Catalyzing American Retail Investment in Community Development Finance: What Can We Learn From other SRI Success Stories?

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Overview

When Calvert Social Investment Foundation launched its current programs in 1995, with the mission of helping to end poverty through investment, we began our first foray into investing in microfinance. Through our increasing involvement in the international impact investing industry, we have seen a true scaling of targeted investments to the microfinance sector. Impact investing can be broadly defined as investments made to solve social or environmental problems while still generating a financial return.[1] The impact investing community in the United States grew to $30 billion in 2009.[2] Impact investors have proven their commitment to microfinance even in times of economic crisis. This is evident in the ability of microfinance investment funds to raise more than $1 billion in new funds from a range of capital market sources in 2009 despite the ongoing effects of the global financial crisis.[3] We believe the Community Development Financial Institution (CDFI) industry is poised to be a catalyst for comparable capital in the United States. CDFIs are "mission-driven financial institutions that provide financial products and services to people and communities underserved by traditional financial institutions."[4] They include regulated depository institutions, such as credit unions and banks, as well as unregulated loan funds.

Calvert Foundation has worked actively in the U.S. "socially responsible investing" (SRI) industry since our inception. SRI is an umbrella term that refers to responsible methods of investment including screening, shareholder advocacy, and impact investing.[5] With the desire to have a deeper impact, Calvert Group–an investment management company–joined with several traditional endowed foundations to establish Calvert Foundation by allocating a portion of its mutual fund assets, along with foundation financing. These funds help finance underserved communities through "impact investments" in CDFIs, affordable housing, and microfinance. Owing to its early relationship with an SRI mutual fund, Calvert Foundation has always been focused on the power of the retail investor. Raising retail investment

1 The GIIN, www.thegiin.org/cgi-bin/iowa/home/index.html.
2 2009/10 Socially Responsible Investing Trends in the United States, SIF.
3 July 2010 State of Microfinance Investment, The MicroRate 2010 MIV Survey.
4 CDFI Fact Sheet, CDFI Coalition, http://cdfi.org/uploads/other/CDFI_Fact_Sheet.pdf.
5 "Socially Responsible Investing: Top 10 Frequently Asked Questions and Answers," Social Investment Forum.

can offer upwards of $60 billion in programmatically unrestricted capital, a loyal long-term investor base, and favorable terms of investment. Recent studies have pointed to a significant amount of untapped investor demand for impact investment that, with education and the further development of appropriate sales channels, could be significant. Calvert Foundation believes that one way to scale impact investing in the United States is by developing financial advisor and broker relationships to reach everyday people, the true retail investors.

In the 15 years since we began actively investing, Calvert Foundation's unique business model has created a number of opportunities for cross-learning and growth within the organization. Over the years, we have become more adept at understanding our retail investors and reflecting their demand in our portfolio of investments. The impact investing community will continue to be integral in channeling funding toward socially oriented organizations. Witness what has transpired in Western Europe. Favorable tax and regulatory environments have unlocked the wallets of Dutch, British, and Swiss citizens, to name a few, and have vaulted socially responsible investments to €5 trillion ($6.87 trillion) across 19 European countries.[6] Calvert Foundation believes that these mainstream markets truly are the key to scaling community development finance in the United States.

For this reason, Calvert Foundation pays close attention to the shifting winds of investor demand. Retail investors are not a homogeneous group, and over the past seven years, investors have become increasingly interested in making an impact internationally with their investments. Even though modern microfinance began in the 1970s, it wasn't until 2004 that it started to catch the attention of the retail investor. In the fall of 2004, the United Nations announced that 2005 would be the International Year of Microcredit. The following year, the Nobel Peace Prize was awarded to Muhammad Yunus, a micro-finance pioneer, for his work with the Grameen Bank. To respond to this growing interest, in 2007 Calvert Foundation partnered with MicroPlace, a brokerage firm and online platform where retail investors could target their money toward international microfinance institutions. Although Calvert Foundation had been investing in microfinance since its launch in 1995, MicroPlace offered the ability to involve a much broader audience in microfinance and impact investing. Specifically, it gave access to those who could not meet the original purchase minimum of $1,000, many of these being younger investors. Since the launch of MicroPlace in 2007, Calvert Foundation has attracted more than 5,000 new retail investors through the platform with an average investment size of just under $300.

