Impact Investing in the Bay Area

Federal Reserve Bank of
San Francisco
101 Market Street

Tuesday, May 7, 2013
9:00AM – 6:00PM

WELCOME

Dear Conference Attendees:

On behalf of the Federal Reserve Bank of San Francisco and Seal Cove Financial we would like to welcome you to **Impact Investing in the Bay Area**.

This full-day conference will highlight impact investing opportunities and challenges for fiduciaries operating in the San Francisco Bay Area and broader California. Many fiduciaries of institutional assets are unfamiliar with impact investment opportunities and their related portfolio implementation issues. This conference will explore these opportunities and implementation issues with a particular focus on the Bay Area. The discussion will include leaders in finance, philanthropy, academia, and policy. The goal of the convening is to identify ways for fiduciaries to safely move assets into alignment with regional economic development and sustainability goals.

Thank you for your participation. We hope that today's conversation is a catalyst for transformational change in the Bay Area and beyond.

Sincerely,

Lauryn Agnew, Seal Cove Financial
Ian Galloway, Federal Reserve Bank of San Francisco

MATERIALS

Impact Investing in the Bay Area

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AGENDA

8:30AM	**Registration**
9:00 – 9:15AM	**Welcome and Overview** **Scott Turner**, Vice President, Federal Reserve Bank of San Francisco **Lauryn Agnew**, President, Seal Cove Financial
9:15 – 10:00AM	**State of the Bay Area: Overview of Bay Area Economy, Strengths and Needs** **R. Sean Randolph, PhD,** President and CEO, Bay Area Council Economic Institute
10:00 – 11:00AM	**Impact Investing for Institutional Portfolios: State of the Industry** **Ben Thornley**, Director of Insight, Pacific Community Ventures **Georgette Wong**, Curator, Take Action! Moderator**: Jessica Matthews**, Associate Director, Cambridge Associates
11:00 – 11:15AM	**Morning Break**
11:15AM – 12:00PM	**Fiduciary Duty and Impact Investing: Evolution and Challenges** **Dave Chen**, CEO, Equilibrium Capital Group
12:00 – 1:00PM	**Lunch**
1:00 – 2:15PM	**Community Development Investments** **Mark Sutten**, Policy and Program Analyst, Northern California Community Loan Fund **Michael Garvey**, Former City Manager, City of San Carlos **Brian Prater**, Senior Vice President, Low Income Investment Fund **Liz Sessler**, Senior Investment Marketing Manager, Enterprise Community Loan Fund Moderator: **Lisa Richter**, Principal, GPS Capital Partners
2:15 – 2:30PM	**Afternoon Break**
2:30 – 3:45PM	**Public and Private Equity and Debt for Impact** **Paul Herman**, CEO, HIP Investor **Nancy Pfund**, DBL Investors **Lauryn Agnew**, President, Seal Cove Financial Moderator: **John Goldstein**, Co-Founder, Imprint Capital
3:45 – 4:15PM	**Call to Action: Create the Bay Area Impact Investing Initiative (BA III)** **Lauryn Agnew**, President, Seal Cove Financial
4:15 – 6:00PM	**Reception**

SPEAKER BIOGRAPHIES

LAURYN AGNEW
Seal Cove Financial

Lauryn Agnew is president of Seal Cove Financial, which offers strategic marketing analysis and recommendations to firms with specialized investment strategies. With nearly three decades of experience in developing and implementing strategies in the institutional investment industry, Lauryn serves as a resource to nonprofit organizations for investment consulting services and provides fiduciary education and trustee training for public fund and nonprofit board and committee members. Currently, Lauryn is a trustee on the Board of the San Mateo County Employees' Retirement Association (SamCERA), a defined benefit plan with $2.5 billion in assets. She is the Chair of both investment committees at the United Way of the Bay Area and the Girl Scouts of Northern California, and is a member of the finance committee of the Immaculate Conception Academy of San Francisco. Lauryn has a BA degree in economics from Whitman College in Walla Walla, Washington and an MBA in finance from the University of Oregon. She is a member of the CFA Society of San Francisco and the Financial Women's Association of San Francisco.

DAVE CHEN
Equilibrium Capital Group

Dave Chen is CEO of Equilibrium Capital Group, an asset management platform of sustainability driven real assets funds. Previously, Dave was a general partner at OVP Venture Partners, founder/CEO of GeoTrust, vice president of marketing at Mentor Graphics, an associate at McKinsey & Company, and an early team member at Solectron. He currently sits on the boards of Gerding Elen, Biological Capital, the Federal Reserve's Bank of San Francisco's Portland Branch, Freshwater Trust, and B Corp/B LAB. He is a faculty member at the Kellogg School of Management at Northwestern University and the Stanford Graduate School of Business, and teaches on the topic of sustainability and finance. Dave received his BA from the University of California, Berkeley and his MM from the Kellogg School of Management at Northwestern University. He is co-owner of Patton Valley Vineyards, a sustainably farmed maker of Oregon Pinot Noir.

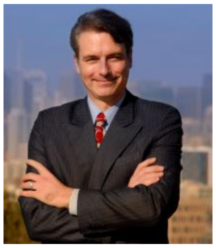
MICHAEL GARVEY
Former Manager, San Carlos, CA

Michael Garvey is the former city manager of San Carlos, CA. Garvey has more than thirty-nine years of experience in local government management. He currently serves as a project director for local agencies. His recent projects include: El Camino Real, a state highway that serves as the main urban arterial for the 19 cities between San Jose and Daly City, and the San Bruno Irrevocable Trust for disaster recovery. Garvey has a BS from Loyola University and an MPP from California State University, East Bay.

JOHN GOLDSTEIN

Imprint Capital Advisors

John Goldstein co-founded Imprint Capital Advisors in June 2007 to help foundations, families and financial institutions create and manage impact investing programs and portfolios. Imprint has worked with 8 of the 20 largest US foundations and has invested over $265 MM across mission areas and asset classes with dedicated research and investment capacity in education & learning; energy and environment; food, health & well-being; and vulnerable communities. Previously, Mr. Goldstein co-founded Medley Capital Management (MCM), a private investment firm. He also served as Senior Managing Director of Medley Global Advisors. During that time, Mr. Goldstein co-founded and served as the Executive Director of the Medley Institute. Prior to that, Mr. Goldstein was a management consultant at Andersen Consulting (now Accenture). Mr. Goldstein graduated from Yale University with honors. He was awarded the Richter Fellowship and the Townsend Prize. John has been an advisor or board member to a diverse set of organizations in the impact space including groups such as the Global Impact Investing Network (GIIN)/ImpactBase, the Global Social Venture Competition (GSVC), McKinsey's working group on Social Impact Bonds, Global Giving, the Sustainable Food Lab, the UN Capital Development Fund, the International Interfaith Investment Group, and a range of others.



