Interview with Gloria Nelund, Chairman and CEO and Paul Sanford, CIO of TriLinc Global LLC

# OpenTalks

## Private Capital for a Positive Social Impact

Nr. 2

March, 2020

# TABLE OF CONTENTS

# OVERVIEW

1

## WHAT IS OPENTALKS?

OpenTalks is a periodical publication by OpenFunds, in which we interview investment managers of funds that we distribute or believe to be somehow unique. The idea is to share with our existing and future clients the challenges and opportunities these managers see in their field and beyond.

2

## TOPIC

*Impact Investing and the need for a more responsible form of capitalism.*

Impact investing – investing in order to generate both financial returns and economic, social and environmental impact - is an approach to investing that can be applied across different strategies, geographies, sectors and asset classes.
In this second edition of OpenTalks we concentrate on those investments/ investors that as per the Global Impact Investing Network ("GIIN") - one of the most respected authorities in this field - focus on investments made into companies, organisations, and funds with the intention to generate social and environmental impact alongside financial returns.

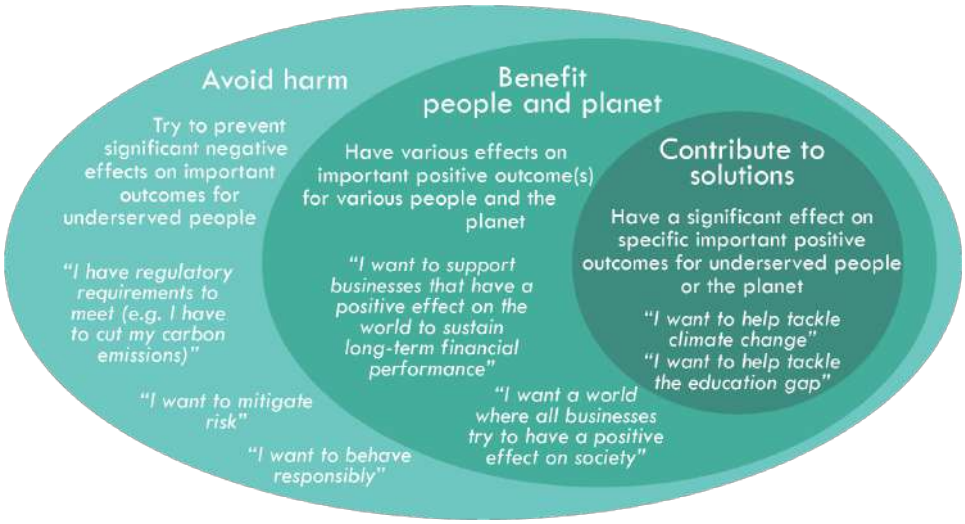
# INTRODUCTION

The Impact Investing movement really took off around 2008. It's not a coincidence that it was around the time of the Global Financial Crisis, which demonstrated that we need a new norm – a more responsible form of capitalism, where transparency and accountability are front and center. Instead of capitalism being the source of problems, it is being reimagined to be part of the solution.

Today one problem continues to persist: we are still confused about what means what. While we are making progress in putting some clarity around it, still, the terms DO mean different things to people who are familiar with the field.

As investors are key in this process we thought to try categorising them in "groups" based on what their mission is, how they want to make a difference, and where, both geographies and sectors.

A broader way how investors can be grouped is described below :




Source : The Impact Management Project

- The widest, least green circle are those who try to avoid harm to the people and the planet – also known as negative screening. They may be trying to meet a regulatory requirement, want to mitigate headline risk say with gun investing, or may just want to behave responsibly as they define it.
- The middle circle defines those who want to avoid harm but also benefit stakeholders where possible.
- The inner circle defines those who in addition to the above, also want to have a significant effect on specific important outcomes for underserved people and the planet.

