

Federated Hermes Impact Opportunities



Quarterly Impact Report
Q1 2024

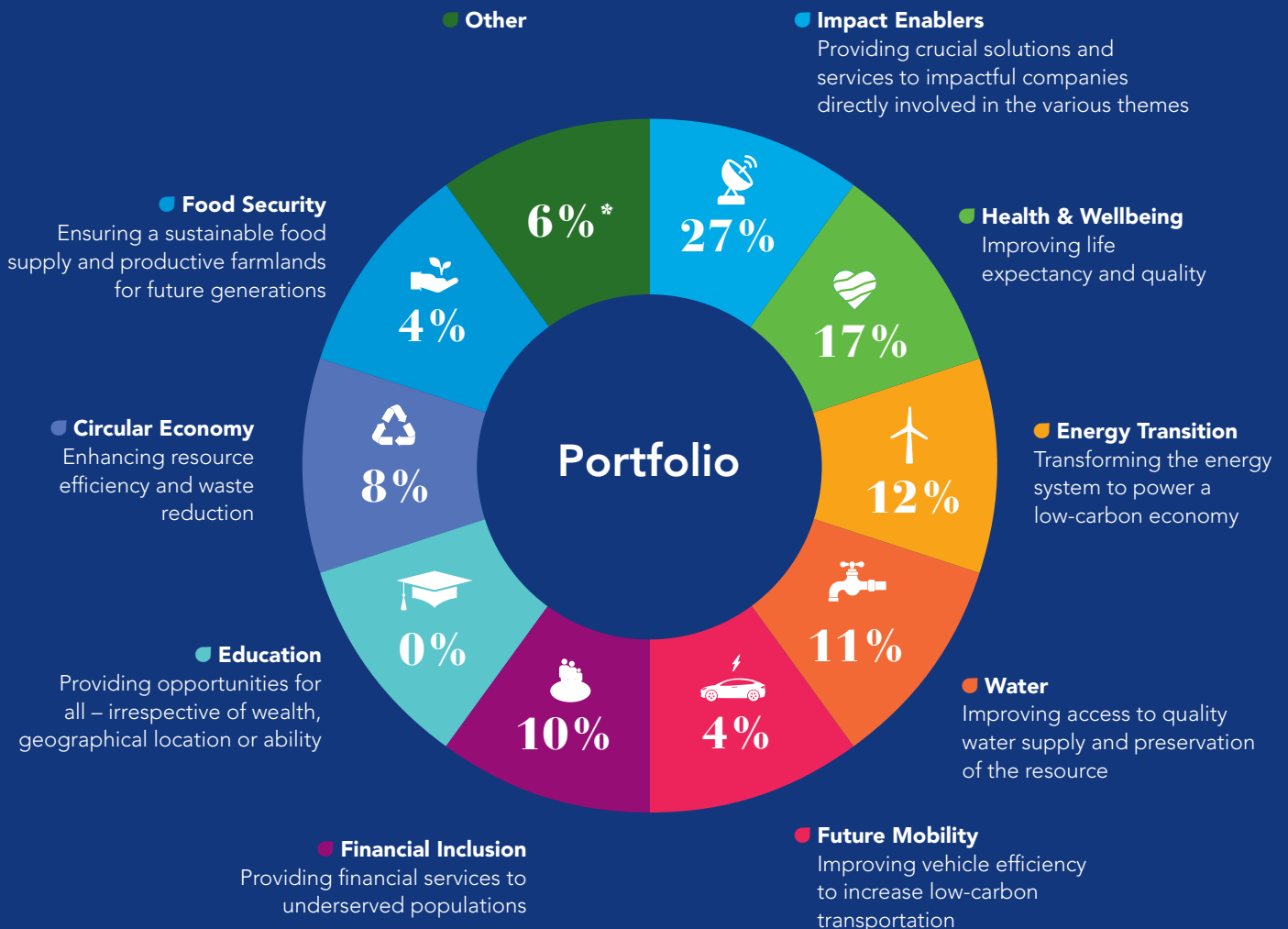
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The Federated Hermes Impact Opportunities Strategy is a high-conviction global equity strategy with a bold objective. It aims to generate long-term outperformance by investing in companies succeeding in their core purpose: to generate value through positive impact 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

We take a thematic approach: our holdings fit into one or more of nine impact themes aligned with the Sustainable Development Goals (SDGs) of the United Nations (UN). We believe the nine themes address the most critical needs of our planet).