There was also a significant increase in microfinance funding by the private sector in 2007. This jump was the result of the successful development of new financing mechanisms to scale investments, such as responsibly managed, collateralized debt-obligations, or retail investment products, and pension fund allocations. Much of this growth was financed by European asset managers dedicated to microfinance and impact investment. In advance of this scaling, the microfinance industry had to make itself more investment ready. This

6 European SRI Study 2010, EUROSIF Executive Summary.

included adopting new strategies to improve the industry's transparency, organization, and responsiveness.

Our experience in microfinance has confirmed our belief that gaining access to capital markets, and specifically the retail investor segment, is the key to expanding social impact. These markets offer the consistent and significant streams of unrestricted funding needed to reach our developmental goals. While growth is important, equally crucial is ensuring such industry growth is achieved responsibly. This includes ensuring a high level of transparency, promoting strong industry associations and collectively responding to issues that arise. The CDFI industry is approaching a crossroads where it has the opportunity to grow substantially if it can capitalize on the opportunities presented and prepare itself to absorb significant growth.

Investor Demand: U.S. Market Potential

Forms of socially responsible investing have existed in the United States since the 1960s, but it has only been in the last 10 years that the idea has really begun to take off. The 2010 Report on Socially Responsible Investing Trends in the United States reports that sustainable and social managed investments (mutual funds and separate accounts) grew to more than $3 trillion at the end of 2009, even as the overall markets contracted. Of this $3 trillion, $30 billion was targeted to community development financing or impact investments.[7] Impact investments differ from other socially responsible investments in that socially responsible investments generally use screening methods to avoid investing in publicly traded companies with questionable practices while impact investments involve financing private companies and non-profits to generate and effectively measure social, environmental and financial returns. Although impact investments funded by U.S. investors have grown by $5 billion since the last survey in 2007, there still remains a significant gap between the potential investor demand for this type of social finance and the actual amounts funded, as evidenced by the findings in a recent "Money for Good" report by Hope Consulting. It is up to the impact investment industry to reduce the barriers of entry for these potential social investors in order to reach the scale and impact that is possible.

In its recent "Money for Good" report, Hope Consulting surveyed more than 4,000 individuals on the market opportunity for impact investments in the United States.[8] The results are extremely encouraging, pointing to a potential $120 billion in investor capital that could be targeted to impact investments. Half of this estimated market would come from smaller-sized investments (less than $25,000) from both nonaccredited and accredited investors. A strong case can therefore be made for developing more retail impact investing products that would allow the everyday investor to target his or her money to community development.

7 2010 Report on Socially Responsible Investing Trends in the United States, Social Investment Forum Foundation.
8 May 2010, Money for Good: The US Market for Impact Investments and Charitable Gifts from Individual Donors and Investors, Hope Consulting.

The survey also found that while only 12 percent of Americans have made an impact investment in the past, an additional 48 percent were interested but said they wanted to know more about the industry before investing. The primary issue raised was the relative immaturity of the market and the associated risk. To those surveyed, a guarantee on principal and low risk were six times more important than a high return. This desire matches well with the low risk, low volatility, and low return that CDFIs seek for investors. It also represents an almost unlimited market for CDFIs' favorable unrestricted, low-rate, long-term financing.

While the market potential is huge, the field still lacks sufficient distribution channels to match demand with the supply of impact investments. One reason for this is that many people discover new investments through their financial advisor. Approximately 45 percent of respondents to the Hope Consulting survey said they would be willing to make an impact investment through their current financial advisor or broker. This suggests that a crucial step in expanding impact investing through retail investors will be educating the advisors and brokers on the industry and convincing them to offer impact investment options on their platforms. With education, there is also the opportunity for large financial institutions such as Fidelity or Vanguard to structure and sell impact investments.