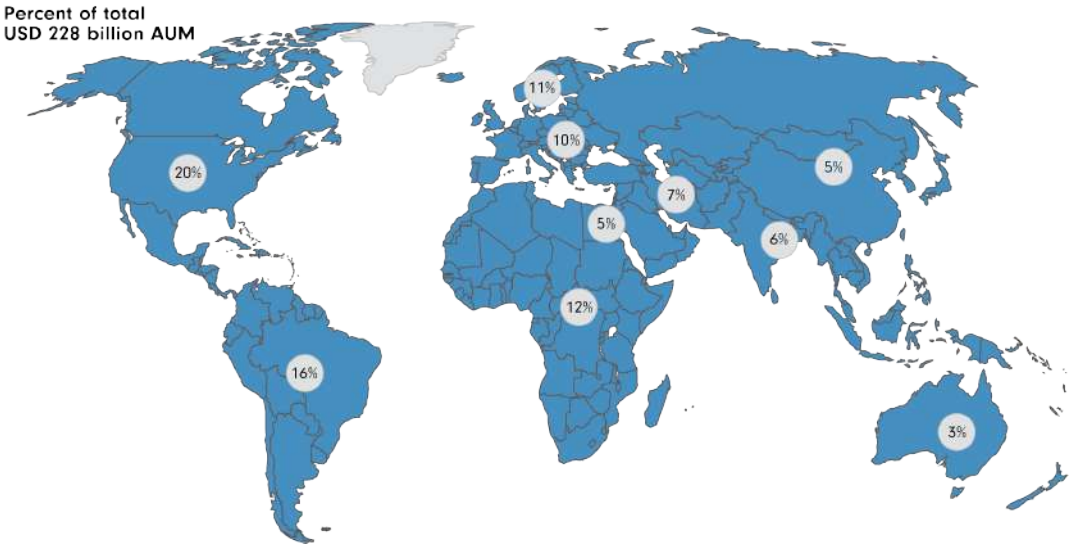
The vehicles utilised by those investors and the depth of their "Impact" is another key of this process. The table below nicely depicts how investors and the products they invest in can vary greatly in their approach and focus. While some are to be considered "only" as Responsible, others do create Impact.

| | Financial-only | Responsible | Sustainable | Impact | | | Impact-only |
|---|---|---|---|---|---|---|---|
| | Delivering competitive financial returns | | | | | | |
| | | Mitigating Environmental, Social, and Governance (ESG) risks | | | | | |
| | | | Pursuing Evinronmental, Social, and Governance opportunities | | | | |
| | | | | Focusing on measurable high-impact solutions | | | |
| Focus: | Limited or no regard for environmental, social or governance (ESG) practices | Mitigate risky ESG practices in order to protect value | Adopt progressive ESG practices that may enhance value | Address societal challenges that generate competitive financial returns for investors | Address societal challenges where returns are as yet unproven | Address societal challenges that require a below-market financial return for investors | Address societal challenges that cannot generate a financial return for investors |
| Examples: | | • PE firm integrating ESG risks into investment analysis<br>• Ethically-screened investment fund | • "Best-in-class" SRI fund<br>• Long-only public equity fund using deep integration of ESG to create additional value | • Publicly-listed fund dedicated to renewable energy projects (e.g. a wind farm)<br>• Microfinance structured debt fund (e.g. loans to microfinance banks) | • Social Impact Bonds / Development Impact Bonds | • Fund providing quasi equity or unsecured debt to social enterprises or charities | |

