

# Federated Hermes Impact Opportunities Fund

A man in a plaid shirt and blue apron is walking through a field of green leafy plants, carrying a wooden crate filled with fresh vegetables. The background shows a blurred landscape with trees and a fence.

**Quarterly Impact Report**  
Q3 2021

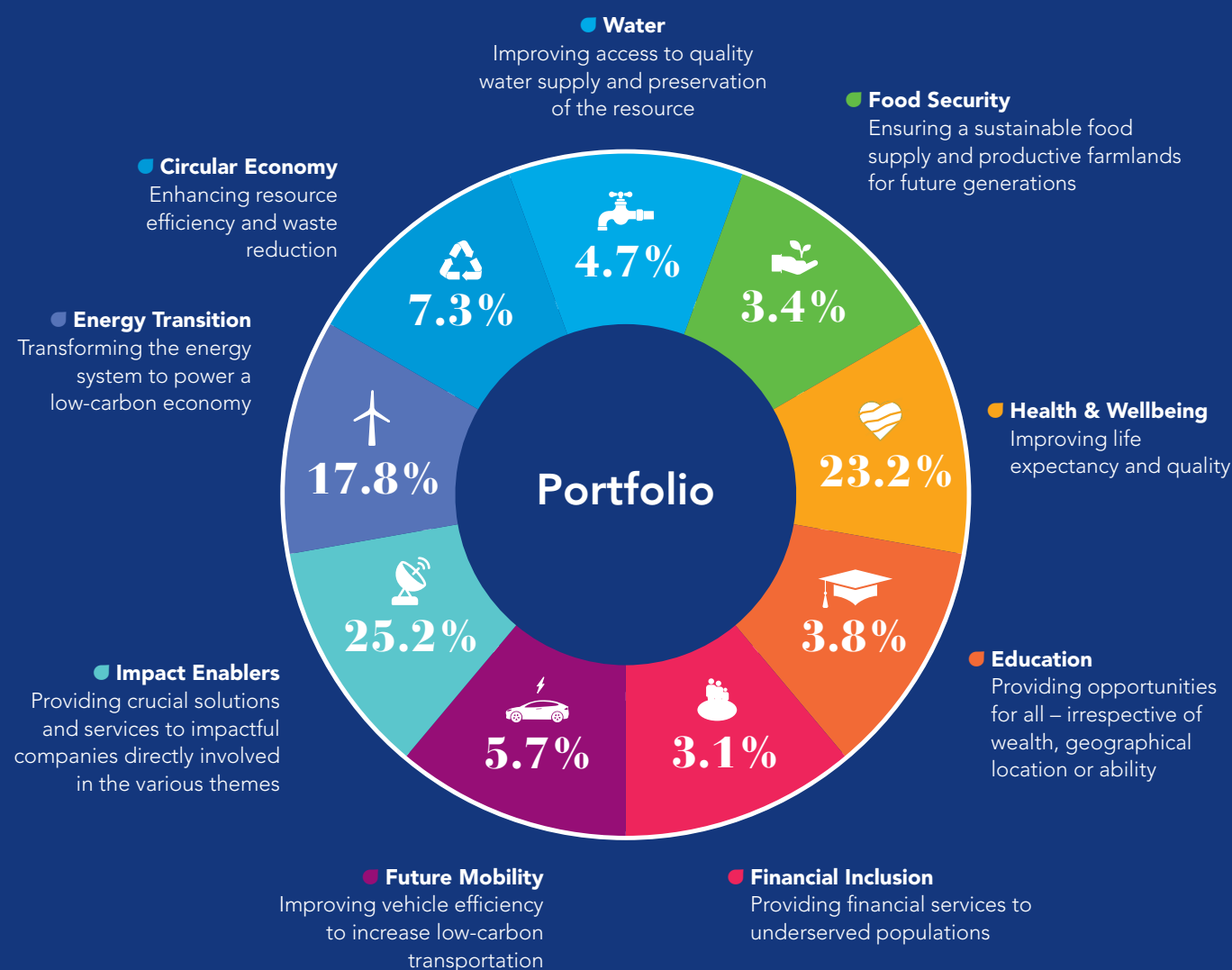
**Federated  
Hermes**   
International

[www.hermes-investment.com](http://www.hermes-investment.com)  
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The Federated Hermes Impact Opportunities Fund is a high-conviction global equity strategy with a bold objective. It aims to generate long-term outperformance by investing in companies succeeding in their core purpose: to generate value by creating positive and sustainable change that addresses the underserved needs of society and the environment. In this way, it focuses on tomorrow's leading companies, today.

## Exposure by impact theme

A thematic approach: our holdings fit into one or more of nine impact themes that are aligned with the SDGs.



Source: Federated Hermes, as at 30 June 2021. Note: as at 30 June 2021, 3.7% of our exposure was not directly related to any of our nine impact themes, while 2.3% was held as cash.

