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FIVE BUILDING BLOCKS FOR IMPACT MANAGEMENT

Impact in practice: Social Infrastructure

By Franklin Real Asset Advisors, in collaboration with Tidelive

EXECUTIVE SUMMARY

Impact investing is a growing practice that now covers almost \$250 billion in assets under management (AUM).¹ It differs from other kinds of sustainable and responsible investment strategies, such as the exclusion of certain investments on ethical or religious grounds, or thematic investing, which focuses on specific societal problems such as water scarcity or climate change. Rather, the defining feature of impact investing is the explicit intention to generate positive, measurable social and environmental outcomes alongside a financial return² in most cases.

As impact investing gathers pace, investors are refining their approach from an early emphasis on impact *measurement*—the practice of quantifying impact outputs and outcomes—to focus on impact *management*, a forward-looking approach that integrates impact considerations into each stage of the investment process. This focus on managing impact aims to understand an investment's impact more fully and improve social and environmental performance throughout the lifetime of an asset.

There are now a range of tools that enable investors to manage for social and environmental

impact with increasing rigor and confidence. However, no single, unified best practice has yet emerged for impact investing, and in its absence, the proliferation of methodologies and metrics has introduced an element of confusion. Simply navigating through all the resources available to impact investors can be a challenge.

This paper seeks to provide a guide to help investors build impact management systems that are both tailored to their strategic focus and aligned with best practices. It will provide an overview of the different frameworks and tools available to impact investors and classify them into five broad categories: objectives, standards, certifications, methodologies and metrics. These building blocks of impact management come into play at different stages of the impact management process, and we provide an example of how they might interact with each other in the case of a social infrastructure strategy.

Ultimately, each investor must decide which combination, and what degree of customization is appropriate for their impact management system. The practice of impact management is a dynamic process and subject to continuous improvement.

1. Global Sustainable Investment Alliance (GSIA): Global Sustainable Investment Review, 2016.

2. Adapted from the Global Impact Investment Network (GIIN).

INTRODUCTION: THE GROWING DIVERSITY OF IMPACT INVESTING ACTIVITIES

Impact investing is investing with the explicit intention to generate positive, measurable social and environmental outcomes alongside a financial return. It is distinct from other sustainable and responsible investing strategies, including the exclusion of certain investments based on an investor's ethical or religious values, thematic investing, which focuses on sectors or trends that affect society but

does not intentionally seek impact outcomes and Environmental, Social and Governance (ESG)-tilted strategies, which focus on selecting companies based on their ESG practices and potential. Each of these strategies may also incorporate material ESG factors (ESG integration) into fundamental research to provide a comprehensive view of an investment's value, risk and return potential. (See Exhibit 1)

Exhibit 1: Approaches to Responsible Investing



Source: Franklin Templeton Investments. For illustrative purposes only.

The impact investing market is growing in both size and diversity. It represented \$248 billion in AUM in 2016—just one part of the broader sustainable and responsible investing market. However, impact investing has expanded faster than other strategies, with 146% growth from 2014 to 2016 compared with 25% in sustainable and responsible investing overall, according to the Global Sustainable Investment Alliance.³ The acceleration of impact investing in Europe has been particularly rapid, with a 385% increase over the same period. More recent studies and the launches of new and larger strategies

confirm that the space continues to experience accelerated growth. Impact investors have identified 'win-win' opportunities where impact and financial returns align with and often reinforce one another, across a diverse range of sectors and asset classes. The latest survey from the Global Impact Investing Network (GIIN), for example, identified financial services, energy, microfinance, housing, food and agriculture, and infrastructure as major sectors of focus and listed private debt, private equity, public equity, and real assets as the most popular instruments for making impact investments.⁴

3. Global Sustainable Investment Alliance (GSIA): Global Sustainable Investment Review, 2016.
 4. Global Impact Investment Network (GIIN): Annual Impact Investor Survey, June 2018.