R. PAUL HERMAN

HIP Investor

R. Paul Herman created the HIP (Human Impact + Profit) Scorecard and methodology for investors and their advisers in 2004. HIP annually scores 4000+ companies and 300+ issuers of bonds (munis, sovereigns, agencies) that quantify and value the unseen risks and undiscovered potential for enhanced financial performance. In addition to licensing the HIP Scores to investment management professionals for use with their funds, portfolios and clients, Herman is an investment adviser and wealth manager for individuals, families, family offices and foundations. He also manages the HIP portfolios and investment indexes, like the HIP 100 and HIP REITs. "The HIP Scorecard" investment approach is featured in his 2010 book (The HIP Investor; Make Bigger Profits by Building a Better World; John Wiley & Sons, Fast Company magazine, 18 business school curricula, and at www.HIPinvestor.com. Herman's financial acumen was honed at the Wharton School and McKinsey & Co., and he accelerated social entrepreneurs at Ashoka.org and Omidyar Network. Herman has also advised leading corporations (including Walmart and NIKE) on how to be more HIP. His insights have been quoted in the Wall Street Journal, The New York Times, Fortune, Forbes, BusinessWeek, and on CNN, Reuters, Morningstar.com and CNBC.

JESSICA MATTHEWS

Cambridge Associates

Jessica Matthews is associate director of the Mission-Related Investing (MRI) Group at Cambridge Associates. Jessica oversees and coordinates the activities of all MRI resources across the firm, including a team of generalist and research consultants and analysts. Jessica advises a variety of clients on their mission-related investment programs, including foundations, religious institutions, universities, and high-net worth families. She also works with various functional areas across the firm, including manager research, capital markets research and performance measurement. Previously, Jessica was an associate at Booz Allen Hamilton, specializing in transformation and change management for government clients in the financial services sector. She also worked in the investment office at the American Red Cross, with a focus on the alternatives assets portfolio, and in the global consultant relations group at BlackRock, where she cultivated and maintained relationships with investment consulting firms. Jessica began her career with Cambridge Associates as a consulting analyst. She graduated from the University of Virginia with a degree in government and a minor in economics.

NANCY PFUND

DBL Investors

Nancy Pfund is founder and managing partner of DBL Investors, a venture capital firm located in San Francisco, whose goal is to combine top-tier financial returns with meaningful social, economic and environmental returns in the regions in which it invests. Ms. Pfund currently sponsors or sits on the board of directors of several companies, including; SolarCity (NASDAQ: SCTY), Solaria, BrightSource Energy, Primus Power, Eco.logic Brands, EcoScraps, OPx Biotechnologies, Powergenix and, prior to their public offerings, Tesla Motors and Pandora Media. Originally a regional venture capital group within JPMorgan, DBL Investors spun out as an independent firm in January 2008. Ms. Pfund joined JPMorgan (then Hambrecht & Quist) in 1984 first as a securities analyst and then as a venture capital partner and managing director. Ms. Pfund also built and directed H&Q's external affairs and philanthropic programs from 1996 to 2001. In 1988, President Bush appointed Ms. Pfund as a charter member of the National Advisory Council for Environmental Policy and Technology. In 1999, Ms. Pfund was appointed by President Clinton to serve on the Congressional Web-Based Education Commission. Ms. Pfund is a member of the board of directors of the California Clean Energy Fund (CalCEF); member of the Advisory Board of the UC Davis Center for Energy Efficiency; member of the Advisory Council of the Bill Lane Center for the American West at Stanford University; member of the California STEM Learning Network board of directors; a C3E Ambassador to the U.S. Clean Energy Education and Empowerment Program, led by the U.S. Department of Energy in partnership with the MIT Energy Initiative; and is a founding officer and director of ABC^2, a foundation aimed at accelerating a cure for brain cancer. Ms. Pfund is the author, along with Benjamin Healey of the widely cited report on the history of U.S. energy subsidies entitled, *"What Would Jefferson Do? The Historical Role of Federal Subsidies in Shaping America's Energy Subsidies"* and co-authored with Michael Lazar, *"Red, White & Green: The True Colors of America's Clean Tech Jobs"*. Ms. Pfund received her BA and MA in anthropology from Stanford University, and her MBA from the Yale School of Management.

BRIAN PRATER

Low Income Investment Fund

Brian Prater is the senior vice president for strategic development and corporate affairs at the Low Income Investment Fund (LIIF). LIIF is a national Community Development Financial Institution (CDFI) based in San Francisco. LIIF is one of the largest affordable housing, education and childcare facility lenders in the country, and is a five-time recipient of New Market Tax Credit (NMTC) awards. Prater oversees LIIF's federal policy shop, national fundraising, communications, knowledge sharing, transit-oriented development (TOD) and innovation functions. Previously, Prater led LIIF's lending and program work in the Western Region, overseeing the San Francisco and Los Angeles offices, including all transactional work, TOD and green programs and state and regional policy. LIIF is partnering with Enterprise Community Partners to advance equitable TOD nationally, including program, planning, policy and transactional work. In March of 2013, Living Cities released a paper "Filling the Equitable TOD Financing Gap" that Prater and Melinda Pollack from Enterprise co-authored. Prior to joining LIIF in 2008, Prater was a senior vice president and team leader in community development banking with Bank of America in San Francisco, and was responsible for the Northern California and Nevada markets. Prater also spent seven years with the Local Initiatives Support Corporation (LISC), and three years with the New York City Housing Authority (NYCHA). Prater has masters' degrees from Columbia University (School of International and Public Affairs) and Syracuse University (S. I. Newhouse School), and a bachelor's degree from Illinois State University.

R. SEAN RANDOLPH

Bay Area Council Economic Institute

R. Sean Randolph, PhD is president & CEO of the Bay Area Council Economic Institute, a public-private partnership of business, labor, government and higher education that works to foster a competitive economy in California and the San Francisco Bay Area, including San Francisco, Oakland and Silicon Valley. Dr. Randolph previously served as president & CEO of the Bay Area Economic Forum, which merged with the Bay Area Council in January 2008, and as director of international trade for the State of California, where he developed trade strategy and directed international business programs to stimulate exports and introduce California companies to overseas markets. Before service with the state, he was Managing Director of the RSR Pacific Group, an international business consulting firm specializing in Asia and Latin America, and before that served as International Director General of the Pacific Basin Economic Council, a 15-nation international organization of leading U.S., Asian and Latin American corporations. His professional career includes extensive experience in the U.S. Government, including the U.S. Congress staff, and the White House staff. From 1981-85 he served in the U.S. State Department, as officer for Asia on the Policy Planning Staff, as Special Adviser for Policy in the Bureau of East Asian and Pacific Affairs, and as Deputy/Ambassador-at Large for Pacific Basin affairs. From 1985–88 he served as U.S. Deputy Assistant Secretary of Energy for International Affairs, managing nuclear non-proliferation, energy research, and global oil and gas issues. Dr. Randolph holds a JD from the Georgetown University Law Center, a PhD from the Fletcher School of Law and Diplomacy (Tufts and Harvard Universities), a BSFS from Georgetown's School of Foreign Service, and studied at the London School of Economics.