The SRI Market: The United States and Europe

The SRI market in the United States has achieved substantial growth in the last decade to just over $3 trillion outstanding in 2009.[9] While the SRI industry in the United States has achieved a certain level of success, significant work remains in the areas of educating the public on the SRI philosophy and working with financial advisors, brokers, and regulators to expand the sales channels available to interested investors.

The European SRI industry has also expanded at an impressive rate, more than doubling the size of the U.S. market with €5 trillion ($7.1 trillion) outstanding in 2009, up from just under €2.7 trillion ($4 trillion) in 2007.[10] Owing to regulations involving pension fund SRI management, institutional investors have driven the growth in the European SRI market. Institutional investors represented 92 percent of total assets under management in 2009. These institutional investors include public pension funds, reserve funds, universities, and insurance companies, among others.[11] In addition, since 2008, the portion of retail investors active in SRI has increased in almost all countries, according to European Social Investment Forum's (EuroSIF) 2010 market study. In particular, Austria, Belgium, France, and Germany have all seen notable increases in their retail SRI market. In Switzerland, retail investors represent the majority of the €23 billion ($31.6 billion) market, with 55.4 percent of all socially responsible investments.[12]

Microfinance is also assuming a prominent role in the SRI strategy in Europe. The

9 2010 Report on Socially Responsible Investing Trends in the United States, Social Investment Forum Foundation.
10 European SRI Study 2010, EUROSIF Executive Summary.
11 Ibid.
12 European SRI Study 2010, EUROSIF p. 51.

amount of European SRI funds targeted to microfinance investment in 2009 was an estimated €1 billion ($1.4 billion). EuroSIF predicts that microfinance will continue to be of significant interest to SRI investors over the next few years, signaling the continued demand for microfinance-focused investment funds.[13]

How have the Europeans expanded their market so significantly? One important factor is the progressive regulation in Europe that encourages responsible investing. However, where local legislators failed to enact SRI legislation, many European financial institutions have taken it upon themselves to update their practices and invest in a socially responsible and transparent way.

The Case for Regulation

According to the EuroSIF 2010 European market study, at least eight countries in Europe have specific national SRI regulations in place pertaining to their pension systems. These eight include the United Kingdom (passed in 2000), Germany (2001), Sweden (2001), France (2001), Belgium (2004), Norway (2004), Austria (2005) and Italy (2005). Elsewhere, regulations on environmental, social, and governance (ESG) reporting for companies (France in 2001; Denmark in 2008) provide a good basis for similar developments in SRI.

The principal motivation for these regulations is the desire to enhance consumer protection, to strengthen SRI investments, and enhance transparency in financial institutions handling the public's money. The British SRI disclosure regulation, enacted in July 2000, is largely accepted as the first of its kind in Europe.[14] The regulation requires that the statement of investment principles for private and public occupational pension trustees include the extent to which social, environmental, or ethical considerations are taken into account when selecting investments. Germany has passed similar legislation in its 2001 Pension Reform law requiring pension funds to report annually to their members on SRI policies. Compliance with these regulations requires little additional effort, but the impact is significant: it creates a greater level of transparency and accountability between the retail investor and the pension fund manager. Overall, these regulations have elevated the profile of SRI in Europe, helping to familiarize the public with the concept and thereby increasing the market of interested investors.

Although regulation has spurred the growth of the SRI industry in several countries, others, such as The Netherlands, have seen growth without specific SRI laws. The Netherlands does, however, have a special tax credit–1.3 percent of the average amount invested during the year in recognized socially responsible investments. The maximum exempt amount per taxpayer is €55,145 ($75,780), proving the tax credit to be truly focused on the Dutch retail investor.[15] This tax credit has resulted in socially and environmentally worth-

13 European SRI Study 2010, EUROSIF p. 17.

14 2000-2010 Celebrating ten years of responsible investment disclosure by UK Occupational Pension Funds, UK Sustainable Investment and Finance (UKSIF) June 2010.