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## THEMATIC FOCUS:

## Financial inclusion

- Globally, an estimated 1.7 billion people are unbanked<sup>1</sup>
- More than 40% of global assets are uninsured<sup>1</sup>
- Foreign workers sending money home lose approximately 7% in remittance fees<sup>2</sup>

**What exactly is financial inclusion?**

- Commonly defined as the access to products and services people need to manage their money, at a reasonable cost, while having the understanding to use them appropriately.
- Services include transactions and payments, savings, pensions, investments, credit and insurance.
- Financial services provide opportunity and security for individuals and businesses.

**Why is financial inclusion so important now?**

It is increasingly understood that absolute levels of poverty are far from the only issue affecting the world's poor. Almost a third of adults globally (about 1.7 billion people) remain unbanked.<sup>1</sup> Many more are unable to access financial services at economical prices, like loans, payment services and insurance. Being excluded from the formal financial economy can often create a vicious circle, trapping people in a cycle of debt.

**The impact of the Covid-19 pandemic**

According to the World Bank, global extreme poverty worsened in 2020 for the first time in a generation, with about 120 million additional people joining the ranks of the poor worldwide<sup>3</sup>.



<sup>1</sup> World Bank Group, Findex report, 'The Unbanked' (2017)

<sup>2</sup> World Economy, 'Sending Money Home: Transaction Cost and Remittances to Developing Countries' (January 2021)

<sup>3</sup> World Bank Group, 'Understanding Poverty' (October 2021)

## UN SDGs positively impacted by financial inclusion



### The benefits of financial inclusion

Financial inclusion is an almost uniquely powerful theme in terms of the number of areas it touches. The UN has linked financial inclusion to progress in relation to 13 of its 17 Sustainable Development Goals (SDGs). Financial inclusion:



#### Reduces income inequality

International Monetary Fund (IMF) studies show a strong association between extending traditional financial services to low-income households and reducing income inequality. The data shows that the largest reduction in income inequality comes when women are given increased access to finance.<sup>4</sup>



#### Fosters gender equality & political stability

Bolstering financial inclusion can improve gender equality and help build stronger institutions which, in turn, improves political stability. This minimises conflict and creates more just societies.



#### Improves access to clean water, affordable energy

Access to formal financial services can indirectly improve access to clean water and sanitation, affordable energy and quality education.



#### Creates economic opportunity

As well as bringing up to 1.7 billion people into the financial system, greater financial inclusion has the potential to generate 95 million jobs and boost global GDP by a massive \$3.7 trillion come 2025.<sup>5</sup>

<sup>4</sup> International Monetary Fund (IMF) – Women in Finance: A Case for Closing Gaps (imf.org) – September 2018.

<sup>5</sup> International Monetary Fund (IMF) – Finance and Inequality (imf.org) – January 2020.



Square

**Square was established in 2009 to enable small and medium-sized sellers to accept card payments and provide ecosystem of financial services and software tools to help. In 2019, Square launched its Cash App, an ecosystem of financial services to help individuals manage their finances. The company's purpose is economic empowerment through financial inclusion.**

**Impact theme:** Financial inclusion



### Solutions for businesses too small for mainstream banking

Micro, small, and medium-sized enterprises (MSMEs) are sometimes perceived as too risky or too small for mainstream banking institutions, meaning they often lack access to basic banking features. In particular, small businesses could face prohibitive costs when considering point-of-sale terminals. Square has revolutionised payments with their 'Square Reader', making it possible for anyone to accept card payments using a smartphone or tablet.

Another issue faced by small businesses and hourly workers is that it typically takes two business days for payroll funds to move from an employer to their employees. To tackle this problem, Square launched two new features within its

payroll product: Instant Payments and OnDemand Pay. This simplified the payroll experience, providing employees and employers more flexibility and control over their money.

### Helping small businesses grow

In the US, 69% of small businesses do not receive the funding they want<sup>6</sup>. Square's credit solutions help these businesses to grow; in particular, they help women and entrepreneurs from minority backgrounds access funds. More than 85% of Square sellers live outside the 25 most populous US cities<sup>7</sup>.

Since the launch of Square Capital in 2014, Square has originated \$8.1bn worth of loans<sup>8</sup>. 58% of loans through Square Capital went to women-owned businesses, compared to just 17% of traditional loans. Meanwhile, 35% went to minority-owned businesses, which compares favourably to the 27% serviced by traditional loans<sup>9</sup>.

### Square's investment platform, a means of realising sustainable capitalism

Square's investment platform provides access to capital markets, which is crucial if people are to take control of their broader finances. Share ownership should be more diversified; this is the only way to realise a more sustainable form of capitalism.

### Going forward, expansion on two fronts

Square's development focuses on two key areas.

Firstly, Square is constantly launching new products to complete its ecosystem and fulfil the needs of business owners and individuals with one integrated offering.

Second, the company is expanding into new geographies (currently, Canada, Australia, Japan and the UK). Businesses in these international markets have limited omnichannel options, as the banks and legacy acquirers they are using lack online solutions and integrated software.

We continue to engage with Square to increase the company's impact.