Source: The Bridges Spectrum of Capital

## So how do investor lastly invest?

### A. Geographies

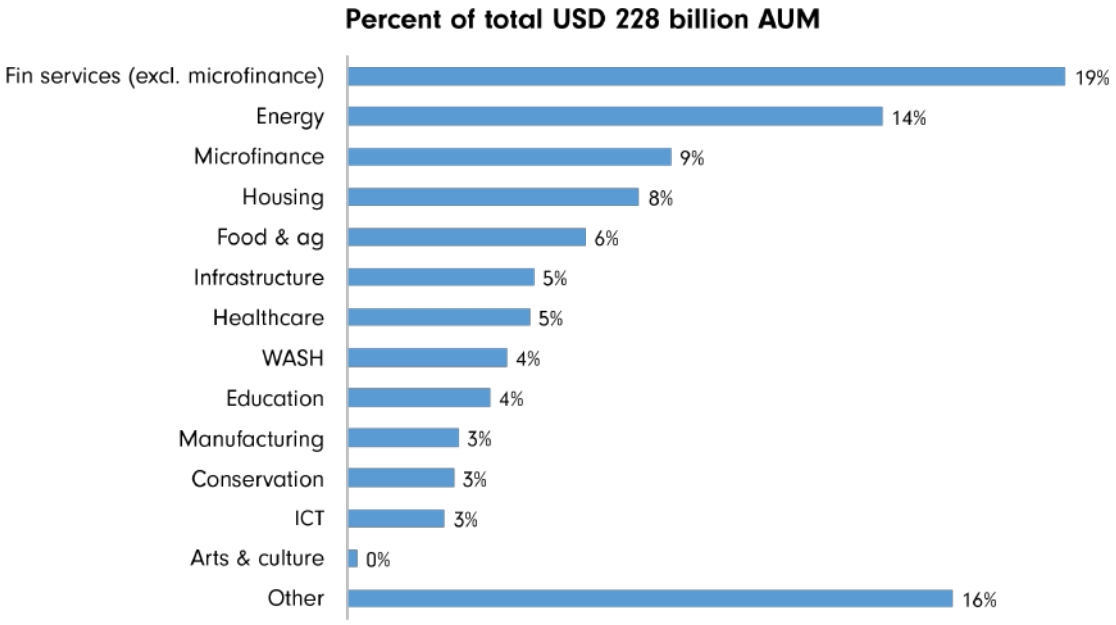



Source: 2019 GIIN Annual Impact Investor Survey

One of the ways impact investors differ is by where they invest.

The first thing to note is that impact investing really does take place everywhere – in **all** regions of the world. A little over 50% of global AUM is in emerging markets and the rest in developed markets.

## B. Sectors




Sector allocations – Source: 2019 GIIN Annual Impact Investor Survey

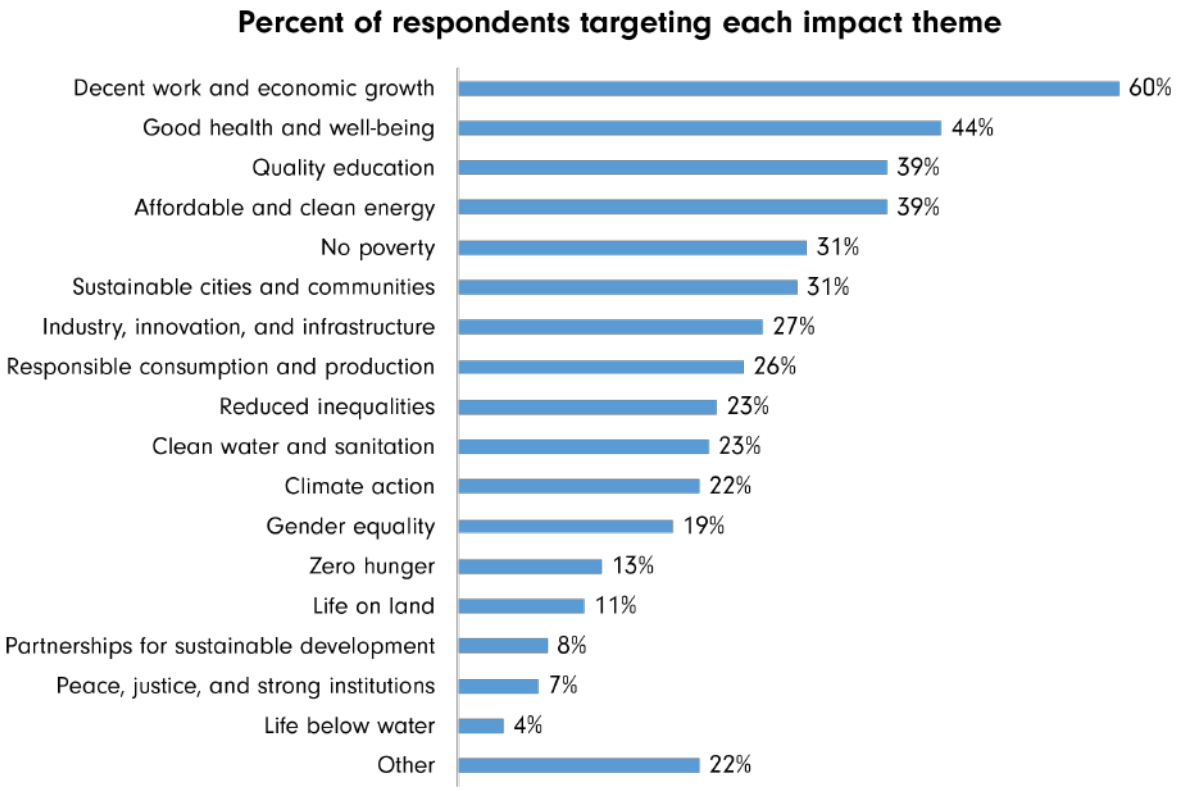
Another way impact investors differ is by what sectors they invest in. It's important to note the distinction between "sector" (the industry you're investing in) and "impact objective" (the improvement you're looking to achieve with your investment).
The provision of basic services to underserved populations - such as financial services, energy, and housing - certainly stands out. There is also growing interest in areas such as healthcare, education, food & agriculture.