15 Dutch Tax Administration (Belastingdiens) www.belastingdienst.nl/variabel/buitenland/en/private_taxpayers/private_taxpayers-40.html#P661_57865.

while projects that would otherwise not have had access to finance.[16] Dutch pension funds have also become very active in SRI, sparked by a 2007 documentary that revealed questionable pension fund investments into high polluting companies. The scandal that followed encouraged many large pension funds to draft and implement their own SRI policies and, in combination with the favorable tax credit, this has made The Netherlands one of the most active SRI markets in Europe.

The legal framework for SRI in the United States is less supportive than in Europe. The laws, and perhaps more importantly, the practices that govern everyday retail investment contain significant barriers to increasing impact investments in the United States. The 1933 Securities Act was the first major federal legislation regulating the offer and sale of securities. It divides the investing public into accredited and non-accredited investors and defines rules for serving each type of investor group. Accredited investors include most institutional investors with total assets in excess of $5 million, or an individual whose household net worth exceeds $1 million. Accredited investors are permitted by law to participate in securities such as hedge funds, limited partnerships, and angel investor networks that are not registered federally with the Securities and Exchange Commission or with the state securities regulators. Everyday retail investors are only allowed to invest in securities that are registered and in full compliance with federal and state regulators. It requires a fair amount of infrastructure and financial resources to register, and therefore, most impact-investing intermediaries have not expended the effort, choosing instead to focus solely on the accredited investor market. That said, 75 percent of American investment capital is located in the retail segment, and according to the Hope Consulting report, there is $60 billion of retail demand for impact investments. Therefore, unleashing significant amounts of capital will require tapping this segment.[17]

The United States has no federal regulations pertaining to SRI; however, there has been some progress at the state level. At least 17 state governments offer their employees the option to invest their retirement money in SRI funds (socially screened stocks and bonds).[18] The U.S. Social Investment Forum has also recently introduced the Employees Responsible Investment Act, which proposes granting federal employees the option of selecting an SRI fund for their retirement account allocations. This bill would be the first federal legislation pertaining to SRI and, if approved, would give an SRI option to more than four million current or retired federal employees, whose funds totaled $244.4 billion in 2009.

16 Impact Investing: A Framework for Policy Design and Analysis, The Initiative for Responsible Investment at Harvard University, January 2011, p. 60.

17 May 2010, Money for Good: The US Market for Impact Investments and Charitable Gifts from Individual Donors and Investors, Hope Consulting.

18 September 21, 2010, Social Investment Forum Applauds Introduction of Bill Allowing Federal Employees to Select SRI Retirement Option, SIF Press Release.

Looking to the Future

Although the regulatory environment has not enabled the U.S. industry's growth, traditional financial institutions can be proactive in advance of any favorable legislation, as was demonstrated in the Netherlands. To date, SRI advocates have experienced resistance from certain mainstream financial institutions to incorporating SRI practices into their policies due to varying interpretations of the definitions of fiduciary responsibility. Some managers argue that SRI could potentially lead to a lower financial return which they see as a violation of their fiduciary duties to investors.[19] Similar resistance was also evident in the United Kingdom in 2000, prior to the regulation requiring pension funds to disclose environmental, social, and governance. At that time, it was common to hear pension funds claim that legal constraints prevented responsible investing. Now it is widely accepted in the United Kingdom that long-term, responsible investment is integral to fiduciary duties. With new studies showing an expansive potential impact-investing market in the United States, the SRI industry should create an enabling environment for these new entrants to the market.[20]

One area worth attention is the tax treatment of such investments. The success of the Dutch SRI tax credit could be a model for a campaign to introduce a similar SRI tax credit in the United States. Today, there are no tax benefits or federal insurance for impact investments in the United States. Another target could be raising investor awareness of how retirement funds are allocated and pushing for greater transparency in pension fund reporting. The main driver of the SRI industry's growth in Europe has been through pension funds. In certain countries, such as the United Kingdom, France, and The Netherlands, trade unions have been granted increased say in how their pensions are managed. Thanks to this increased agency, unions have chosen to allocate some of their retirement funds to SRIs. The recent financial crisis in the United States may have increased interest among everyday investors to direct their assets to low volatility, fixed income options with impact. These are just the options that social lenders such as MFIs and CDFIs are best positioned to provide to the investing public.