INTEGRATING IMPACT INTO THE INVESTMENT PROCESS

Impact investors are committed to understanding and improving the social and environmental benefits of their investments, and impact management has increasingly become the standard approach for doing so. A few years ago, impact investors were primarily concerned with quantifying and validating the impact of their investments, advocating for the practice of *measuring impact* ex post. As the practice has matured, the focus has evolved to managing impact over the lifetime of an asset. Put simply, impact management is the process of determining which of an investment's effects on people and the planet are relevant and trying to prevent the negative effects and increase the positive effects. In practice, impact management goes beyond impact measurement to integrate impact considerations into each stage of the investment process: from setting investment goals and conducting due diligence, to portfolio management and reporting.

The sheer number of initiatives and organizations involved in developing and systematizing impact management is indicative of the growing size and importance of this market. It also speaks to the impact industry's complexity and need for multiple approaches. Examples of these initiatives include the International Finance Corporation's Operating (IFC) Principles for Impact Management, the United Nations' Sustainable Development Goals (SDGs), the Global Impact Investing Network's (GIIN) catalog of metrics, and the Impact Management Project, to name a few.

Five Building Blocks of Effective Impact Management: Highlighting Key Frameworks

As part of impact investing's evolution, many frameworks and tools have been developed to categorize and guide investments seeking positive social and environmental outcomes. There is no single, unified best practice or approach. Most commonly, multiple frameworks are used in combination, along with some customized elements to fit an investor's strategy. According to a 2017 GIIN survey, respondents use, on average, a combination of three tools, frameworks, standards, and ratings systems.⁵

To understand these frameworks and their roles in impact management, it is useful to classify them in five broad categories. These are described in Exhibit 2, which includes a selection of the most prominent and widely accepted examples in each category:

“*In practice, impact management goes beyond impact measurement to integrate impact considerations into each stage of the investment process: from setting investment goals and conducting due diligence, to portfolio management and reporting.*”

“*There is no single, unified best practice or approach. Most commonly, multiple frameworks are used in combination, along with some customized elements to fit an investor's strategy. According to a 2017 GIIN survey, respondents use, on average, a combination of three tools, frameworks, standards, and ratings systems.*”⁵

5. Global Impact Investment Network (GIIN): The State of Impact Measurement and Management Practice, December 2017.

Exhibit 2: Taxonomy of impact management tools and frameworks

Category	Descriptions	Examples
OBJECTIVES	Common language around social and environmental objectives for aligning the supply of and demand for impact capital	UN Sustainable Development Goals
STANDARDS	Broad guidelines that provide a common basis for evaluating investor practices	International Finance Corporation's Operating Principles for Impact Management
CERTIFICATIONS	Standardized, third-party analysis for concisely communicating social and/or environmental performance	Aeris Impact Management Ratings, BREEAM
METHODOLOGIES	Instruments for facilitating the diligence, assessment, monitoring, and reporting of impact	Impact Management Project, bespoke methodologies
METRICS	Standardized definitions for measuring impact and comparing investments	Global Reporting Initiative (GRI), IRIS (e.g., PI5501: # students per classroom)

Source: Franklin Templeton Real Asset Advisors and Tideline. For illustrative purposes only.

Objectives

A common language on social and environmental objectives helps asset owners, fund managers, enterprises, and others align the supply of and demand for capital seeking impact.

The numerous interpretations of impact objectives have posed a challenge to investors and entrepreneurs seeking to align around a shared set of goals. As an extension of the Millennium Development Goals launched in 2000, the creation of the **UN Sustainable Development Goals (SDGs)** was a significant step forward in the pursuit of a universal framework. These goals have helped align the public, private, and philanthropic sectors around 17 broadly recognized social and environmental priorities.

Many asset owners and managers are either designing new investment strategies to support the SDGs or highlighting how existing strategies are aligned with the goals. Of investors that responded to GIIN's 2018 survey, 55 percent track the performance of at least some of their impact investments to the SDGs

However, a **challenge for investors is the lack of clarity on what precisely it means to be “aligned with” or to “advance” the SDGs.** Several efforts are underway to spell out what this means in practice, including the United Nations' Principles for Responsible Investment (UNPRI) market map, the Dutch SDG Investing Initiative, and UNDP's SDG Impact, among others. A more precise definition will help impact investors communicate more clearly about their goals, better set expectations, and strengthen accountability.

Standards

Broad guidelines for investing responsibly and intentionally for social and environmental impact help provide a common basis on which to evaluate the specific practices of different investors.