LISA RICHTER

GPS Capital Partners

Lisa Richter is co-founder and principal of GPS Capital Partners, a national consultancy that assists foundations and other institutions to design and execute impact investing strategy. GPS brings over two decades of fund management and investment due diligence experience, spanning asset classes, return expectations, geographies and issue areas, and frequently incorporating place-based or sector focus to increase equitable access to opportunity. Collectively, GPS network consultants have reviewed some $4 billion in impact investments and managed impact investment portfolios within foundations, community development financial institutions, equity funds, and banks. Clients range from small foundations to the nation's largest independent and community foundations, banks and institutional investors. Lisa authored the “Grantmakers In Health Guide to Impact Investing,” co-authored “Equity Advancing Equity,” a guide to community foundation impact investing, and co-designed the Mission Investors Exchange’s Mission Investing Institute, where she continues as a lead trainer. Lisa is a senior fellow with The Philanthropic Initiative, and serves or has served as a director or advisor to the Center for Community Development Investments of the Federal Reserve Bank of San Francisco, the Bank of America National Community Advisory Council, Dignity Health’s Community Investment Program, the American Journal of Preventative Medicine, the Community Development Financial Institutions Coalition, Social Investment Forum, and New Markets Tax Credit Coalition. She holds a BA and an MBA from the University of Chicago.

LIZ SESSLER

Enterprise Community Loan Fund

Liz Sessler is the senior investment marketing manager at Enterprise Community Loan Fund where she manages the Enterprise Community Impact Note. She works to promote impact investing in all of Enterprise’s markets and communicate the Loan Fund’s vision and social impact. Prior to joining Enterprise Liz served as the director of business development for Agora Partnerships. While at Agora she oversaw the organization’s fundraising and marketing efforts and spoke internationally on the role of small businesses in community development. Liz began her work in the impact investing space at Calvert Social Investment Foundation where she developed marketing materials around Calvert’s Community Investment Note. Liz graduated from the University of North Carolina at Chapel Hill with a BA in public policy analysis and has studied economics and music in Singapore and Vietnam on a Gardner Research Grant and Freeman Asia Grant.

MARK SUTTON

Northern California Community Loan Fund

Mark Sutton is a policy and program analyst for the Northern California Community Loan Fund (NCCLF). Prior to joining NCCLF, Mark worked as a research analyst at Impact Assets, a San Francisco-based impact investment firm. Mark has experience in the environmental markets, having worked with the San Francisco Carbon Collaborative and participating in the launch of the carbon market startup Ecoanalytics. He has also been active in sustainable economic development with Green Economy Think Tank, a non-profit that convenes sustainability leaders to catalyze ideas into action to grow the green economy. Mark holds an MBA in sustainable business management from Presidio Graduate School in San Francisco, and a BA in mathematics and music from Williams College in Williamstown, MA.

BEN THORNLEY

Pacific Community Ventures

Ben Thornley directs PCV InSight, the global research and consulting practice at Pacific Community Ventures (PCV) focused on scaling social impact investing. PCV is a San Francisco-based Community Development Financial Institution and growth equity manager deploying $60 million in three funds with the aim of creating quality jobs in low-income areas of California. Ben is responsible for PCV's policy research and impact evaluation initiatives, working with prominent institutions including the California Public Employees Retirement System (CalPERS), The Rockefeller Foundation, Citi, Omidyar Network, and The California Endowment. PCV InSight assesses the social and economic impacts of over $25 billion invested across asset classes. Prior to joining PCV, Ben worked for a decade documenting and advancing the role of financial services in economic development. This included as New York correspondent for a leading Australian business journal, as a program coordinator with the United Nations Association of the USA, responsible for engaging Wall Street in the UN's Financing for Development conference, and as an investment director in the Australian Consulate-General, New York, charged with positioning Australia as a regional financial services center. Ben sits on the strategy and adoption committee of the Impact Reporting and Investment Standards and holds a Masters of Public Policy from the University of California at Berkeley, where he taught graduate and undergraduate classes in political economy and leadership with former US Secretary of Labor, Robert Reich.

SCOTT TURNER
Federal Reserve Bank of San Francisco

Scott Turner is Vice President and oversees the Community Development and Economic Education Departments in the Federal Reserve Bank of San Francisco. Scott joined the Bank in 2002 with diverse experience in areas such as municipal and international finance, housing policy and research, and sovereign risk assessment. A Seattle native, Scott spent most of his professional life in New York City, divided equally between the public and private sectors. His public sector experience includes positions as Director of Research in New York City's Finance Department and Deputy Commissioner for Policy in the City's Department of Housing Preservation and Development. His private sector positions were Senior Analyst in the International Finance Department at Standard & Poor's and Executive Director of the Sovereign Risk Group at Morgan Stanley. Scott has a Bachelor of Arts degree in Political Science and a Master of Public Policy degree from UC Berkeley.

GEORGETTE WONG
Correlation Consulting

Georgette Wong is the CEO of Correlation Consulting and Take Action! The Impact Investing Summit. She is a recognized leader in impact investing, with a focus on asset owners interested in premium financial returns and moving beyond talk to action. Her 2012 gathering brought together families, foundations, corporations, government entities, pension plans and other investors managing more than a combined $4.5 trillion in assets. Since Take Action's founding in 2007, she has helped catalyze at least $325 million in new commitments to impact investing. Georgette advises foundations, families, corporations, and government entities on building and strengthening their impact investing programs. She released Insights & Innovations: A Global Study of Impact Investing + Institutional Investors at the US State Department in April 2012. Georgette earned her MBA from UCLA's Anderson School of Management and her BA from Amherst College.

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RECOMMENDED READING

Executive Summaries

Impact at Scale: Policy Innovation for Institutional Investment with Social and Environmental Benefit

February, 2012

David Wood, Harvard University
Ben Thornley, Pacific Community Ventures
Katie Grace

Insights and Innovations: A Global Study of Impact Investing and Institutional Investors

April, 2012

Georgette Wong, Correlation Consulting

Impact Investing for Small, Place-Based Fiduciaries: The Research Study Initiated by the United Way of the Bay Area

December, 2012

Lauryn Agnew, Seal Cove Financial

Impact at Scale

POLICY INNOVATION FOR INSTITUTIONAL INVESTMENT WITH SOCIAL AND ENVIRONMENTAL BENEFIT

INSIGHT AT PACIFIC COMMUNITY VENTURES
& THE INITIATIVE FOR RESPONSIBLE INVESTMENT
AT HARVARD UNIVERSITY

FEBRUARY 2012

Supported by THE ROCKEFELLER FOUNDATION

1. EXECUTIVE SUMMARY

Impact Investment – investment with the intent to create measurable social or environmental benefit in addition to financial return - has received increasing attention in recent years. This includes interest from policymakers drawn by both the promise of leveraging private capital to support public purpose and the opportunity to make better use of scarce resources to support important social benefits.