Finally, the U.S. SRI industry could push for more engagement and investor activism. Engagement is defined as "a long-term process of dialogue with companies which seeks to influence company behavior in relation to their social, ethical and environmental practices."[21] Engagement has become a common practice in the United Kingdom, with £830.1 billion ($1.34 trillion) of assets managed through engagement mandates.[22] Investors have several tools to ensure they are heard, including writing letters to senior management, filing resolutions at General Assembly meetings, voting, and, ultimately, divesting. Until then, tradi-

19 Derwall, J., Koedijk, K. & J. T. Horst (2010) "A Table of Value-Driven and Profit-Seeking Social Investors", July 13 2010.

20 May 2010, Money for Good: The US Market for Impact Investments and Charitable Gifts from Individual Donors and Investors, Hope Consulting.

21 European SRI Study 2010, EUROSIF, p. 60.

22 European SRI Study 2010, EUROSIF, p. 53.

tional asset managers will only provide the services when their clients demand it. We have significant work to do in the United States to raise investor awareness and encourage investors to communicate their desire for SRI to their asset managers.

Impact Results based on Environment

Pension Fund Involvement

Even without new regulations, pension funds can issue their own SRI guidelines. TIAA-CREF is perhaps the most obvious example of a U.S.-based pension fund that has been proactive in adopting SRI policies. TIAA-CREF is a Fortune 100 financial services company and the leading example of how socially responsible investing can be done by pension funds. It was founded through the Carnegie Foundation in 1918 to provide pensions for professors, and the fund is committed to its nonprofit heritage and mission to serve those who "serve the greater good" by investing in a socially responsible manner. As of March 31, 2010, the company had more than $426 billion in assets under management, all of which had been evaluated through some type of SRI screen. TIAA-CREF has been an impact investor since 1985 and launched its first socially screened portfolio in 1990. The fund offers a spectrum of SRI investments. TIAA-CREF management sees social investments as a critical component of their fiduciary responsibility to investors. TIAA-CREF has also dedicated $100 million to a four-year global microfinance investment program, further demonstrating the microfinance industry's success in attracting mainstream investments.

The Retail Impact Investors

Microfinance-focused asset managers and funds started to gain popularity in the early 2000s as a result of the positive SRI regulatory environments in Europe and the increased focus on microfinance as a tool for development. Although there is a visible contingent of U.S.-based microfinance funds, the European market remains much larger to date. These funds structure and manage billions of dollars in debt and equity investments through a wide range of financial products, including direct financing, structured funds, and collateralized debt obligations. ResponsAbility, a Swiss social investment company, is one of the fairly few European impact investment managers that targets retail investors and that has reached a particular level of scale, with assets under management of $889 million in 2009. A group of well-established Swiss financial institutions (including Credit Suisse) founded ResponsAbility in 2003, and today it manages funds with a minimum investment amount of $1,000. This product may not be sold to an unaccredited U.S. investor owing to the barriers of registration required under the United States Security Act of 1933.

ResponsAbility has worked in a similar retail investor market as Calvert Foundation, although it has been able to scale to twice the size in a shorter period of time as a result of the enabling European market. In 2004, ResponsAbility became the first microfinance fund in Switzerland to be authorized by the Swiss Federal Banking Commission for public sale on the Swiss stock exchange. A huge accomplishment, it gave ResponsAbility unfettered access to the Swiss retail market as its product could be purchased through any broker. The Swiss stock exchange also took part in the United Nation's International Year on Microcredit, further emphasizing the importance of social investment and microfinance in the mainstream Swiss financial market. The ResponsAbility Global Microfinance Fund aims for a return just above money market rates and has a conservative strategy to make it more attractive to retail investors.