## C. Impact objective

A third way impact investors differ is by what impact objective they're targeting:

- About 50% of impact investors seek to achieve both social and environmental impact;
- 40% social only; and
- 10% environmental only.

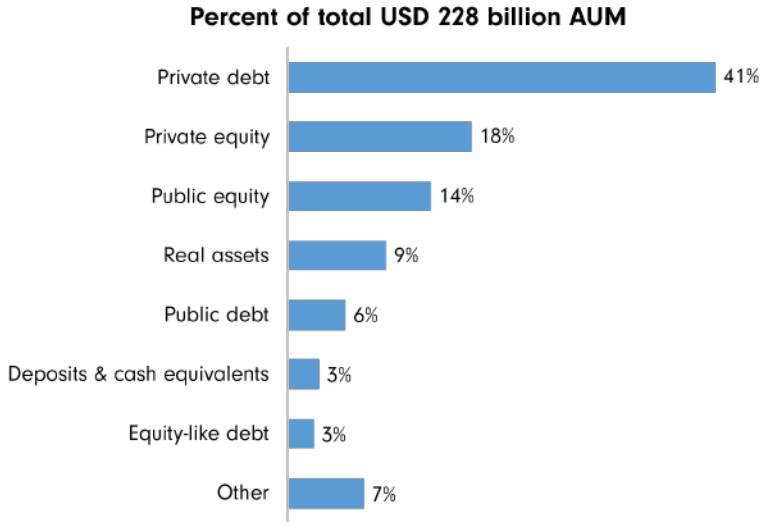
Within these broad categories, there are a number of different impact themes that investors may choose to target.
Pictured below are 17 different impact objectives, aligned to the UN Sustainable Development Goals.




Target impact categories – Source: GIIN, The State of Impact Measurement & Management Practice, Second Edition

## D. Asset Classes

A fourth way impact investors differ is by the asset classes they invest in.




Spectrum of Capital – Source: The Bridges Spectrum of Capital

## E. Motivation

Lastly, impact investors have different motivations for how they invest and give. The largest percentage think it's "very important" to do impact investing for the following reasons:

- It's core to their mission
- It's what responsible investors should be doing
- They have impact goals that they're using impact investing to achieve
- The second largest group in the survey cited:
- Clients are demanding it
- The impact investment strategies are just aligned with growing industries
- The returns are better than other investment opportunities

Regardless of the reason for making impact investments, the most important point is that they're being intentional about the impact they're seeking to create and tracking that impact, and that you must be earning some type of return.