Source: Federated Hermes Limited, as at 31 December 2023.

*Note: as at 31 December 2023, 5.6% of our exposure was not directly related to any of our nine impact themes, while 1.8% was held as cash.

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THEMATIC SECTION:

Building back better: Financial inclusion

Financial inclusion is an essential part of 'building back better'; not just as a moral imperative but as a significant economic opportunity which offers real benefits for society as a whole.

Definition:

Financial inclusion is commonly defined as 'access to and use of formal financial services' – that individuals and businesses have access to useful and affordable financial products and services that meet their needs, delivered in a responsible and sustainable way. It affects people in both the developed and developing world but is particularly prevalent in the developing world. Almost one third of adults globally (1.4 billion people) remain unbanked.¹

Why is financial inclusion important?

Despite a decrease in absolute poverty², billions worldwide remain financially excluded. This is often the case for the poorest, most marginalised individuals, due to geographical barriers (for example, lack of access in rural areas), cost barriers faced by banks for issuing smaller loans, and insufficient education among customers about finance. Access to financial services provides a number of benefits for individuals and businesses. These include:

- Enabling families and small business owners to generate income and work their way out of poverty.
- Providing a safe way to make payments, store and save money and access loans.
- Enabling economic growth and job creation, therefore reducing poverty and boosting prosperity.

Figure 1: 1.4 billion adults around the world do not have a bank account



Source: Global Findex Database, 2021. Note: Data is not displayed for economies in which the share of adults without an account is 5% or less, or for economies for which no data is available.

¹ The Global Findex Database 2021 (worldbank.org).

² World Bank, as at 2021.

Financial exclusion remains most prevalent among traditionally underserved groups, including:

- The poor and disadvantaged
- Women
- Rural communities
- Micro, small and medium-sized enterprises (MSMEs)

Financial inclusion is a key enabler of impact across a range of United Nation’s Sustainable Development Goals (UN SDGs), including:

- **SDG 1:** No poverty
- **SDG 5:** Gender Equality – Women are disproportionately affected by poverty as they face unequal pay, a greater burden of unpaid care work and exclusion from the formal economy.
- **SDG 8:** Decent work and economic growth – Accessing credit can enable MSMEs to grow and create decent job opportunities.
- **SDG 10:** Reduce Inequalities

Financial inclusion also indirectly addresses the following goals:

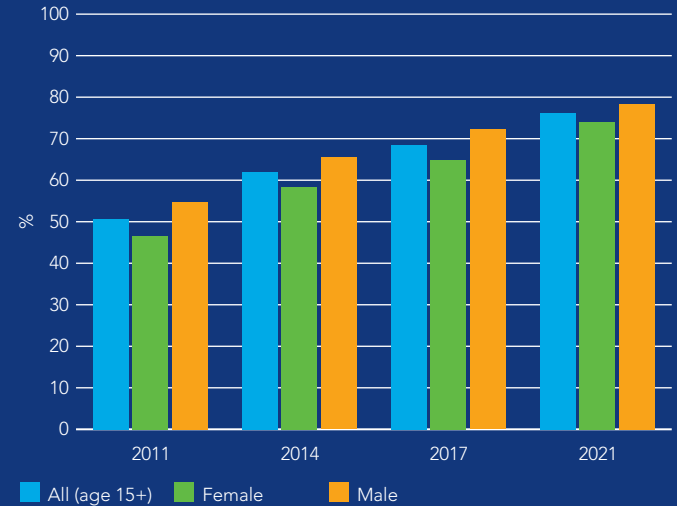
- **SDG 2:** Zero hunger – Financial inclusion among farmers has led to increased yields, as earnings are used to buy more farming equipment.
- **SDG 3:** Good Health & Wellbeing – Out-of-pocket health expenses are a big reason people remain in poverty, but a study in Kenya showed that having a safe place to store money increased health spending dramatically.³ Furthermore, it has been proven financial inclusion leads to an improvement in mental health.