ResponsAbility has been able to capitalize on the enabling environment, diversify its product offering, and has used the existing sales channels to achieve impressive growth since its inception. In the United States, in contrast, the road to growth in impact investments similar to ResponsAbility has been longer owing to regulatory barriers and a smaller SRI market. Although Calvert Foundation, for example, is a peer of ResponsAbility in many ways, it operates within a stricter financial regulatory system. Given this environment, Calvert Foundation and its subsidiary has achieved a notable size with about $500 million in assets under management in 2010. Nevertheless, it has not reached the same level of scale as its European counterparts, even though the foundation was incorporated five years before European retail microfinance funds were formed. While a number of other factors affected its growth trajectory, the regulatory barriers and a less socially inclined financial industry made it more difficult to gain access to the American retail investor. Calvert Foundation issues Community Investment Notes, which are senior, general recourse obligations that pay investors a traditionally below-market fixed interest rate. In Calvert Foundation's experience, retail investors are not only willing to accept this below-market rate to achieve positive social impact, but they are also committed for the long term, investing up to 10 years and renewing at an average rate above 80 percent during the U.S. financial crisis.

Originally, the Note was paper-based and could only be purchased directly from the Foundation for a minimum investment size of $1,000. In 2004, Calvert Foundation entered into an agreement with InCapital, a fixed-income securities distributor, to help distribute the notes through the Depository Trust Company (DTC). This allowed investors to hold the note electronically in a brokerage account with all their other investments. In 2007, Calvert Foundation gained access to another retail channel when it became an initial issuer to offer retail securities on MicroPlace, an eBay subsidiary and online broker in microfinance investments. Through MicroPlace, Calvert Foundation was able to lower its minimum investment amount to $20.

While both the DTC and MicroPlace channels significantly increased Calvert Foundation's access to the retail investor, neither partnership could compete with the enabling regulatory environment in Europe and strong financial industry support, as was the case with ResponsAbility. To be able to sell the note, Calvert Foundation must register separately with each state securities regulator every year in lieu of an even more cumbersome process of registering nationally with the SEC. This is a significant barrier for new entrants looking to access the retail impact investor. Traditional financial outlets have also needed continued education on SRI, as the concept is not as widely accepted as it is in Europe. Calvert Foundation has worked diligently for 15 years to develop relationships with brokers and financial advisors on a case by case basis, but the general accessibility of the Calvert Foundation Note still falls short of what is available in Europe.

Investment Readiness and Vehicles in the CDFI Sector

Although the microfinance industry has grown rapidly with the development of new financing mechanisms, the CDFI industry has also seen innovative financing solutions although very few, other than through Calvert Foundation, have targeted retail impact investors on a national scale. The Community Reinvestment Fund (CRF) is a national CDFI that purchases and warehouses community development loans and transfers them to an affiliated off-balance sheet or with a third-party investor, which then sells ownership interests to institutional investors. As of February 2010, CRF serviced $515 million of managed assets while its total on-balance sheet assets were just under $103 million in 2009.

Over time, as CRF gained experience in the institutional capital market, they began to use a variety of structured financing techniques and instruments to finance their loan purchases. These include the sale of asset-backed debt securities for economic development loans, New Market Tax Credit incentives for commercial and facilities loans, and direct placement of pooled loans with private institutional investors for affordable housing loans. These innovative structures have permitted CRF to grow considerably. However, many CDFIs are not-for-profit 501(c)3 companies, which are prohibited from accepting equity unless they transform into or create a subsidiary for-profit entity. Although there have been innovations in equity-like products offered to nonprofit CDFIs, the scale of these products (existing or promised) remains inadequate. When nonprofits are only able to take on debt financing or grants, it limits the CDFI industry's ability to grow. Once a nonprofit CDFI has reached a certain level of leverage, it is limited in its ability to grow unless it can devise some type of off-balance sheet structure, as is the case with CRF.

Explaining Success

Demand: How to Become "Investment Ready"

Although the external regulatory environment is clearly crucial to scaling capital market investment in the U.S. community development arena, there are also steps the industry can take to make *itself* more attractive to the everyday investor. Over the past few years, the microfinance industry has successfully established itself as a transparent, organized, and responsive industry--all things mainstream investors look for when making their money management decisions.