In light of unsubstantiated impact claims, or “greenwashing”, standards can help investors be more confident about what social and environmental practices are expected of them, and inform society of what to expect of impact investors.

The market has been eager for a set of industry-wide best practices, and in 2018 the International Finance Corporation (IFC) released the Operating Principles for Impact Management. The principles were developed in partnership with more than 15 organizations to encourage authenticity and transparency on the part of investors.

By following the IFC's principles, investors can more readily assess the impact of their strategies. However, as no specific practices are prescribed, this can present some challenges for investors. This will be discussed later in the case study.

Certifications

Third-party analysis and ratings using standardized methodologies and metrics can help provide clear and concise communication of social and/or environmental performance. Certifications can exist at the company, asset or fund level and provide a foundation for impact benchmarking.

Impact investing is still a burgeoning space where identifying impactful companies, assets, or fund managers can be challenging. Certifications can be used by investors as valuable indicators in screening and due diligence, as well as to demonstrate and report impact performance. They help to verify the quality and validity of impact approaches and build trust between parties.

Third-party certifications range from sector-specific ratings to much broader multi-sector benchmarks. They include standards for particular industries, such as the Building Research Establishment Environmental Assessment Method (BREEAM) for sustainable real estate and Aeris Impact Management Ratings in U.S. community development, to broad ratings such as the Global Impact Investing Rating System (GIIRS) for the fund management industry and the B Impact Assessment to certify B Corporations, a class of impact-seeking enterprises.

Despite the proliferation of certifications, **many asset owners are still not armed with enough nuanced data to gain comfort in asset managers and their impact management processes. In the coming years, more flexible and robust certifications need to be created** to better and more precisely assess impact management strategies across asset classes.

Methodologies

Defined processes and approaches for diligence, assessment, monitoring, and reporting of impact translate the broad guidelines provided by standards into focused and practical means of implementing a given investment strategy.

Universal methodologies like the Impact Management Project's dimensions of impact (What, Who, How Much, Contribution, and Risk) are emerging as best practice for the industry, and have been adopted by a diverse group of investors and entrepreneurs. **However, it is still common for investors to customize the Impact Management Project's methodology or develop their own to fit their unique priorities and needs.**

Metrics

Standardized sets of social and environmental metrics that promote shared understanding across a market and allow for comparability across investments. Impact measurement depends on clear definitions of what is being measured.

Before the development and adoption of standard metric sets like the Global Impact Investing Network's (GIIN) Impact Reporting Investment Standards (IRIS) and the sustainability metrics developed by the Global Reporting Initiative (GRI), some companies and investors measured social and environmental impacts, but it was impossible to compare performance. Approaches for what to measure and how to report on impact varied widely. The credibility of impact measurement suffered as a result, causing some to be skeptical of impact investing more broadly.

Benefitting from nearly a decade of use and refinement since it was first introduced, IRIS has emerged as the most widely recognized and applied framework for metrics among impact investors. IRIS combines metrics from different industries into one central system. According to the 2018 GIIN survey, 59 percent of respondents use IRIS metrics in their impact management practice.

While often a core resource, many investors have found it beneficial to supplement IRIS metrics with proprietary metrics, qualitative information, and/or additional external frameworks and standards. As such, the most common approach for investors surveyed by the GIIN is to use a combination of select standard, portfolio-wide metrics with other indicators as appropriate.⁶

These five building blocks enable the practice of impact management to be more efficient, robust, and consistently implemented. To understand how the tools are used in practice, we will explore their use in a particular strategy.

6. Global Impact Investment Network (GIIN): Annual Impact Investor Survey, June 2018.

IMPACT MANAGEMENT IN PRACTICE: SOCIAL INFRASTRUCTURE

To understand how impact management can be applied in practice, we took an example from the real estate sector and considered the specific demands of social infrastructure.

Definition of Social Infrastructure

Social infrastructure assets are the physical buildings that are essential to deliver social services, such as hospital, schools, courts and affordable housing. As such, social infrastructure plays a crucial role in the health and vibrancy of communities and the surrounding environment. Despite its important civic and environmental role, however, social infrastructure has suffered from underinvestment in the past decade. The High-Level Task Force on Investing in Social Infrastructure in Europe has estimated the minimum size of the annual investment gap to be €142 billion.⁸

Social infrastructure is a natural fit for most impact investors. It can deliver a positive impact together with financial benefits such as predictable, steady returns as well as a lower exposure to market and systemic risks.