Institutional Asset Owners – such as pension funds, endowments, and insurers – are an especially important category of current and prospective impact investor, even if they are not familiar or do not self-identify with the term "impact investing." With total assets of over $20 trillion, these anchor investors play a fundamental role in the domestic U.S. and world capital markets. For advocates of impact investing, engagement of institutional asset owners is one key to growing markets that create measurable social and environmental benefits. Institutional asset owners can also help legitimize the field for asset management intermediaries, consultants, lawyers, and other service providers.

But institutional asset owners face specific legal requirements and a distinct investment culture that often constrain their ability to invest with impact. These barriers must be taken into account for the institutional role in impact investing to grow beyond the current limited activity, and careful coordination between policymakers and institutional investors will be essential in building private investment markets that deliver positive social impact.

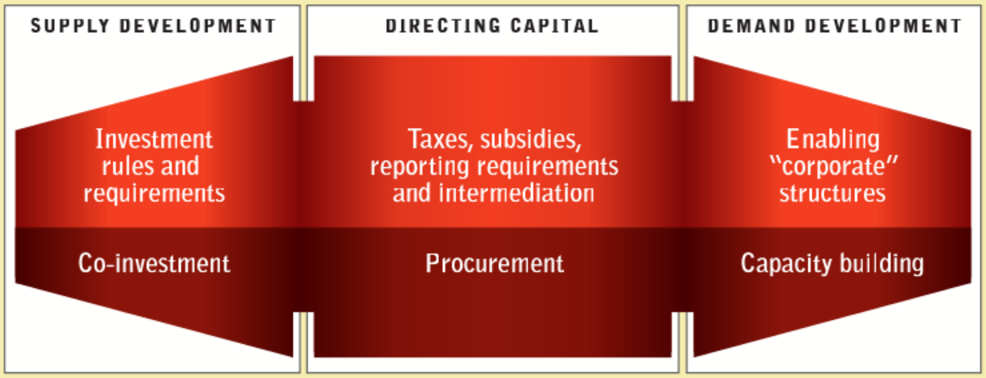
The Culture and Practice of Institutional Asset Owners

When making investments, institutional asset owners follow the conventions of fiduciary duty and portfolio management, as well as the institutional structures that design and implement investment strategies. Such conventions include diversified portfolios, standardized forms of investment that exist at scale, benchmarks that determine how the broader market evaluates products, and, especially in recent years, relatively short time horizons for evaluating investment performance.

In practice, institutional asset owners share a similar approach to impact investing, acknowledging that all investments – whether impact is a consideration or not – meet the legal requirements, due diligence processes, and standard asset class-specific benchmarks for expected financial risk and return. These investments are also typically consistent with the services and product offerings supplied to the institution by its third-party advisors.

Environmental and social targets are rarely acknowledged explicitly as part of the institutional investment framework. From the perspective of institutional asset owners, impact investing – as an emerging field of investments with occasionally unconventional goals or value propositions – may look idiosyncratic, too small, or too new.

POLICY FRAMEWORK



At the same time, an existing track record of institutional investment with explicit non-financial intent can offer policymakers a history on which to draw. Various terminologies are used to describe these activities, from "responsible investment" and "Environmental, Social, and Governance (ESG) integration" to "economically targeted investing."

We can point to two practices in particular that have shaped institutional investor participation in impact investing:

- Discrete targeting of ancillary social and environmental benefits within the context of investment products that otherwise resemble one another; and
- The incorporation of ESG analysis on the belief that long-term financial performance is linked to positive social and environmental performance that mitigates risk and identifies opportunities often not reflected in short-term investment analysis.
- The range of institutional investment practices that target economic development, underserved communities, job creation, and environmental sustainability – often driven by public policies – offers a substantial base on which to build impact investing policy engagement.

A Policy Lens on Institutional Impact Investment

The public policy lens can provide a useful tool for examining institutional impact investing as the availability of capital from asset owners is closely tied to the public policy environment. For example, interpretations of fiduciary duty, defined by policy, can constrain investment by limiting real or perceived opportunities. But public policy can also encourage investment by supporting, for instance, tax credits that leverage private capital for investment in underserved communities or by creating investment opportunities that subsidize business enterprises delivering defined social benefits.

Our initial work on the role of government in impact investing, *Impact Investing: A Framework for Policy Design and Analysis*, described policy as intervening in three places: the supply of capital for impact investing; the demand for impact investing capital and availability of investment opportunities; and in directing existing capital toward investments with social benefit.

We can view these policies through a framework that identifies where government intervenes to shape investment outcomes.

- **ON THE SUPPLY SIDE,** policies can direct how institutional asset owners can or should invest capital, setting the regulatory framework that governs investment decisions. Policies may also create co-investment opportunities that lend government credibility and security to impact investment.
- Policies that **DIRECT CAPITAL** operate at the product or transaction level (i.e. at the "point of sale"), influencing markets primarily through incentives like tax credits and subsidies for industries and sectors that meet specific impact goals. Impact areas can include affordable housing, energy efficiency, transit-oriented development, urban or rural regeneration, health and wellness, and education. Other policies may mandate performance floors, like green building regulations or inclusionary zoning laws for affordable housing. Still others provide a related procurement preference. Policies that mandate transparency and reporting requirements are also included here.

MODEL FOR POLICY ENGAGEMENT

POLICY STRATEGY	POLICY PROBLEM	USER FOCUS	EXAMPLES
ENABLING	Markets of interest are small and unconventional	INVESTORS	> Credit guarantees > Safe harbor provision
INTEGRATIVE	Asset owners have limited capacity for or limited interest in impact investing	INTERMEDIARIES	> Performance standards > Tax credits
DEVELOPMENTAL	No functioning market for impacts of interests	INFRASTRUCTURE	> R&D > Technical assistance > Convening

▶ **ON THE DEMAND SIDE,** policies can boost investment opportunities through the development of sound, investable companies, projects, and intermediaries. These policies can help develop or grow impact-related industries through technical assistance, pilot projects or other supporting efforts. They can make existing investment products more financially attractive through credit guarantees. Or they may help identify institutions that create social benefits through certification systems. These policies also help to communicate the existence and suitability of impact investing opportunities.

The policy lens can help public officials, advocates, investors and other stakeholders identify potential interventions that balance the needs of institutional asset owners – for scale, comparability, and comfort – while ensuring the delivery of social and environmental benefits.