The Microfinance Information Exchange (MIX) was founded in 2002 to promote transparency in the microfinance industry by providing objective financial and social data on microfinance providers. The MIX is a free website that solicits audited financial information along with portfolio and social impact data from microfinance institutions worldwide. The data are fully available to anyone accessing the website. MIX staff verify the submitted data to ensure accuracy. After just eight years, the MIX lists 1,400 microfinance institutions and offers data comparisons between MFIs by region, country, and legal structure. This allows potential investors to analyze and compare an institution's relative performance against its peers and industry benchmarks. MIX has introduced a higher level of transparency to the industry and in doing so has given microfinance more credibility in the eyes of investors.

While the MIX has greatly leveled the information playing field for small microfinance institutions, LuxFlag is bringing a new level of transparency to the investment vehicles that place their capital with the MFIs. Since its founding in July 2006, LuxFlag has promoted new investment in microfinance through the issuing of its "LuxFlag Label." This label certifies that microfinance investment vehicles actually do invest in microfinance and comply with certain governance criteria, including publishing regular financial reports, segregating the functions of custody and management of assets, and applying the principle of risk diversification. LuxFlag therefore increases the credibility of the certified investment vehicles in the eyes of potential investors and ensures a certain level of oversight in operations. Only European microfinance investment vehicles have been assigned the label to date, and these organizations in turn benefit from a special listing on the Finesti database, a subsidiary of the Luxembourg Stock Exchange. This is another example of greater transparency opening up new funding opportunities for organizations.

One of the primary founders of MIX is the Consultative Group to Assist the Poor (CGAP). CGAP was formed in 1995 to help create permanent financial services to the poor on a large scale. Today, CGAP has become a thought leader in the microfinance industry, publishing focus notes, technical guides, white papers, consensus guidelines and blogs, all promoting and discussing best practices in the industry. Not only do they keep the different industry constituents informed, but they also actively educate governments and policymakers on the appropriate and enabling regulatory frameworks for financial inclusion. In this way, the microfinance industry has a champion who can work with legislators and central banks globally to make microfinance more manageable from a legal standpoint.

The microfinance industry has also proven responsive to industry-wide issues that have surfaced recently, such as client and consumer protection. A recent example of this is the "SMART Campaign," launched in late 2008 by CGAP and ACCION International's Center for Financial Inclusion in response to the global financial crisis and calls for a greater focus on consumer protection. The international microfinance community rallied around this campaign, which asked organizations at every level of the financing chain that signed on to agree to implement the six principles of consumer protection into their internal processes. These principles included ensuring transparent pricing to clients, ethical loan collections and staff behavior, privacy of client data, and avoidance of over-indebtedness. To date, the SMART Campaign claims strong support from industry players across the board: 349 MFIs, 62 networks and associations, 95 supporting organizations, and 101 investors and donors have all signed on to comply with the principles of client protection.[23] This demonstrated responsiveness to serious industry issues gives further comfort to investors that their money will be properly managed through any problems that arise.

Significant challenges of course remain in microfinance, and the industry could learn lessons from the CDFI sector. In particular, the CDFI industry has been grappling with outcome-based impact reporting requirements to its funders for many years. Impact measurement standards have become more developed in the U.S. market, where in many ways, CDFIs have a more varied impact story, creating housing, education, health care, and jobs, all areas that need to be measured. The microfinance industry as a whole is currently tackling how and to what extent to report on social impact or social performance.