# OpenTalks with Gloria Nelund & Paul Sanford

The Capitalist model is under attack from all sides, there is craving for changes, as not even governments, philanthropist and development agencies have been able to come up with functioning alternative models. Can capitalism be reformed to operate in the service of society?

**Gloria:** I have always been a believer that harnessing the power of the capital markets for good is our best chance at solving the world's most pressing social and environmental issues. The best efforts of governments, philanthropists and development agencies are simply not enough to improve outcomes for the world's poor and middle class, let alone meet the rising demands of staggering global population growth and diminishing natural resources. Impact investing – investing in order to generate both financial returns and economic, social and environmental impact – I believe, is the much needed but oft missing instrument from our toolset of solutions for socio-economic progress. By deploying more socially-conscientious capital to the public and private markets we can move the needle on and improve outcomes for the world's poor and middle class.

## And impact investing is part of the solution ?

**Gloria:** Impact investing isn't just one thing, it's an approach to investing that can be applied across very different strategies, geographies, asset classes and sectors. As such, it has attracted the attention of a diverse range of organisations, including foundations, banks, family offices, DFIs, institutional investors and fund managers. One of the ways impact investors differ is by where they invest. Though development aid is good and helpful, it only meets a fraction of the need. According to the UN Sustainable Development Goals report, official aid and development assistance stood at $135.2 billion in 2014, the highest level ever recorded, and yet 1 in 5 people live on less than $1.25/day and 836 million people still live in extreme poverty. At the same time global aquifers are being pumped 3 times faster than rainfall can recharge them and 23 hectares of land is lost every minute due to drought or desertification. Last but not least over 5 Billion Tons per year of carbon dioxide from fossil fuels are pumped into the air contributing to global climate change.

As we are living in a capitalistic world (if we want it or not) it makes a lot of sense so that we effectively address these challenges, by engaging the full power of the capital markets.

## How would you describe the form of Capitalism you envision ?

**Gloria:** Catalysed by impact investing, I envision a new form of capitalism aimed at working for everyone, all around the world, despite previous hardships and obstacles. Similar to traditional capitalism, profits continue to be a driver of sustainability; however, this new form of capitalism is not about exclusively maximising profits for shareholders, but rather maximising benefits to all stakeholders at the same time. Rather this form

of capitalism is about the purposeful and deliberate infusion of values and principles into investing in order to intentionally derive positive outcomes for society. It is about providing much needed financing to companies, entrepreneurs, and other individuals who are making a positive and measurable impact in their communities and whose impact will have encore benefits for their families, communities and societies as a whole.

### ...and where do you think we stand on it?

**Gloria:** A quick scan of the investment landscape confirms that we have a way to go before this vision becomes reality. The reason for this is because of the current make up of our investor landscape. If you imagine for a moment an inverted bell curve – a bimodal distribution that falls to a trough between two peaks – we find at one peak a group of investors utilising a traditional investment approach; employing a range of investment strategies with no consideration for the social benefits derived. These investors may associate with a philosophy predicated on the intentional and deliberate separation of their investments from social good. That is, they draw their investment dollars from one metaphorical "bucket" and their social dollars from a separate "philanthropic bucket." At the second peak, however, the opposite group of investors sits: ardent supporters of using investment dollars to create economic, social and environmental impact. These effusive torch-bearers of the impact investing movement see no separation between their investments and social good, and rather endeavour to align their investment dollars with their values. In particular, these investors can be found among the millennial generation and women; segments that have leveraged their positions at work, as consumers, and as investors to bring about social change. And while these efforts have been noteworthy and catalytic, they have not yet alone succeeded in moving the vast resources and capital needed to sufficiently scale the impact investing industry. In the trough, between the two peaks of this investment landscape, lay the rest of us, the general public. We patronise restaurants, frequent commercial enterprises, consume products, make purchases for our households, and go to work. We aim to provide for our families, save, and set some money aside for retirement. Yet when it comes to our investments, we remain for the most part disconnected. When it comes to our finances, we might not readily admit it, but most of us are not engaged. Yet if we hope to succeed in bringing private capital to bear on society's pressing social and environmental needs, we must engage. We must adopt a new approach –

a paradigm that purposefully infuses our values with the decisions we make around what we buy, where we work, and how we invest.