A Model for Policy Engagement

Our research suggests that it may be useful to think of three key strategies for using policy to catalyze institutional impact investment:

1. ENABLING: By making impact markets investable, policy can help deliver the impact objectives institutional asset owners care most about. Enabling policies primarily address the challenge of small, untested, or unconventional markets where the impacts are of interest to institutions. These policies focus primarily on investors themselves and would establish guarantees to reduce risk in unconventional markets or fiduciary safe harbor provisions that assure investment decisions are legally defensible;

2. INTEGRATIVE: By adding an impact element to traditional markets, policy can expand the universe of impact nvestments suitable for institutional asset owners. Integrative policies primarily address the challenges of insufficient opportunities for investors to deploy capital for ancillary social and/or environmental benefit, and the lack of interest or capacity on the part of investors. Integrative policies target established intermediaries and would provide performance standards mandating social and environmental criteria, like green building standards, or tax credits to bolster the risk/return characteristics of investments; and

3. **DEVELOPMENTAL:** By developing market ideas and infrastructure, policy can build a pipeline of future impact investing opportunities for institutional asset owners. A developmental strategy is needed when markets are undeveloped or non-existent but impacts might be of interest moving forward. Developmental policies generally target the underlying infrastructure of nascent markets through support for research, technical assistance for prospective investees and their service providers, and convening key stakeholders to facilitate knowledge sharing.

As with all government interventions in impact investing, a balance must be struck between a policy's fidelity to an explicit public purpose and the risk that the intervention does more harm than good. To serve the public interest, government must ensure the policy is well targeted, transparent, and implemented efficiently at the appropriate scale and for the right duration.

Policies should also be designed not to reduce effective private investment or become subject to regulatory capture. In preparing to reform policy, government should ensure these questions are answered by engaging key stakeholders in the process and coordinating with other policies and agencies of interest.

Current practice and an evolving understanding of long-term value creation demonstrate a growing willingness and capacity on the part of institutional asset owners to seek social and environmental value through investments. Public policy can build on this practice to support institutional impact investing at scale.

APRIL 2012

INSIGHTS AND INNOVATIONS

A Global Study of Impact Investing + Institutional Investors

PREPARED BY

correlation

TakeAction! 2012
The Impact Investing Summit
May 22–23, 2012 The Julia Morgan Ballroom San Francisco, California

PREPARED FOR

The Secretary's Global Impact Economy Forum 2012
Investment, Innovation & Impact

WITH MAJOR SUPPORT FROM

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I. EXECUTIVE SUMMARY

At a time when the world is facing challenges such as climate change, a rapidly growing population, food and water shortages, widespread unemployment, and poverty, investments can be part of the solution. Often called "impact investments," these investments aim to generate financial returns while also creating measurable social and environmental benefits to address some of the world's most pressing challenges.

Interest in impact investing has grown during the past few years. Has the interest moved beyond talk to action? Are capital commitments to impact investment programs growing?

In 2011, Correlation Consulting commissioned a study to assess the current impact investing practices of the world's foremost institutional and institutional-sized asset owners—pension plans, corporations, foundations, ultra-high-net-worth individuals and families, and development finance institutions. Participating asset owners, representing more than $2.5 trillion of combined assets, were asked about their current and pending impact investments, and how they source and perform due diligence.

In this report, asset owners provide: insight into their impact investing activities, case studies that can be used as successful models, and tips for those investors just starting with impact investment programs.

This report focuses on those impact investments that create or expect to create a return of capital and competitive, market-rate and premium (above-market-rate) financial returns.

Asset owners are defined as those pension plans, corporations, ultra-high-net-worth individuals or families, foundations and development finance institutions who directly control and allocate capital to managers of funds, funds of funds, or management teams of individual companies. Asset owners control large financial assets, and as such, have great influence. Their opinions matter profoundly to the investment consultants and product creators who are, or who hope to, serve them. In this position, asset owners have the power to shape markets.

Designed to provide pragmatic guidance, this study is written primarily for asset owners, either those who are looking to understand the field of impact investing with the goal of possibly putting capital to work, or current practitioners looking to expand their impact investing programs. A secondary goal is to provide useful information for those who work alongside asset owners—investment consultants, financial advisors, philanthropic advisors, asset managers and others.

IMPACT INVESTING DEFINED

Impact investments aim to generate financial returns while also creating measurable social and environmental benefit to address some of the world's most pressing challenges. Impact investments span all asset classes, issue areas and geographies. They go beyond environmental, social and governance (ESG) models and responsible investments to fully integrate social, environmental and developmental objectives into the fabric of investing. These objectives may be stated publicly or left unspoken.

Impact investing combines sensible investing and positive social and environmental change. Investing for social good does not necessarily lead to nancial loss. Impact investing differs from philanthropy because there are expectations of nancial return.

We do not incorporate social and environmental considerations just for feel-good reasons. We see a great opportunity and we invest in it, says one pension fund executive surveyed.

Like other investments including ESG, socially responsible investing (SRI)), triple-bottom-line investing and long-term investing impact investments are measured by the standard investment parameters of risk and nancial return. They add, however, an expectation of measurable social and/or environmental bene t.

Traditionally, solutions to challenges such as poverty alleviation, job creation and climate change have been the realm of philanthropy, nonpro t organizations, and government. Over the last few decades, however, businesses have shown that they can create tremendous social value as well as strong nancial returns. In addition, the world's greatest problems cannot be solved solely through grant dollars, government funding or policy initiatives. Business and investments bring a different approach to problem solving as well as enormous amounts of capital. As such, they have an important role to play.

The full extent of investment opportunities in impact investing is dif cult to quantify. JP Morgan and the Global Impact Investing Network's December 2011 report[1] states that a combination of 52 asset owners and asset managers plan to invest $3.8 billion in the 12 months following the survey, and most expect that 5-10 percent of overall portfolios will be allocated to impact investments in ten years. In their 2010 report[2], JP Morgan and the Rockefeller Foundation estimated that assets under management through impact investment strategies were $50 billion with projections of between $400 billion and $1 trillion and pro t opportunity of between $183 billion and $667 billion over the next decade..

In addition, opportunities for impact investing are enormous if one considers projected needs: $1.3 trillion to halve greenhouse emissions from the energy sector by 2050[3], $41 trillion to modernize global infrastructure by 2030[4], and $5 trillion[5] to reach 4 billion people in the global consumer market.

KEY FINDINGS

Institutional asset owners pension plans, corporations, high-net-worth individuals, foundations and development nance institutions are committing assets. They are expecting and are achieving market-rate and premium returns. They are making investments across all asset classes from debt to equity, in a variety of structures and were addressing a variety of social and environmental themes. Only investments with solid nancials and strong mission are being considered.