Next Steps

How to "Unlock" the Impact Investing Market

The current mindset of the American investor offers new opportunities for the CDFI industry to grow by raising investments with favorable terms from the retail markets. In Calvert Foundation's experience, the best approach to expanding the retail market is to create and market vehicles that can meet the internal demands of the financial services firms. Every year since the implementation of our sales channel through the Depository Trust Company, the Calvert Foundation has seen a quantum leap of investment through the platform: from $19 million in 2008, to $36 million in 2009, to $45 million in 2010. In 15 years of marketing and selling through investment advisory firms, Calvert Foundation has found that meeting the specific demands of interested clients means working within the entrenched U.S. distribution system for investment products and with the gatekeepers who sell and monitor them. At one brokerage firm, approval for our Note product came from the Taxable Fixed Income Trading and Legal department, while at another firm, the private bank in conjunction with the estate planning group made the decision. Ultimately, overcoming these hurdles has been the key to the Calvert Foundation's 10 year average growth rate of 22 percent per year. Although significant challenges, costs, and uncertainty remain in creating an impact investment product targeted to retail individual investors, Calvert Foundation believes that this target market is the lynchpin to appreciably increasing the flow of American capital to disadvantaged communities. The potential funding amount not only substantial, it is also attractively structured as potentially long-term and unrestricted, resulting in an beneficial source of capital for many social enterprises.

Why Would a CDFI Want to Gain Access to the Capital Markets?

Although the premise that CDFIs should access capital markets might be a given for some, others may be asking what the benefits are of accessing private capital, particularly in

23 www.smartcampaign.org/about-the-campaign/campaign-endorsers.

the retail segment. After all, CDFIs have been successfully raising capital through Community Reinvestment Act (CRA) funds from banks, foundations, and government support for decades. As the SRI movement grows in the United States, more retail investors will be looking for outlets where they can earn a reasonable yield on their capital, with low volatility, and also have a social impact. This retail capital can enable an industry such as microfinance or community development finance to reach a scale that would otherwise be impossible when relying on traditional capital sources for social organizations.

The potential impact of such growth on underserved U.S. communities is an extremely important consideration. Once a track record has been established, not only are the amounts invested larger, but the terms are often more favorable as well. In Calvert Foundation's experience, retail investors are willing to accept a lower rate of return (between 0 and 2 percent) at a longer term (up to ten years) for the trade-off of a stable investment that provides social and financial return. It should also be stressed again that these investments are generally unrestricted, allowing greater flexibility in their allocation. This type of capital should be very attractive to CDFIs that often must manage restricted funding sources based on product or region. Lastly, retail investments, in our experience, have had a high rate of renewal, averaging above 80 percent during the financial crisis between 2008 and 2010, and over 90 percent since inception. This proves that they can be counted on as a long-term source of financing.

Significant work remains to prepare the CDFI industry for this type of investment. As in the case of CGAP in microfinance, although CDFIs do have existing networks, the industry needs a strong voice that is representative of all industry players to champion its causes. It has become a standard for microfinance institutions looking to grow to transform themselves into regulated entities. However, mission drift is a serious concern in many of these transformations. This risk has been mitigated in the past by a group of microfinance-focused social investors who use an engagement strategy to keep the organization in line with its mission. Should more CDFIs choose to incorporate as for-profits or create for-profit subsidiaries allowing them to accept equity, similar structures could be designed. If CDFIs choose not to change their legal structures, the industry will need to innovate once again, at a larger scale, in order to expand its impact. Without such a shift in structure or new financial innovation, the growth of the CDFI industry could be limited due to capital adequacy minimum requirements.

The future for impact investing in the United States looks very promising. The domestic impact investing community can learn from the European example and begin to lobby for changes in financial regulations to encourage more transparency from financial institutions. In doing so, a more enabling regulatory environment will increase public awareness and allow organizations such as Calvert Foundation to truly go to scale. New channels must also be developed to include pension funds, brokers, and financial advisors in the socially responsible investing movement. Now more than ever, in the context of economic downturn and post-financial crisis, Americans are looking for ways to allocate their assets safely and responsibly while also having a positive impact on their struggling communities. These retail investors can offer favorable terms of investment to CDFIs. Amid high unemployment, the growth of the CDFI industry that directly spurs the creation of new small businesses becomes ever more valuable. The microfinance industry's experience with the capital markets also offers key lessons. Should the CDFI industry be able to capitalize on this moment in history and ready itself by promoting greater transparency, strengthening its industry associations, and being prepared to act with a unified voice should any criticisms surface in the future, the opportunity for scaling their social impact is boundless.

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