## Is TriLinc the tool for bringing this new vision of Capitalism 2.0 to a broader public, i.e. the people living in the "trough" as described before?

**Paul:** Gloria, our Founder and CEO, created TriLinc to demonstrate that professionally managed attractive risk-adjusted investment strategies could be paired with ESG risk management and impact tracking/reporting in a holistic investment process that would prove investors do not need to sacrifice returns to do good. Gloria set about first identifying what TriLinc's first flagship strategy would be, she could not help but notice the immense investment and impact opportunity in Emerging Markets ('EM') created by the massive financing gap for small and mid-size businesses there. That realisation set the stage for TriLinc's EM private debt strategy. To that end, TriLinc's thesis is that the EM private debt opportunity is one of the most significant impact investment opportunities of our lifetimes. Similarly, McKinsey has called the growth opportunity in EM the biggest in the history of Capitalism. TriLinc's strategies are designed to be attractive from an investor's perspective, with a risk mitigated investment strategy and structure, that is yield oriented (in the midst of low yield environments in advanced economies), with capital preservation emphasised over capital appreciation, while also seeking to minimise ESG risks and generate significant measurable impact.

## Why is the EM Debt Opportunity so attractive for TriLinc and its investors?

The fundamental opportunity for investors stems from the supply/demand imbalance of financing that is available to credit-worthy lower middle-market/SME companies. The IFC's (the International Finance Corporation, a member of the World Bank Group) most recent estimate is that the

financing gap for EM SMEs is as much as $4.5 Trillion. A supply/demand mismatch of that magnitude cannot help but be a compelling risk-adjusted investment opportunity that is inherently impactful from a developmental economics perspective.

TriLinc is able to generate double digit gross yields in its portfolios, with underwriting standards typical of cash flow lenders but also with the over-collateralisation typical of asset backed lenders. The combination of which can significantly mitigate the risk of default loss.

We believe that another profoundly attractive trait of the EM Debt Opportunity is that it easily lends itself to comprehensive diversification. Diversification is too often an over-used word, such that it sometimes loses its meaning, yet it is systemically important to risk mitigation generally and TriLinc's EM private debt strategy specifically. We are able to create a portfolio of private debt investments that is pan-EM, across 4 different regions of the world (Latin America, Emerging EU, Sub-Saharan Africa and Emerging Asia), in over 30 carefully selected countries, and a like number of industries. The portfolio is further diversified by type (TriLinc provides both term lending and trade financing), tenor (from 60 days to 60 months) and local market investment partner (we have nearly a dozen covering the four TriLinc regions). This level of comprehensive diversification essentially allows TriLinc to create a quasi-index of private debt exposure that provides the return premium of idiosyncratic private companies while simultaneously diversifying out the tail-risk. Also, from an impact perspective, a strategy as diversified as TriLinc's also provides for a diversified set of borrower-level impacts each company is making in its community, beyond the fund-level economic development impact we track and report for all of our investments.

Finally, in addition to what we believe is a naturally compelling risk-

adjusted investment opportunity and the comprehensive diversification EM private debt naturally lends itself to, the strategy is non-correlated to public market securities.

So, in summary, the value proposition is (i) attractive risk-adjusted returns, (ii) comprehensively diversified to further mitigate risk, (iii) while having no correlation to public securities.