[1] Insight into the Impact Investing Market, JP Morgan/Global Impact Investing Network, Dec 2011: http://www.thegiin.org/cgi-bin/iowa/download?row=334&field=gated_download_1,
[2] Impact Investments: An Emerging Asset Class, JP Morgan, The Rockefeller Foundation & Global Impact Investing Network, Nov 2010: http://www.jpmorgan.com/pages/jpmorgan/investbk/research/impactinvestments
[3] Deutsche Bank Investing in Climate Change 2011: http://www.altassets.com/pdfs/deutsche_bank_climate_feb2011.pdf
[4] UNEP Financing Global Deal on Climate Change: http://www.unepfi.org/fileadmin/documents/FinancingGlobalDealExecutiveSummary.pdf
[5] World Resources Institute, The Next 4 Billion: http://www.wri.org/publication/the-next-4-billion

IMPACT INVESTMENTS: A SAMPLE

When asked about their impact investments, our interview participants named the following funds and direct investments. Please note that these are viewed as having impact by the investors, and that the investments themselves may or may not identify themselves as impact investments. This list is a sample and is not meant to be exhaustive or comprehensive.

Asset Class	Investment Firm or Investment Name	Issue Area
Fixed Income	Blue Orchard Finance	Poverty, access to financial services
	MicroVest Short Duration Fund	Financial services for the working poor
Public Equities	Carbon Aware International Shares Fund	Created by VicSuper, an Australian superannuation fund (de ned contribution plan) to actively reduce the carbon exposure of its listed equities
	Generation Investment Management Climate Solutions	Climate change, low-carbon economy
	LGA (Light Green Advisors)	Environmental sustainability
Venture Capital	SJF Ventures III, L.P.	Quality employment and environment improvement driven by high growth, positive impact companies
	Emerald Cleantech	Natural resources conservation and environmental sustainability
Private Equity	Bamboo Finance Oasis Fund & Bamboo Finance BOPE Fund	Providing access to quality healthcare, energy, agriculture, nancial services, housing, education and water to low-income populations
	Kilter Pty Ltd.	Environmental sustainability
	Sarona Asset Management Inc.	Economic Development through direct small and medium enterprise (SME) investment funds and private equity funds-of-funds
Real Assets	Carrus Land Systems	Improve ecological outcomes of ranching industry on a large scale
	Conservation Forestry	Align private equity with conservation capital for the purpose of acquiring and managing large forest landscapes
	TimberVest	Risk-adjusted returns with low correlation to other asset classes, never at the cost of environmental degradation or unsustainable forestry management
Alternatives	SNS Institutional Micro nance Fund II	Micro nance
	OikoCredit	Access to nance
	GroFin Pan African Fund	Access to nance
	ProCredit Holdings	Access to nance

Sources: TriLinc Global and Morgan Stanley

BAMBOO FINANCE OASIS FUND AND BAMBOO FINANCE BOPE FUND	
Asset Class	Private equity
Inception Date	Both funds were started in 2007
Issue Area	Providing access to quality healthcare, energy, agriculture, nancial services, housing, education, and water to low-income populations
Description	The Bamboo Finance Oasis Fund invests in growth-stage companies with capital ef cient and scalable distribution models that provide goods and services to directly bene t low-income communities. The Bamboo Finance BOPE fund invests in a range of micro nance institutions and funds worldwide.
Domicile	Geneva, Switzerland
Regional Focus	Global: Latin America, Asia, Eastern Europe, and Africa
Total Assets Under Management (AUM)	Bamboo Finance Oasis Fund: $53 million Bamboo Finance BOPE Fund: $195 million
Track Record	Bamboo Finance Private Equity Group has made more than 35 private equity investments in over 20 countries and in diverse sectors. The rst exit yielded a 23% IRR.
Representative Clients	Development nance institutions, European and Asian-based family foundations, Middle East family of ces, sovereign wealth funds
Sector Focus	Affordable housing, healthcare, education, energy, livelihood opportunities, water, sanitation, and micro nance institutions and funds
For more information	www.bamboo nance.com

Source: Bamboo Finance

MICROVEST SHORT DURATION FUND	
Asset Class	Fixed Income
Inception Date	September 2010
Issue Area	Financial services for the working poor
Description	The Fund is designed for investors seeking monthly liquidity, risk adjusted returns above LIBOR, exposure to emerging markets, portfolio diversi cation and development impact. The Fund investment objective is to address demand for short-term nancing from institutions that provide nancial services to the working poor in emerging markets. It aims to achieve this by buying debt instruments and term deposits of low-income nance institutions (LIFIs), which include micro nance institutions (MFIs).
Domicile	U.S. Master Fund, Cayman Feeder Fund
Regional Focus	Global
Total Assets Under Management (AUM)	Fund AUM: $33.7 million (March 2012) Firm AUM: $126 million (Dec 2011)
Track Record	Inception to date returns (Sep 2010-Mar 2012): Tranche A 4.7%, Tranche B 5.7% 2011 annual returns: Tranche A 4.1%, Tranche B 4.7% Tranche A = Monthly liquidity with 30 days notice; no lock-up Tranche B = Annual liquidity with 90 days notice after an initial two year lock-up
Representative Clients	Calvert Foundation, MEDA, Swift Foundation. Fund is limited to Quali ed Purchasers
Sector Focus	Low-Income Finance Institutions (LIFIs)
For more information	www.microvestfund.com

Source: MicroVest

There are at least three distinct motivations for impact investing. Depending upon the priorities and requirements of the institution, investors may use one as a predominant approach or all three approaches below.

Investment First: The aim is for market-rate and premium returns in order to create long-term nancial stability. Creation of social and environmental good is important, but the alignment with duciary responsibility and traditional portfolio management is preeminent.

Impact First: The aim is to create stated social or environmental goals. Financial returns are important in order to achieve long-term impact. Without nancial stability and at least a return of capital, these long-term objectives may be compromised. In some cases, these nancial returns have been market-rate or higher, but the primary reason these investors committed capital is social or environmental bene t.

Catalyst First: With this approach, investors actively look to bring together nancial return and social and environmental bene t. They see these as intrinsically linked, often with the social and environmental bene t as the driver of nancial returns. Many of the participants told us that they value the catalytic role their capital can play, whether seeding investments in underserved markets, leveraging additional dollars or transforming ecosystems and capital markets.

Despite different priorities, these investors shared a few characteristics. They are all seeking nancial returns on their impact investments, with most categorizing their realized returns (and return expectations) as either market-rate or above-market-rate. Despite the achievement of competitive returns, asset owners acknowledge these are early days for impact investing. Investors are reluctant to buy into the hype or create more hype around impact investing. While investors externally position these investments as return of capital and risk-mitigation, their internal expectations are for competitive or above-market-rate returns. They recognize that their investments serve as demonstration projects, and success may be able to catalyze the ow of additional capital. Therefore the business case for and the management teams of the investments must be solid. Notably, none of the study's participants planned to reduce the size or number of impact investments they make.

Asset owners say there is more available capital than the number and size of high-quality investments. They would put more capital to work if they were able to nd high-quality investments. As the eld grows, they view the dearth of talent of investment managers, investment consultants and entrepreneurs as the major obstacle to the growth of impact investing.