What progress has been made?

We have seen strong progress since 2011 on a global basis, with the World Bank estimating that the number of people with bank accounts has risen from ~50% to over 76%⁴. While women continue to lag men, this gap has started to close since 2017.

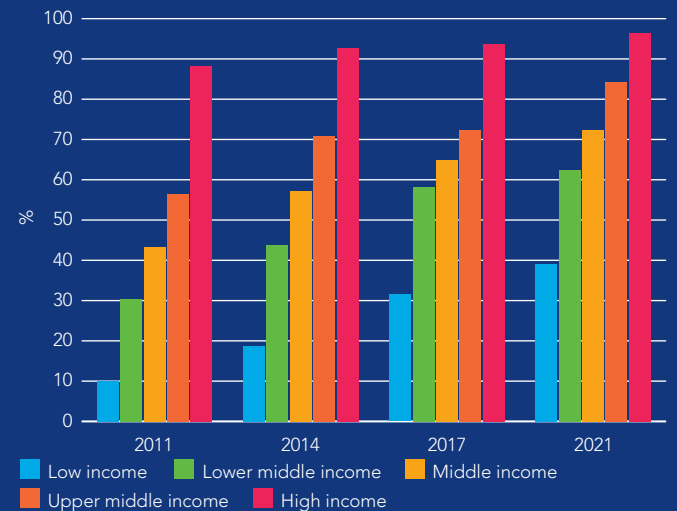
Figure 2: The percentage of people with a bank account, globally



Source: The World Bank, Global Financial Inclusion database.

The biggest gap lies within income levels – the lower the income, the less likely a person is to have a bank account, as shown by Figure 3 below. We are seeing some progress, but there is a long way to go.