This case study considers how investors can maximize the potential for dual returns in social infrastructure—an attractive risk-adjusted financial return as well as the social and environmental benefits—by actively managing for impact.

Impact Management Approach

The impact management approach developed by Franklin Templeton Real Asset Advisors (FRAA) and Tideline is based on industry best practices and aligned with a commitment to transparency and authenticity. A key aspect of the design is the integration of impact management throughout the investment process as illustrated below in Exhibit 4. This approach integrates impact from the early stages of the investment process—for example, the sourcing and management of social infrastructure assets—informs investment decisions, and allows for proper impact measurement at the reporting stage. And as most of the desired impact outcomes will be achieved over the long term, this approach supports better tracking over time.

Targeting market-rate returns with impact strategies

Although impact investing spans a wide variety of return expectations, from concessionary to commercial, the case study outlined in this paper focuses on the pursuit of market-rate returns, which comprises the largest proportion of investor activity. In the GIIN's 2018 survey, for example, 95% of the AUM targeted risk-adjusted, market-rate returns and 91% of respondents reported that financial performance to date has met or exceeded their expectations, as depicted in Exhibit 3.⁷

Exhibit 3: Impact investing AUM by targeted returns

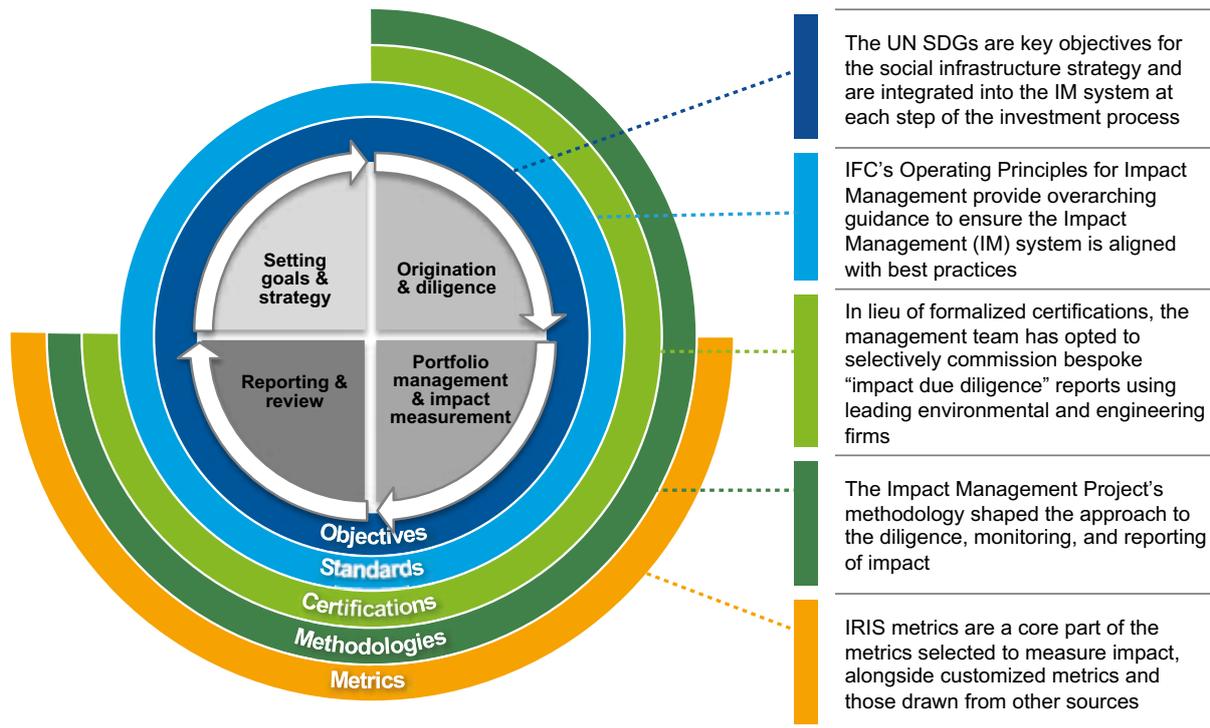


Source: Global Impact Investment Network (GIIN): Annual Impact Investor Survey, June 2018.