As one investment rm told us, impact investing is a way to go beyond Wall Street returns and takes a long-term investment view:

> The management teams that have taken a longer-term view of the markets in which they're operating are pro t optimizers, not pro t maximizers. Instead of raising the pro ts high over two years with a Wall Street mentality, they raise them for the long term. We look for co-investors and management teams that believe in this.
>
> Privately owned investment rm

Five types of asset owners were studied; below is a summary of our ndings:

Pension funds. The nancial returns range from positive to premium. Most internally position these as return of capital and risk-mitigation. Over the next ve years none of the pension funds expected their allocations to impact investing programs to decline, but to stay steady, double or triple.

Corporations. They seek qualitative bene ts that result from impact investing: enhanced reputation and brand, competitive bene ts, as well as more effective development and management of supply chains. In the corporate world, common impact investing drivers include developing new markets; managing supply chains; and customer, employee, shareholder, government, and/or NGO pressure.

High-net-worth individuals and family of ces. Their investment strategy is based upon their ability to take risks. The risk they take for traditional investment dollars differs from the risk they are willing to take with their philanthropic portfolio. Yet, most say it is important to manage impact investments as if they were traditional (nancial returns only) investments, especially the direct impact investments into so-called social enterprises.

Foundations. These investors use their endowments and grants to break down barriers and address basic social and environmental challenges. These early adopters and proponents of impact investing tend to focus on the bene cial outcomes of impact investments, including their nancial returns, as models for traditional investors with pro t motives. They also aim to create an ecosystem and investments that will catalyze additional capital to create long-term change.

Development Finance Institutions. DFIs are typically backed by nations with developed economies and aim to be rst movers in engendering private capital to impact investment areas. They often partner with other capital providers, and solicit the support of local regulatory and capital markets to scale the bene ts of stimulating entrepreneurship, economic growth, and job creation. DFIs aim to invest in a commercially sustainable manner that demonstrates nancial success.

CASE STUDIES

Six in-depth case studies of impact investments were included in this report. They are summarized below.

s PGGM, a leading Dutch pension fund service provider managing around 114 billion, is beginning to measure the social, economic and environmental impacts of its targeted ESG investments, which are approximately 4.7 billion (as of year end 2011). PGGM has seen an increase in interest from its pension fund clients, who want to not only safeguard their investments, but to use them to increase sustainability in the world. The aim of this project is to have a complete picture of both the positive and negative impacts of its portfolio and predominantly covers mainstream private investments. Key themes include renewable energy, clean tech, micro nance and sustainable forestry. All investments in the targeted ESG portfolio meet PGGM's standards of duciary investment.

- Intel Capital, the venture capital arm of the world's largest semiconductor company, makes equity investments in innovative technology start-ups and companies worldwide in support of Intel's strategic objectives. In June 2007, Intel Capital co-led the Series A investment with the International Finance Corporation (IFC) in Financial Inclusion Network and Operations (FINO), the market leader in delivering banking products and services to the base of the economic pyramid in India. In June 2011, Blackstone Advisors India and another party nanced FINO's entire Series C round of Rs 150 Crores (approximately US$ 33 million). Intel Capital does not disclose nancial outcomes but did note this investment was made based on nancial merits alone. The growth of FINO has allowed low-income people in India to participate much more in the nancial economy, directly impacting standard of living and nancial literacy.

- Virgin Unite is the not-for-pro t foundation of the Virgin Group, founded by Sir Richard Branson. Virgin Unite created the Carbon War Room (CWR), an independent non-pro t entity, to address one of the largest threats to our planet today: the over 50 billion tons of human-generated CO2 emitted each year. In late 2011, the CWR announced The Green Capital Global Challenge, which seeks to unlock the multi-billion dollar building retro t market. In bringing together a business consortium (Ygrene Energy Fund, Lockheed Martin, Barclays Bank, Energi and Hannover Re) that will invest up to $650 million, the Carbon War Room aims to decrease greenhouse gases by at least 1 billion tons, potentially stimulate billions of dollars in economic activity and create thousands of new jobs in renewable energy and energy ef ciency technologies in the U.S. For the investor purchasing these loans, the upgrade loans typically will carry interest rates of 10-year U.S. Treasury plus 3.75% for up to 20 years.

- James Chen, CEO of Legacy Advisors Ltd. (Hong Kong), a family of ce, and Chair of the Chen Yet-Sen Family Foundation, provided seed capital to build a specialty cardiovascular hospital in China. Cardiovascular disease is the leading cause of death in China, due to changes in lifestyle, rapid economic growth and an increase in life expectancy. The objectives of the investment are to: 1) create better patient care with an emphasis on cardiology and lifestyle, to prevent and treat cardiac disease; and, 2) increase the supply of doctors who can ably address the increase of cardiovascular disease. $3 million in seed funds catalyzed $58 million in institutional equity. Projected returns are 5-7x for the seed round and 3-5x for the institutional round.

- The DOEN Foundation (Netherlands) started examining concepts that would enable the Dutch residential market to take a quantum leap forward in ghting climate change in 2009. DOEN Foundation ultimately purchased Qurrent Renewable Energy in May 2011 and believes the company can create a one stop shop solution for residential customers. The new company aims to make it easy for residential customers to choose options that ght climate change and that are nancially viable. The end goal for customers is to generate as much of their own electricity and save on consumption as much as possible, thus decreasing their costs. The DOEN Foundation believes that the enterprise will be self-sustaining and deliver a return before all the 13.5 million capital is invested. DOEN aims to recoup the investment in full plus a return that will enable it to reinvest and expand the company.

- CDC Group, plc, the UK's Development Finance Institution managing 2.3 billion, identi ed and addressed a market gap to create a sustainable forestry fund in sub-Saharan Africa in 2008. Following a request for proposal, CDC identi ed Global Environment Fund (GEF) as a fund manager with existing expertise in emerging markets forestry investments. With a seed commitment of $50 million, CDC catalyzed the GEF Africa Sustainable Forestry Fund (ASFF), which managed a total of $160 million as of the end of 2011. This fund is expected to produce high single-digit to low-teens returns over its 12-year term, consistent with risk-adjusted returns for the forestry sector in emerging markets. Social and environmental impacts include: biodiversity conservation, carbon sequestration; increase in jobs; and rural community development impact. The ASFF story is a good example of how a robust approach and strong reputation can catalyze other investors to commit capital to an underinvested market.

BEST PRACTICES

Current best practices across these approaches include: maintaining strict due diligence standards, adding to traditional investment practice and processes to accommodate impact investments, being adaptable and patient with these new forms of investment, and being aware of potential market distortion that occurs as a result of having some investors primarily motivated by nancial returns and other investors motivated primarily by social and environmental impacts interested in the same opportunities.