## How has TriLinc been able to effective convey the value proposition of EM private debt to investors?

**Paul:** TriLinc's business strategy revolves around pairing attractive impact investment opportunities, like EM private debt, with investment product structures that are easily consumable and investable by large numbers and types of investors. Specific to TriLinc's EM private debt strategy, from a lender's perspective there is an attractive risk/reward opportunity stemming from the lack of available financing, which can be further enhanced through ESG risk mitigation. From a borrower's perspective, TriLinc's EM private debt strategy provides impactful bespoke financing solutions tailored to the needs of the businesses it finances, including the availability of moderate intermediate tenors (up to 5 years) and an alignment of return incentives (TriLinc can generate higher returns the better its borrowers perform). Importantly, just because an investment opportunity is compelling doesn't mean investors will appreciate it and just gravitate towards it on their own. To that end, TriLinc's strategies are also designed to be attractive from an investor's perspective, with a risk mitigated investment strategy and structure, that is yield oriented (in the midst of low yield environments in advanced economies), with capital preservation emphasised over capital appreciation, while also seeking to minimise ESG risks and generate significant measurable impact.

## Can you briefly describe how the understanding of what investors look for has influenced your approach to investing.

**Paul:** First, we understand how investors view new/underinvested strategies. Namely, they are skeptical of a manager and strategy until it has proven itself. So we begin with risk-mitigation as fundamental to the strategies we develop. For example, we have had many opportunities over the years to stretch for returns at the cost of weaker risk mitigation (e.g. subordinated, less collateral, lighter covenants and information

rights, etc.), but we've stayed committed to our view that most investors really need and want a predictable return over time rather than swinging for the fences at the risk of striking out. Another example of this has to do with exits. One of the biggest complaints investors have regarding private

asset investing in EM is the lack of exits in PE. Well, with private debt being naturally self-liquidating (TriLinc has had approx. $650 Million, approx. 60%, of loans go full cycle and pay off) we remove that objection from consideration. This emphasis on risk mitigation and self-liquidation has allowed TriLinc to deliver a positive experience to its investors, which often leads to additional commitments, investor referrals and "sticky" assets under management. Next, we understand how investors need to functionally process their investment management, so we create investment vehicles that seek to match what investors are used to investing in and (importantly) gives the investment professional recommending our strategy to their investment committees fewer idiosyncrasies that need to be explained and worked around. Finally, we understand that outstanding client service is an exceptionally important part of the glue that binds investors to their investments, so we provide transparency into everything we do through robust and frequent client reporting and communication. This provides TriLinc the opportunity to not only service our investors at a very high level, but to reinforce all of the reasons they made the investment in the first place.

So, you've identified a very attractive, largely untapped, investment opportunity and then packaged it and are client servicing it in a way that is easily investable and attractive to investors. You still need to execute in order to deliver results to investors. How do you do that?

The short answer is that we work very hard. While "working smarter" is always an attractive goal for businesses, often there is just no substitute for spending the extra time and doing the extra work that others are not as

willing to do. That hard work is not just on an ongoing, day-to-day, basis, but also includes all of the early stage research and development TriLinc

did at its founding, in its early years, and continues to do in order to be very intentional about what will deliver the best results for our investors.
A common refrain in investing is that the best investment decisions are often the decisions to NOT proceed with certain investments or accept particular risks. At TriLinc those decisions to avoid particular risks were taken just as readily at the strategic level as at the individual investment level. We spent years of work very intentionally researching and analysing the risks we believed were worth accepting vs. the risks that were NOT. A good example of this is our unique investment partner model.

We believe strongly that investors in any markets (let alone EM) need to have a local presence and deep local market knowledge to consistently perform over time. There are only a couple of ways to obtain that local market presence and expertise – built it yourself over a period of several years or partner with local market specialists. We chose the latter. That decision was made after extensive research into the markets themselves, who the local market players were, and whether they would make good partners for TriLinc and its investors.