Note: This holding was added to the portfolio this year and therefore impact metrics will be included in our 2021 annual report.

<sup>6</sup> Federal Reserve Bank, 'Small Business Credit Survey' (2018)

<sup>7</sup> Square, 'Corporate Social Responsibility Report (2020)

<sup>8</sup> Square, 'Notice of 2021 Annual Meeting of Stockholders' (June 2021)

<sup>9</sup> Square, 'Corporate Social Responsibility Report (2020)



## CASE STUDY

## Tinkoff (TCS)

**Tinkoff, or TCS Group Holding (TCS), was founded in 2006 as the first digital bank in Russia. The company is set to become the world's largest independent digital bank over the next decade.**



**Impact theme:** Financial inclusion

### Unlike most fintechs, TCS started with consumer finance rather than payments

Since launching, TCS has transformed itself from a credit card monoliner to an ecosystem for financial services. The company has diversified into cash and point of sale (POS) loans, as well as small and medium-sized enterprise (SME) loans and mortgage lending. TCS offers all these products through a best-in-class mobile app – rated 'Best Mobile Banking App' by Global Finance in 2020<sup>10</sup> – and services adjacent to financial services, which look to educate customers on how to save, invest and spend.

All this, and with uncompromising focus on profitability. The appeal of TCS' offering – and its diversified business model – is that both have enabled the company to grow its customer base from 5.1m in 2017 to 16.7m in 2020, while posting average return on equity of 56%, and earnings per share growth at 38% CAGR<sup>10</sup>.

### Bringing financial services to the customer's physical and, increasingly, "digital" doorstep

Russian regulators still demand face-to-face meetings to onboard new customers. Before TCS was established, this justified a branch-based model. But TCS decided to bring financial services directly to the doorstep of customers by employing a workforce of over 10,000 smart couriers to meet customers anywhere in Russia within 24 hours of their financial product application. TCS also pioneered mobile onboarding through their mobile app. We believe TCS enables financial inclusion by making it easy and convenient for customers to open new financial accounts.

### Growth potential in Russia, particularly amongst SMEs

Despite impressive growth rates, banking penetration in Russia (retail and corporate) remains low relative to both developed and emerging markets, implying strong growth potential. Thus far, SME contribution to GDP in Russia is low. The World Bank estimates SMEs to represent about 90% of businesses and 50% of employment worldwide<sup>11</sup>; in Russia, this is closer to 22% and 26% respectively<sup>12</sup>.

Furthermore, Russia is seeing accelerated growth in several key market segments, such as payments and investments, driven by widespread digital adoption. For businesses, digitalisation presents an opportunity, and we believe TCS is in an enviable position to capitalise on this trend given its superior technological capabilities.

It should also be noted that ecommerce penetration in Russia remains in single digits, much lower than the 11-32% seen in other markets. Rising ecommerce penetration – and an increase in TCS's share of online payments – should continue exponentially in the coming years.

### Investments, the next frontier

Impressively, TCS's investment business managed to break even after two years. The number of new accounts opened with the company has outpaced other key players, some of whom have been established in the market for over 20 years. Today, TCS is the largest broker in Russia by number of active accounts (60%-70% market share)<sup>10</sup>. The company has become synonymous with retail investment in Russia, helping to advance an investment culture that has historically been absent (>80% of Russian household savings are held in cash and deposits)<sup>13</sup>.

Note: This holding was added to the portfolio this year and therefore impact metrics will be included in our 2021 annual report.

<sup>10</sup> Tinkoff, 'Strategy Day Presentation' (7 April 2021), p.3

<sup>11</sup> The World Bank, 'Understanding Poverty: Improving SMEs' access to finance and finding innovative solutions to unlock sources of capital' (2019)

<sup>12</sup> OECD, 'Financing SMEs and Entrepreneurs 2020: An OECD Scoreboard' (2019)

<sup>13</sup> Tinkoff, 'Strategy Day Presentation' (7 April 2021), p.13



## Federated Hermes

Federated Hermes is a global leader in active, responsible investing.

Guided by our conviction that responsible investing is the best way to create long-term wealth, we provide specialised capabilities across equity, fixed income and private markets, multi-asset and liquidity management strategies, and world-leading stewardship.

Our goals are to help people invest and retire better, to help clients achieve better risk-adjusted returns, and to contribute to positive outcomes that benefit the wider world.

All activities previously carried out by Hermes now form the international business of Federated Hermes.

Our brand has evolved, but we still offer the same distinct investment propositions and pioneering responsible investment and stewardship services for which we are renowned – in addition to important new strategies from the entire group.

## Our investment and stewardship capabilities:

- **Active equities:** global and regional
- **Fixed income:** across regions, sectors and the yield curve
- **Liquidity:** solutions driven by four decades of experience
- **Private markets:** real estate, infrastructure, private equity and debt
- **Stewardship:** corporate engagement, proxy voting, policy advocacy

For more information, visit [www.hermes-investment.com](http://www.hermes-investment.com) or connect with us on social media:  

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