Figure 3: Financial inclusion by income level

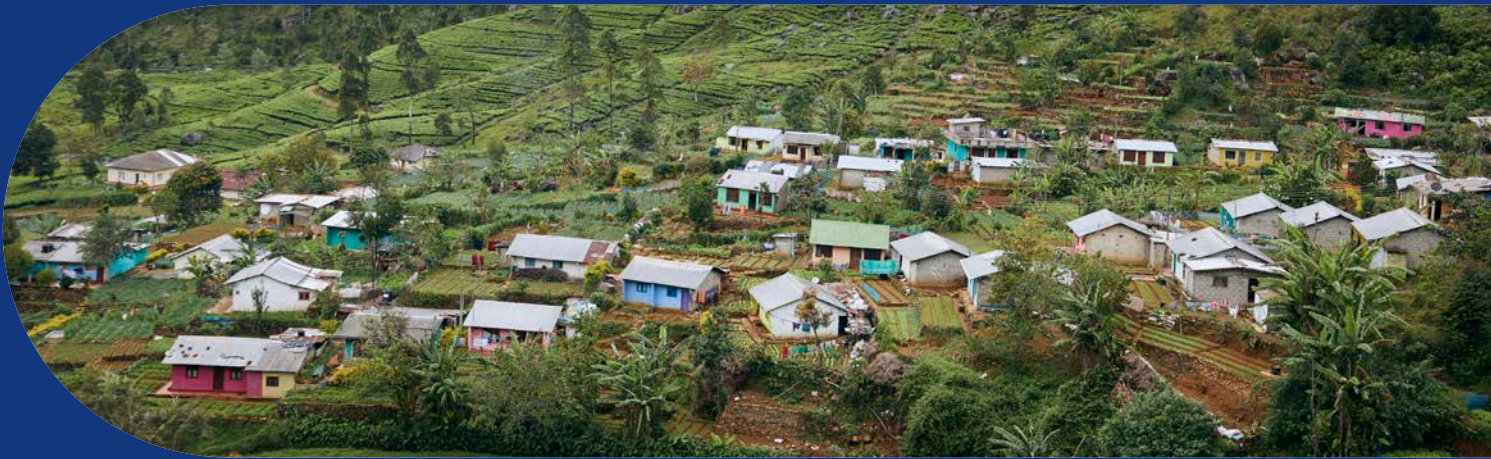


Source: The World Bank, Global Financial Inclusion database.

As demonstrated, less than 40% of people in the low-income band still do not have access to a bank account with 60% of individuals representing the same for the lower middle-income class. The proportion of middle-income people with a bank account is just shy of the global average, while over 80% of those with an upper middle income have access, increasing to more than 95% with high incomes.

³ Financial inclusion has a big role to play in reaching the SDGs (worldbank.org).

⁴ The Global Findex Database, as at 2021.



The importance of financial inclusion in rural areas

According to the Food and Agriculture Organization of the United Nations, 80% of the world's poor live in rural areas. A large proportion of these individuals depend on agriculture for food security and in order to make a living.

Only 60% of the rural population in developing countries have an account with a financial institution, according to Global Findex data, and usage remains low as products and services tend to be aimed at urban customers.

Inclusive financial services play a critical role in supporting and improving rural livelihoods – especially for vulnerable people that are less likely to be financially resilient. Financial inclusion also helps to diversify the source of livelihoods towards non-agricultural incomes.

How can we address the issue?

There are several potential levers to address the problem of financial inclusion:



1. Digital and mobile banking

66% of low-income people own a mobile phone, creating a viable opportunity for digital financial services.

In many pockets of the world, digital financial services have stepped in to provide resources traditionally offered in brick-and-mortar banks; namely, via digital channels tailored to those with mobile access or potential educational gaps.

However, the rural-urban gap in mobile internet usage remains high with reliability an issue in rural areas and the use of cash remains the dominant means of payment in these regions.

Education is needed due to the lack of financial literacy, beyond savings accounts. Individuals also feel uncomfortable using traditional lending products, due to a lack of stable income.

A key ingredient is required to mobilise this: a mobile network connection. Banks are therefore increasingly relying on telecommunications providers to expand connectivity into underserved areas of the world to better deliver on promises of financial inclusion, broadening their reach to more of the 2.3 billion people without internet access in 2021.⁵



2. Agent banking

An agent bank is a type of franchise, often a local business, contracted to provide financial products and services to the banked, unbanked, or under-banked population on the behalf of a financial institution. Agent banking is a useful tool in combating inhibitors to financial inclusion.

Agent banks can offer these services to individuals who reside in rural areas, meaning that they can open bank accounts and manage their finances.

This service also has the benefit of being cheaper than the cost of providing branch access.



3. Improving the breadth and scope of credit scoring

Credit scores operate on a scale of 300 – 850. The higher the score, the easier and cheaper it is to borrow money while, conversely, a low score or no score at all hampers the ability to build wealth.

An individual with no credit history is considered 'credit invisible', meaning they are unable to qualify for a credit card or loan. There are about 28 million individuals in the US that are credit invisible and 21 million have 'unscorable' credit.⁶ It disproportionately affects Black and Hispanic Americans, immigrants, younger people, and those on low incomes.

Improving the scope and breadth of credit scoring is an important lever to financial inclusion.

Below we discuss two portfolio holdings, Bank Rakyat and Experian, who are providing solutions to this important issue:

⁵ 'The Global Findex Database 2021,' World Bank as at 2022.

⁶ [How Many People Are Credit Invisible in the US?](#) As at February 2024.



