors are requesting. This primer is intended to explain what verification is and outline use cases where LPs may consider urging their managers to take the extra step of engaging a third party to provide independent verification as part of their investment processes.

What is Impact Verification?

- Impact verification is the process of confirming that the social and environmental representations made by an investor are supported by rigorous processes and credible data. Verification can be managed internally or performed independent of an organization.
    - Internal verification is conducted either by the organization responsible for implementing (GP) or funding (LP) the impact activity, using its own staff, systems, and governance processes.
    - Third-party verification involves engaging an external entity to conduct the review. The use of an outside independent organization provides an additional level of assurance of the review's objectivity.

When Might Verification Be Useful?

- Verification is most relevant for:
    - Investors managing large or complex portfolios.
    - LPs with reputational risk concerns or strict accountability requirements.
    - GPs looking to signal credibility to co-investors or stakeholders.

- It is important to consider that verification requires additional time, cost, and access to data. Smaller investors may find other approaches, such as internal verification or aligning to voluntary standards that don't require verification but provide a framework or guidelines for robust impact practices and reporting to be more appropriate.



Understanding Types of Verification

- Several types of independent verification of sustainability and impact claims are available to market participants, each serving distinct purposes. These include:
    - **Systems and Processes:** Assessment of processes, frameworks, and governance structures for managing impact throughout the investment lifecycle.
    - **KPIs and Data:** Third-party validation of specific impact metrics and reported performance through the examination of data collection methods, calculations and reporting processes.
    - **Reports:** Third-party assurance of impact reports to confirm accuracy, completeness, and alignment with reporting standards. This goes beyond the verification of data to examine the overall narrative, examining both data and report content.
    - **Compensation Models:** Validation of performance measurement and payout mechanisms tied to impact outcomes. This involves assessing measurement methodologies, data collection processes, and the specific metrics used to determine compensation payments.

Implications for LPs

For LPs, verification can support several investment activities, including:

Due Diligence

- Independent verification can provide a valuable third-party check when evaluating managers. It can allow LPs to feel more confident that they are investing in funds that are set up to deliver on their stated impact objectives, protecting their reputation, and ensuring adherence to best practices. This is particularly important as verification also ensures that the impact strategy of potential GPs aligns with the impact objectives and values of the LPs supporting them.

> In a recent publication, Impact Capital Managers (ICM) asked impact allocators to identify "deal killer" traits that make a GP's strategy a "non-starter" in deployment decisions. Poor impact measurement and management was the most cited deal killer, followed by weak impact theses and lack of track record and experience.

- Beyond risk mitigation, relying on independent verification reduces the internal burden on an allocator's team to conduct deep, specialised impact diligence on every potential fund manager. This allows teams to redirect the focus of internal resources on other value-add activities, such as managing portfolio-level impact and strengthening relationships with managers. The standardised outputs of verifications also help LPs to more systematically assess and compare the strategies and performance of different funds and managers on an apples-to-apples basis, which can significantly improve allocation decisions as LPs work to build portfolios aligned with their impact goals.

- As part of their value-add to GPs, some LPs may choose to fund verification services, helping GPs learn and improve their practices while also identifying areas where additional LP support would be most valuable.

Performance Monitoring

- Verification of impact data, particularly information included within reports, increases confidence in the completeness and reliability of the information provided by GPs. Independent reviews can assess the extent to which the report has been prepared in alignment with best practices (e.g. Impact Performance Reporting Norms) and, as such, contain a complete and holistic picture of the fund's impact performance. Verifications can also be used to validate the data in the reports, including assessing the GP's data collection, review, and calculation/aggregation processes. An assessment of both completeness and reliability provides LPs with confidence that the impact story being told is both comprehensive and accurate, enabling them to use the data more effectively in their own stakeholder reporting and offering reassurance to those audiences about the credibility of the impact information.

- Verification is also important when it comes to the design and assurance of sustainability- and impact-linked incentive structures. These mechanisms require careful validation to ensure that financial incentives are credible and ambitious, that reported results used to trigger incentive payments are reliable, that incentive structures are aligned with impact achievement, and that safeguards exist to protect against the gaming of metrics.

Internal System Evaluation

- Verification can help allocators gain more confidence in their own approaches and practices for building and managing impact portfolios. By subjecting their processes and frameworks to independent review, LPs can ensure that they are appropriately and accurately adopting best practices and standards, supporting continuous improvement and learning.

- While certain voluntary standards for LPs encourage or require the verification of disclosures (e.g., OPIM and PRI), obtaining verification can serve as a market signal of integrity and commitment as an impact investor. This signaling function can be valuable for attracting both like-minded co-investors and demonstrating credibility to stakeholders.

Verification Services And Providers

- Understanding how verification works in practice is important for both LPs considering these services for themselves and when interpreting GP-specific verification outputs.
    - **How it works:** Verification typically involves document review, data validation, and stakeholder reviews, culminating in a formal verification statement or certificate assessing the credibility of impact claims and management systems. The specific approach varies depending on the type of verification and the provider selected.
    - **How to find a provider:** When seeking a verification provider, LPs will find a wide range of options available, from traditional assurance providers to specialised impact investing experts. More information on providers and their specialties can be found by connecting with standard setters

such as OPIM, or using the websites of impact investing industry bodies such as the Global Impact Investing Network (GIIN). What to consider:

- **Avoid conflict of interest:** Is the provider fully independent of the GP managing the fund?
- **Credentials:** Does the provider have recognised sustainability assurance credentials such as ISAE 3000 or AA1000AS and specific experience in impact investing?
- **Track record:** Does the provider have a clear history of verification engagements, supported by testimonials and/or case study examples?
- **Methodology:** Are the provider's verification methodologies explicitly aligned with recognised industry standards?

Who pays: The question of who pays for verification services depends on the use case. LPs typically bear the cost when soliciting verification services to support their due diligence processes, when used during their GP engagement and value add support, or when verifying their own systems or data. GPs usually pay when they are seeking market credibility, pursuing third-party validation to attract capital, or supporting their own learning and improvement processes.

Looking Forward

Verification can serve as a valuable tool for allocators building credible, transparent, and high-performing impact investment portfolios. By providing an objective assessment of a GP's claims, processes, and performance, verification can help LPs mitigate risks, meet evolving stakeholder expectations, and contribute to the continued maturation and institutionalisation of the impact investing market.

As the impact and sustainable investing sector continues to grow and attract increasing amounts of capital, the role of verification in maintaining trust and driving genuine impact outcomes will only become more critical. For LPs committed to impact investing, embracing verification as a standard practice represents both a practical necessity and a contribution to the long-term health and credibility of the impact investing ecosystem.

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