

Structuring an impact fund: key differences from traditional investment funds

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While there have been [headwinds this year around diversity, equity, and inclusion \(DEI\) initiatives](#), impact investing is still very much alive and often forms a significant component of institutional portfolios. In this article, we distinguish the key structural and legal differences between impact investment funds and traditional institutional investment funds, and offer insight into why these increasingly sophisticated vehicles require close scrutiny.

What you need to know

- While many funds will nowadays promote ESG-related features, impact funds distinguish themselves by placing “sustainable investment objectives” at the core of their investment strategy, pursuing measurable outcomes on issues such as gender, diversity or environmental factors while delivering financial returns.
- Certain climate-related impact funds can be a powerful tool for institutional investors seeking to meet net-zero or regulatory commitments.
- As the impact investing sector matures, scrutiny on credible and standardized impact measurement has begun to intensify. Managers should adopt standardized measurement frameworks and carefully review marketing materials to ensure the fund doesn't fall afoul of “impact-washing” or “greenwashing” accusations. Managers and investors should ensure that the fund terms provide mechanisms to ensure accountability with respect to the relevant impact goals of the fund and ensure these are commensurate with the desired intent.

What is an impact fund?

In Canada, there is no regulatory framework that defines what an impact fund is, but the concept could broadly be considered to encompass any investment fund that demonstrates an intent to achieve concrete, measurable non-financial (e.g., sustainability) impacts. For the purposes of this article, we focus primarily on investment funds which would likely be described as falling under Article 9 of the EU's Sustainable Finance Disclosure Regulation in that they pursue a “sustainable investment” objective¹: this can include funds that pursue gender balance and diversity objectives, as well as funds that have a climate or environmental-related focus.

These investment vehicles are designed to achieve specific impact goals while delivering financial returns—not the other way around. Unlike traditional investments, which may consider ESG factors as peripheral, impact funds place these objectives at the core of their investment strategy, and ensure their outcomes are measurable. Managers of these types of funds typically develop a clear theory of change, outlining how investments will lead to concrete and specific outcomes, and then measure progress towards those outcomes.

While investment returns may be (and often are) still relevant to investors who invest in impact funds, returns are typically not the central motivation. In some cases, the primary objective will be accessing certain types of incentives, as is the case with climate-related funds. For others (such as government-sponsored investors), the main goal will be to ensure that the fund generates outcomes that would not have occurred without the fund's investments. This may result in increased scrutiny on the reporting provided by the fund manager. Investors seeking to put their capital into such funds should ensure that they understand the hierarchy of considerations that will drive the manager's decisions and influence the exercise of its duties towards the fund, and that these align with their own objectives.

Climate-related impact funds: unique features and investor incentives

Climate-related impact funds have been gaining prominence as a specialized category within the broader impact investing ecosystem. These vehicles are structured to achieve measurable environmental outcomes—primarily related to emissions reduction or climate adaptation—while also generating competitive financial returns. These funds can also be positioned as tools to manage transition risk by reallocating capital away from assets vulnerable to climate regulation or stranded-asset scenarios.

One distinguishing feature of climate-related impact funds is their potential engagement with carbon markets. Many such funds invest directly in projects that generate verified carbon credits, such as credits generated by nature-based solutions, industrial carbon capture and sequestration projects, or emerging technologies like direct air capture and sequestration.

Climate-related impact funds are often marketed to institutional investors seeking to meet their own net-zero commitments or regulatory obligations. Fund managers will sometimes attempt to attract such investors by providing a preferential access to such carbon credits—for example, by allowing fund investors to purchase those credits or by providing for such credits to be transferred as a distribution in specie. In such circumstances, managers must make sure to take into account the complexities and requirements that may be tied to credit origination, registration, transferability and monetization to avoid a situation where they may not be able to meet any of the commitments made at the inception of the fund and to ensure proper disclosure of any resultant risk.

Another marketing tool available for fund sponsors is the use of green bonds and sustainability-linked bonds (SLBs) within climate fund portfolios or as capital-raising instruments. Green bonds require net proceeds to be used for certain categories of eligible environmental projects and activities, with frameworks such as the ICMA Green Bond Principles offering guidance².

Green bonds require fund managers to prepare offering documents, ensure proper use-of-proceeds tracking, and manage reputational risk tied to post-issuance disclosures. Sustainability-linked bonds (SLBs), by contrast, embed environmental performance targets directly into financial terms—for example, by lowering a coupon rate if emissions reductions are verified. Structuring SLBs demands careful attention to target definition, third-party validation, and the consequences of failing to meet environmental KPIs.

While SLBs are not used exclusively by investment funds, they may be issued by climate-related impact funds as an additional source of capital (in addition to traditional equity). These can be issued to the same investors pursuant to a pre-determined ratio or to different types of investors. In both cases, the fund will need to adequately disclose the intended distribution waterfall among these various types of instruments.