CASE STUDY

Bank Rakyat

Bank Rakyat (BRI) is one of the largest banks in Indonesia and specialises in small-scale and microfinance. Recognising its pivotal role as a financial institution in Indonesia with a primary focus on serving clients in the micro, small, and MSME segments, it has formulated a corporate strategy known as 'BRIVOLUTION 2.0.' The overarching vision of the company's strategy is to become "The Most Valuable Banking Group in Southeast Asia and Champion of Financial Inclusion".

Indonesia is made up of over 13,000 islands which presents a unique challenge for banks to reach its rural population. Indonesia is also home to 60 million ultra-micro and micro businesses⁷, which play a critical role in the country's economy and account for:

60%
of Indonesia's GDP

97%
of Indonesia's workforce⁸

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⁷ World Economic Forum, as at 2022.

⁸ Ibid.

In its drive to address financial inclusion, BRI has spent time surveying its customers and has identified six key characteristics of its micro customers:

Figure 4: Key characteristics of BRI's micro customers

- | | |
|---|--|
| 1 | Familiar with smartphone technology , although smartphone penetration remains low |
| 2 | Limited knowledge of financial products |
| 3 | Cash being the dominant chosen method of transactions |
| 4 | Prefers a financial institution that is "locally embedded" and is able to "gain their trust" |
| 5 | Majority without stable income and not comfortable with traditional lending products |
| 6 | Prefers banking via an agent rather than digital banking |

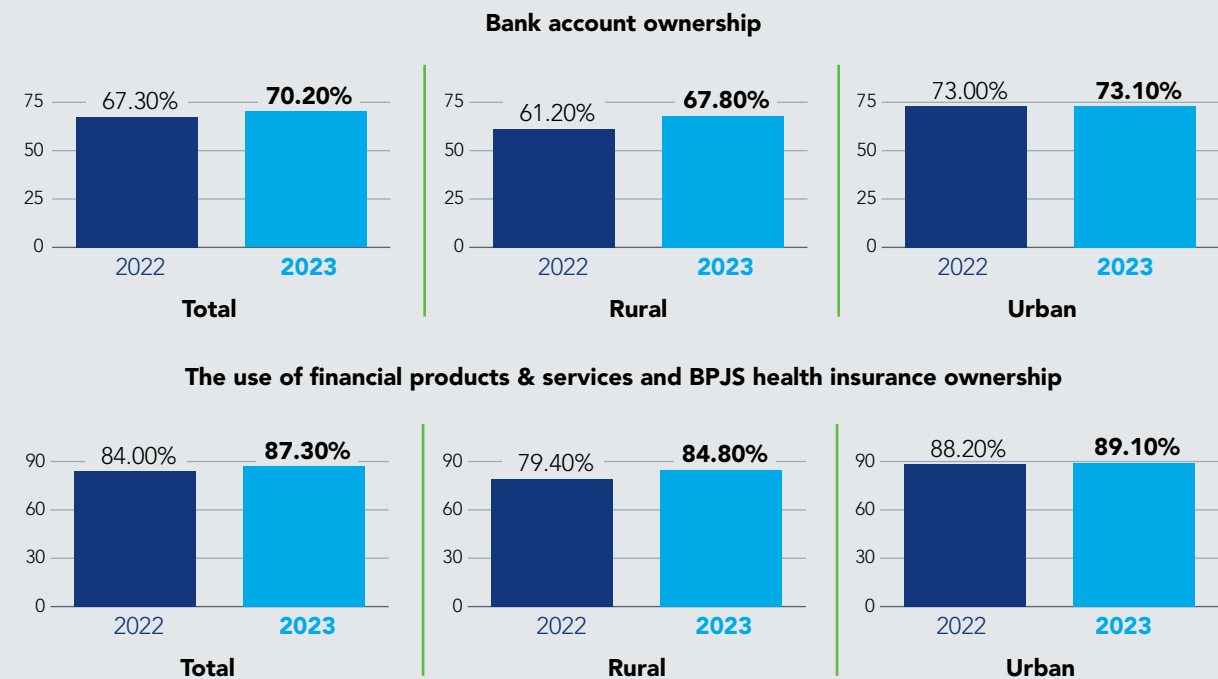
Source: [World Economic Forum](#), as at May 2022.