Our investment partner model provides investors with local market access and knowledge, coupled with dual underwriting and structuring, while meeting the exacting compliance standards of U.S. regulated investment firms. Over the last 5+ years of TriLinc's EM private debt strategy, the value of having access to institutional quality local market investment partners has been demonstrated many times over.All of this work and intentionality has served TriLinc and its investors well over the last several years.
While hard work has been fundamental to TriLinc's success, disciplined, institutionalized processes, policies and procedures have been the other side of that coin. TriLinc's processes, policies and procedures (which are

more likely to look like those of a global bank than a fund manager) help maintain the discipline required to deliver consistent results even as everyone is working hard and running fast.

Impressive! You and your investors are no doubt pleased with your results over the last 7+ years. How do you keep it going and what's next?

a. Keep doing what we're doing with this EM private debt strategy, while raising significant additional investor capital – there's still plenty of opportunity left

b. Keep doing what we've done for TriLinc's business strategy

c. Find under-invested opportunities with attractive risk-adjusted returns

d. Structure, package and explain the products such that they are consumable and investable to large swaths of global investors (despite of how unique or niche they may be)

e. Stay laser focused on execution so investors' expectations can continue to be met or exceeded in order to continue building a loyal investor base and following

f. Keep reaching for the stars – continue driving our strategies and processes to seek the best of all worlds with attractive risk-adjusted returns and sustainability (ESG), while also driving positive impacts to the companies, communities and economies we invest in.

Thank you very much, Gloria and Paul for the interview.

## Gloria Nelund

In 2005, Gloria retired from a highly successful investment career on Wall Street and dove in to philanthropic work. Through her extensive world travels and participation in think-tanks sourcing solutions to address pressing social, economic and environmental issues, Gloria had an epiphany. She realised that the capital markets may be our best chance to solve some of the biggest social and environmental issues we face today. Combining her philanthropic values with her passion for business, she forged a path where she could make the most direct impact using her extensive investment experience.

## Paul Sanford

Paul Sanford is a key member of the Executive Management team, responsible for planning, implementing and managing all investment management related activities of the firm. His extensive experience in the banking and investment industry includes portfolio manager positions at Deutsche Bank, HSBC and Morton Capital Management. For over 17 years, Paul has been a global macro investor with a focus on central bank policy, GDP growth trends, global interest rates, global currencies and foreign government policies with an emphasis in emerging markets.

TRILINC GLOBAL

INVEST WITH IMPACT

TriLincGlobal LLC, founded in 2008, is a private investment sponsor dedicated to launching innovative funds that increase participation in impact investing. Founded on the conviction that significant private capital is needed to help solve some of the world's most pressing issues, TriLinc's primary goal is to create sophisticated, institutional-quality impact investment products that will attract private capital at scale. As an impact investing company, we strive to achieve both a competitive, risk-adjusted financial return for investors as well as create positive, measurable economic, social and/or environmental impact in the communities where investments are made. With an average of 26 years' experience, the senior management team of TriLinc has overseen and operated over USD 50 billion in investor funds including multi-manager and global strategies across various asset classes, geographies, and industries.

# OpenFunds
investment services

OpenFunds Investment Services AG. ('OpenFunds') is an independent company established in 2013 under Swiss law, licensed and supervised by the Swiss Financial Market Supervisory Authority (`FINMA`) as legal representative and as distributor of foreign collective investment schemes for qualified and non-qualified investors. The company works with selected funds that have undergone our internal due diligence and that cater to qualified and non-qualified investors. The principals of OpenFunds have many decades of experience in distributing selected funds to their networks of qualified investors, located predominantly in Switzerland and the Middle East.

OpenFunds App is a powerful tool for its users, funds/fund managers, investors and distributors. It stores all important information of the funds such as monthly factsheets, legal documents and news form the managers.

OpenFunds
investment services

Zurich Office:
Seefeldstrasse 35, 8008 Zurich
Phone: +41 44 500 3108

Lugano Office:
Via Pietro Peri 9D, 6900 Lugano
Phone: +41 44 500 3109

Geneva Office:
Rue de la Cloche 8, 1201 Geneva
Phone: +41 44 500 3175

www.open-funds.ch