The growing importance of impact reporting

Reporting attracts increased scrutiny in the context of impact funds. As the sector matures, the emphasis on credible and standardized impact measurement has intensified. Investors and stakeholders increasingly demand transparency and accountability to ensure that funds deliver on their promises. To verify that reported impacts are real and not merely aspirational, impact funds are increasingly adopting standardized measurement frameworks. These tools enable investors to evaluate the effectiveness of their investments in achieving stated objectives.

Frameworks such as the GIIN's IRIS+ framework³ and COMPASS methodology⁴, the Universal Standards for Social Performance Management⁵, and the Impact Management Project's five dimensions of impact⁶ provide shared norms and data structures to evaluate progress in certain areas. These standards help facilitate comparability across impact investments and guide decision-making with data-driven insights.

Despite advancements in impact reporting, the sector faces challenges: notably the risk of "impact-washing" or "greenwashing" where funds overstate their social or environmental contributions. In June 2024, [Canada adopted specific anti-greenwashing provisions in the Competition Act](#) focused on representations that promoted the environmental benefits of products or business activities, although the recent federal budget implementation bill proposes to pare back some of these provisions⁷.

By contrast, the United States has recently taken a lighter regulatory touch: earlier this year, the Securities and Exchange Commission (SEC) announced the withdrawal of its 2022 anti-greenwashing proposal⁸, which would have required registered investment advisers, certain exempt advisers, registered investment companies and business development companies to disclose additional information regarding their ESG investment practices. While the shift reflects a broader retreat from the more prescriptive approach taken under the prior administration, the SEC acknowledged the possibility of future rulemaking, and changes in federal leadership could also have a material impact on where ESG regulation in the United States ultimately lands. In the meantime, investment advisers should not assume that the SEC will refrain from bringing enforcement actions for misstatements relating to ESG factors.

When it comes to impact funds, the risk of reputational damage related to inaccurate impact reporting can be significant, even in the absence of regulatory actions.

In light of these concerns, managers should take steps to avoid providing misleading information or making unsubstantiated claims about the fund's ESG practices, performance, products or credentials. In addition, marketing materials will generally need to provide detailed information as to how the fund intends to assess, measure and report on ESG goals. In the context of an impact fund, it will be important to adequately highlight how the manager will balance financial objectives (and any desire to generate investment returns) with impact goals to align investors' expectations.

From the investor's perspective, adequate due diligence remains key, but many institutional investors will further protect themselves against these risks by requiring the fund manager to obtain third-party verifications, where available, or agree in certain circumstances to undergo robust verifications or audit processes.

Further, in an impact fund, reporting on impact metrics is often not only a question of transparency but also one of accountability. Where the fund sponsor or manager is not able to meet certain metrics or measurable goals, it is not uncommon that the fund documentation—whether the limited partnership agreement itself or side letters with certain investors—will specify consequences or provide investors with certain rights. These can go as far as imposing a haircut on the manager's carried interest or allowing investors to terminate the investment period—or even the fund itself, with the support of a sufficient threshold of limited partners. These measures are often bespoke and dependent on how important the relevant impact goals are with respect to any given fund strategy. Fund sponsors and investors alike must therefore fully understand the relevant impact reporting standards in order to avoid unintended consequences and ensure that they are commensurate with the desired intent.

The importance of such reporting also often puts the relevant ESG personnel at the forefront of the fund strategy. This can make these personnel a material aspect of an investor's operational due diligence and may even lead to certain ESG officers falling within the scope of certain "key man" provisions or considerations.

Key takeaways

While impact funds often resemble traditional institutional investment funds, they are increasingly sophisticated vehicles requiring novel combinations of financial modelling, reporting and accountability. Proper structuring is central to ensuring that these funds deliver not only on their goals, but also on their legal obligations to investors.

For investors and legal advisors, understanding the nuances of impact fund structures, measurement methodologies and the evolving landscape is essential. As the sector continues to grow, robust governance and transparent reporting will be key to sustaining trust and achieving meaningful change.

FOOTNOTES

1. [Regulation \(EU\) 2019/2088](#) of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector.
2. International Capital Market Association, [Green Bond Principles: Voluntary Process Guidelines for Issuing Green Bonds](#), June 2025.
3. GIIN, [IRIS+ Standards](#), 2025.
4. GIIN, [COMPASS: The Methodology for Comparing and Assessing Impact](#), May 2021.
5. Cerise+SPTF, [Social and Environmental Performance Management for Responsible Inclusive Finance](#), February 2022.
6. Impact Frontiers, [Five Dimensions of Impact](#).
7. Parliament of Canada, Bill C-15, [An Act to implement certain provisions of the budget tabled in Parliament on November 4, 2025](#), November 2025.
8. Securities and Exchange Commission, [Withdrawal of Proposed Regulatory Actions](#), June 2025.

To discuss these issues, please contact the author(s).

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