7. Global Impact Investment Network (GIIN): Annual Impact Investor Survey, June 2018.

8. European Commission: Boosting Investment in Social Infrastructure in Europe, January 2018.

Exhibit 4: Impact Management frameworks in practice – Relevance and value in the investment process



Source: Franklin Templeton Real Asset Advisors and Tideline. For illustrative purposes only.

What follows is a discussion of how we selected the key frameworks for our impact strategy; how they could be used throughout the investment process; their limitations; how they interact and complement one another; and how they can be appropriately tailored to an investment strategy.

Objectives

This social infrastructure strategy targets six Sustainable Development Goals as key objectives: Good Health and Well-being, Quality Education, Decent Work and Economic Growth, Sustainable Cities and Communities, Climate Action, and Life on Land (Exhibit 5).

The SDGs inform the entire impact management system and process. For example, in screening and due diligence, the alignment of an asset’s impact with the targeted SDGs is specifically evaluated. In impact measurement, metrics were identified that would demonstrate the degree of progress against the SDGs, which are also used later in reporting. Finally, where possible, we prioritize opportunities to manage the assets in ways that will enhance this impact in line with the SDGs.

Exhibit 5: Social infrastructure and the SDGs



Source: United Nations.

Standards

We consider the **IFC’s Operating Principles for Impact Management** because the principles help clarify the contribution the investor can make from the very start. This concept is important for identifying the additive value an investor brings to the impact of an investment. However, IFC principles do not prescribe specific contributions and a taxonomy is not available, hence customization is required at this stage in the process.

In this specific case exhibit 6 shows the key contributions investors could achieve through a social infrastructure strategy. These were brought together to create a tracking tool that documents the current versus projected (or realized) impact of each asset. This tracking tool is based on a 10-factor scoring system—five related to community aspects and five to environmental ones. Current and projected impact scores rank from 1 to 5 and are grounded on different metrics (i.e. IRIS) and due diligence reports.

Certifications

Though FRAA does not pursue third party certifications for the assets in its social infrastructure strategy, it does leverage BREEAM and LEED for discrete purposes in its impact management system. In lieu of formal certifications, the management team has opted to selectively commission bespoke “impact due diligence” reports using leading environmental and engineering firms.

These reports provide valuable data on the current state of each asset and identify potential environmental improvements. The reports provide benchmarking information versus the BREEAM and LEED certifications allowing the scoring system to stay grounded in best practices and to obtain useful environmental data.

Exhibit 6: Key contributions from Social Infrastructure



Source: Franklin Templeton Advisors and Tideline. For illustrative purposes only.

“ *The social infrastructure strategy targets six Sustainable Development Goals as key objectives. They inform the entire impact management system and process.* ”

Methodologies

The diligence tools and impact reporting for the case study are influenced by the Impact Management Project (IMP) and its five dimensions of impact: **what, who, how much, contribution, and risk**. In practice, this means that an annual impact assessment for each asset in the portfolio is designed to address directly these five dimensions. It does so through

a documentation of SDG-alignment, specific contributions achieved or planned, and through the 10-factor scoring system designed to assess the current and future state of community value and environmental performance. An impact assessment report for a healthcare asset would examine the following questions in alignment with the five dimensions. (See Exhibit 7).

Exhibit 7: IMP's five dimensions of impact, applied to a healthcare example

WHAT	What outcomes the asset is contributing to, such as the health-related outcomes of serving patients in the community
WHO	Who is experiencing those outcomes and how underserved were they previously (e.g., low-income communities)
HOW MUCH	How many people are experiencing the outcomes and the degree of change they experience (e.g. quality of care)
CONTRIBUTION	FRAA's specific contribution to the impacts of the hospital (e.g. operational enhancements or energy upgrades)
RISK	Any potential risks to the community or environment if the expected impacts of the hospital do not occur as planned

Source: Impact Management Project.