To support these customers and create an inclusive financial system, Bank Rakyat has a vast network of outlets, partners, agents, and digital platforms. It has 8,000 physical outlets and more than 740,000 agents, which helps it reach individuals and businesses in rural areas that are difficult to reach, especially in isolated islands and coastal areas.

It also promotes deep financial inclusion, going beyond simple bank accounts or micro loans to cover a broader array of products and supporting digital and financial literacy through customer training.

- A recent study by the BRI research institute covered 8,000 micro loan and product beneficiaries and found that 23.8% qualified as 'deep financial inclusion', 39% qualified as 'financially literate' and 85% qualified as 'financially included'.
- We are encouraging the company to set a long-term strategy with targets, and it is working with consultants to define how best to measure its social impact and it has asked for our input on examples of best practice.



Bank Rakyat in numbers:

Based on research by BRI Research Institute (BRIRINS) in 2023.

BPJS (Social Health Insurance Administration Body) is a government agency authorized and established to administer the social health insurance program for the Indonesian population.

51.66 million

Number of lending customers in the micro and ultra micro segments (including Pegadaian and PNM) in **2023**

Source: [Bank Rakyat 2023 Sustainability Report](#), as at February 2023.

163.76 million

Number of savings customers in micro and ultra micro segments (including Pegadaian and PNM) in **2023**

27.6 million Number of new people given financial access

Source: Federated Hermes / Net Purpose as at 31 December 2022.

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Experian is the world's largest credit bureau, maintaining credit information on consumers and businesses worldwide. It also provides marketing information to help businesses generate leads by maintaining information on the demographics and habits of consumers. Experian serves clients across different markets, including financial services, health, retail, and government. It also offers free and paid direct-to-consumer products.

Experian provides exposure to a high-quality asset, operating in oligopolistic⁹ markets. It has a strong competitive advantage in an attractive market with high barriers to entry and benefits from structural growth. It is benefitting from regulatory change and the data monetisation megatrend, while product innovation and entrance into adjacent markets in North America provide further avenues of growth.

Experian can have a major positive impact by improving financial inclusion. According to the Global Findex Database, 1.4 billion people remain unbanked globally and millions more have no credit history. This 'credit invisibility' means millions of people are missing

opportunities to improve their lives because they are unable to access fair credit. By empowering them to take control of their financial lives and improving their credit profiles, Experian can help them improve their wellbeing. New innovations such as **Experian Boost**, which has already allowed 3 million people in the US to add positive data to their financial records, is a good example of the positive impact Experian can have.

It has a financial inclusion target to reach 100 million through social innovation products by 2025, which was set during the pandemic. The figure was arrived at by teaming up with NGOs to identify those most in need. For example, in the UK, the company has teamed up with a charity to work with people at food banks who provide financial health information.

Those food bank users were encouraged to use Experian Boost to improve their credit score. Alongside this they have set up various platforms where they teach financial education. In the context of the 28 million credit invisible and 21 million unscorable people in the US¹⁰, the company noted that since the March 2020 launch of their Boost product, 90% of users have seen an improvement in their credit score and more than 11 million have used Boost in the US since its launch.

In parallel, the company's Lift and Go products are directed at helping the credit invisible individuals get a credit report for their first FICO score (a three-digit number between 300 and 850 that tells lenders and other creditors how likely you are to make on-time bill payments). The company explained it took years to get these products to where they are today: being able to score the invisibles. To date, over 100,000 have credit reports who did not previously and in the UK the number of credit invisibles has moved from six million to five million in three years.

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⁹ A state of limited competition, in which a market is shared by a small number of producers or sellers.

¹⁰ [How Many People Are Credit Invisible in the US?](#) As at February 2024.

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