Changes in these five dimensions are calculated on an annual basis, to monitor continuously and manage the impact of the social infrastructure investments.

Metrics

The impact management system for the social infrastructure strategy draws heavily from the **GIIN's IRIS** catalog of metrics. Because IRIS is the most widely used metrics framework in impact investing, aligning with IRIS is an important way of making impact outputs more comparable and readily understood. The ultimate benefit of doing so is increased accountability and transparency in impact performance and reporting.

However, the team also wanted to track key metrics that were not in the IRIS catalog and

found value in creating custom metrics and asset-class specific metric standards, like those used for real estate ESG reporting by the Global Real Estate Sustainability Benchmark (GRESB).

The combination of standard and custom metrics aims to be both practical and comprehensive. In practice, key performance metrics are identified for each asset and are designed to be aggregated to the portfolio level. Also, to stay aligned with the stated objectives for the strategy, each metric is mapped back to an SDG (Exhibit 8).

Exhibit 8: SDG's and Key Performance Indicators

 The icon for SDG 15, 'Life on Land', features the number '15' in a large white font on a green background. To the right of the number, the words 'LIFE ON LAND' are written in white, stacked vertically. Below the text is a white graphic of a tree with a cloud above it and two birds flying to the right. At the bottom of the icon are two horizontal white lines representing a ground surface.	<ul style="list-style-type: none">• Area of Space Preserved/Developed• Land Contamination• Toxic Materials Exposure• Waste Disposed: Landfill• Waste Disposed: Composted• Waste Disposed: Recycled/Reused• Area of Greenspace• Biodiversity Data
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Source: UN SDG's and Franklin Templeton Real Asset Advisors. For illustrative purposes only.

Furthermore, while metrics are a key building block for any impact management system, FRAA also acknowledges the value of asset-specific case studies to illustrate positive outcomes. Together, quantitative metrics and qualitative case studies can present a fuller and more robust report for investors.

FUTURE DIRECTIONS

Robust systems for impact management that are embedded end-to-end in the investment process have come to play a central role in the maturing impact investing market. Drawing on a suite of tools and frameworks—ranging from broad objectives to precise impact metrics—investors are increasingly empowered to understand, manage, and improve the social and environmental outcomes of their investments.

As impact investing grows, the clarity and efficiency of impact management practices will continue to increase with the introduction of new frameworks and the refinement of best practices. Keeping pace with this constant evolution will require commitment from investors and managers. After all, continued improvement on impact management lies at the heart of achieving social and environment outcomes through investment, with authenticity and rigor.

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More information on social infrastructure and FRAA

To learn more about social infrastructure and FRAA, please see FRAA's previous publications focused on opportunities for social infrastructure investment in Europe,⁹ the impact on communities and the environment,¹⁰ and FRAA's intentional approach to community impact.¹¹

9. Franklin Real Asset Advisors: Social Infrastructure in Europe: Private Investment Opportunities, February 2018.

10. Franklin Real Asset Advisors, Investing in the Community and the Environment: Impact Investing in Social Infrastructure, June 2018.

11. Franklin Real Asset Advisors: The Value of Community Impact in Social Infrastructure: From the UN SDGs to an intentional impact approach, December 2018.



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About Franklin Real Asset Advisors

Franklin Real Asset Advisors (FRAA) has been investing globally since 1984. Clients include major institutional and retail investors around the world. The team provides global expertise in private real estate funds, listed infrastructure securities, and listed real estate securities.

The FRAA team invests in both private and public markets, drawing on deep knowledge of global capital flows, investor behavior, and sector trends across markets and regions. Each of the world's three major investment regions—the Americas, Europe, and Asia Pacific—is covered by professionals with experience in the local market, providing cultural perspective and specialized asset class knowledge.

TIDELINE

About Tideline

Tideline is a consulting firm that provides tailored advice to clients developing impact investment strategies, products, and solutions. Tideline's partners include some of the largest wealth management platforms, asset managers, insurance companies, and private foundations in impact investing, as well as select family offices and international and community development financial institutions.

Tideline is a leader in the custom design of impact management systems for investors and has also advised the Impact Management Project and SDG Impact, an initiative of the United Nations Development Programme.

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