THE GROWTH OF IMPACT INVESTING

Investors said the top barrier to the growth of impact investing has been the lack of high-quality investment opportunities. Asset owners provided the following recommendations to accelerate the growth of impact investing and to ensure the best chance of long-term success as an industry. First, increase the talent pool of investment professionals who know how to invest pro tably at scale and who also understand how social and environmental factors can drive nancial performance. Our participants stated that more talent is needed within fund management teams, entrepreneurial teams and wealth management teams. Second, collaboration is essential for nding quality deal ow, sharing knowledge, increasing learning, and developing new investment vehicles. Third, leverage knowledge gained in one area of impact investing to make additional investments for impact. Fourth, do not hype the early success of impact investing, as these investments have not yet gone through a full investment cycle. Our participants believe that it is better to perform then discuss results rather than to increase expectations before a track record is proven. Fifth, our participants advise not waiting for perfect metrics on social and environmental impacts to invest, but to support the advancement of standards where possible.

CONCLUSION

The interviews with 51 institutional asset owners with a combined $2.5 trillion in assets made it clear that impact investing is on the rise. The breadth and depth of activities in impact investing, even if our interview subjects did not use those terms, was great. Our interview participants recognized that these are early days for impact investing. As such, they recognize that their investments serve as demonstration projects; they remain humble about their investments and often will not publicly discuss them.

As impact investing expands, Correlation agrees with our interview subjects that it is in the best interest of the eld to keep its de nition broad, as this allows more people to participate using all investment approaches, including debt and equity vehicles, public and private investments and corporate governance, shareholder action and proxy voting. A broad de nition also creates the opportunity to understand which innovative investment approaches are effective in addressing today's social and environmental challenges.

Impact investing is beginning to break out into the mainstream as an accepted investment approach and is at a critical juncture. In order for impact investing to reach its potential, the needs and interests of investors must be addressed.

- For those investment- rst investors ful lling their duciary duty, the easiest way to increase adoption of impact investing is for the investments themselves to meet the same risk/return pro les of traditional investments. The investment rigor must be as high, and the messaging of the investments must be similar so that the products are easily understood Social and environmental value, while important, is relevant only as it relates to the underlying investment thesis and the creation of competitive nancial returns.

- For impact- rst investors, the creation of new vehicles will predominate to address previously unmet social and environmental needs. This is particularly where the most creative talent both new thinking as well as those who have substantial track records for sustained nancial innovation can coexist.

- For catalyst- rst investors, the merging of standard nancial practices must be tied to social and environmental value creation. The first way to address this is to highlight examples of successful investments. In doing so, the industry will begin to emulate them. Yet the broader policy, accounting and legal structures in which these investments work must also be changed.

Many key questions remain to be answered as the eld of impact investing matures. On the level of investments, how can we match supply and demand? What products do asset owners nd so compelling that they will commit capital? How will we know which investments are effective? On a systems level, will policy, accounting and legal structures change to accurately value those environmental and social assets not yet accounted for? And how does one reconcile the current capital markets, which make money on the scarcity of information, with incentive structures that reward increased collaboration towards solving global issues?

Ultimately, Correlation believes that the discipline of impact investing will become an established and accepted investment approach when it can be shown that financial outperformance is the result of positive social and environmental consideration and excellent execution. As impact investing becomes more viable and examples show its potential, the three types of investors will commit their capital while realigning the market. Breakthroughs will also come when investors realize the various roles they can play in the ecosystem and begin to collaborate with others — leveraging one another's strengths and compensating for their weaknesses.

Where does an interested investor start?

1. Be clear about priorities and objectives — financial, social and environmental. This is the most important step in impact investing: a clear definition enables a clear measurement of success. How do you and your organization balance financial returns against risk against social and environmental benefits? How will you and your organization define success?

2. Define the tools available to you and your organization. Are you able to make an allocation to particular asset classes of traditional investment capital? If you are a foundation or a high-net-worth individual, can you also access grant- and program-related investment dollars? If you need tools or skill sets not yet present in your organization, where can you partner? There are a great number of investors who are ready to share their knowledge with you.

3. Pick strategies that are easy to implement and give you the best chance of success. Early successes build momentum and goodwill, and can make it easier to commit more capital in the future.

In this field, all asset owners have the chance to address their requirements, be they financial return, social and environmental impact or changing market dynamics. At its core, impact investing is about smart investing — addressing the financial bottom line and creating change.

At a time when the world is facing daunting challenges — climate change, rapid population growth, food and water shortages, widespread unemployment, and poverty — impact investing can be an integral part of the solution. ▼

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Impact Investing for Small, Place-Based Fiduciaries: The Research Study Initiated by the United Way of the Bay Area

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CENTER FOR COMMUNITY DEVELOPMENT INVESTMENTS

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Impact Investing for Small, Place-Based Fiduciaries:

The Research Study Initiated by the United Way of the Bay Area

Impact Investing is a strategy that intentionally aligns the investments of an organization with its mission, achieving both a prudent financial return *and* a positive impact on the mission.

As a fiduciary for non-profit and public funds for many years, and as an investment professional, I became intrigued with the question of how one could adopt an investment strategy that could align with an organization's mission while adhering to traditional fiduciary standards. In my case, the United Way of the Bay Area offered an opportunity to research and develop a potential investment process and possible structure for its endowment fund that would align with its mission to reduce poverty in the Bay Area.

Most fiduciaries of institutional funds (public defined benefit plans, endowment funds and quasi-private/public foundations) have been reluctant to adopt Impact Investing, Socially Responsible Investing (SRI) or Environmental, Social and Governance (ESG) factors in their investment policies and philosophies, for many reasons. Primarily, such social impact factors are deemed to be limiting to the opportunity set of investments and therefore imply a financial return that is potentially sub-standard. As fiduciary duty interpretations have evolved over the years, current practices seem to dictate a sole focus on achieving a maximum rate of (risk-adjusted) return without any regard to the social or environmental externalities in the world today. Resource scarcity, such as energy or water, or other limits to growth, and the consequences of climate change, are risks in our future that are not incorporated into standard Modern Portfolio Theory and Capital Asset Pricing Models, which base risk model factors (correlations) on historical asset class relationships.

Nonetheless, current practices of fiduciary standards today would consider creating portfolios that would incorporate ESG factors or positive social impact intentions in addition to prudent financial returns *only* if they can be shown to be 'economically indistinguishable' from traditional investment opportunities as measured against standard (backward-looking) benchmarks. Therefore, we will apply this more narrow interpretation and consider only investments that do not suggest a sacrifice in expected returns.

We were challenged to identify if and how a model portfolio could be built for a small, place-based endowment fund, like that of the United Way of the Bay Area (UWBA) and whether our stock and bond investments could be aligned with our mission to reduce poverty in the San Francisco Bay Area, without deviating from our fiduciary responsibilities. The Ad Hoc Committee, consisting of some senior staff and members of the board and investment committee, undertook the challenge to create a process that (1) would identify appropriate investments, (2) design a model portfolio, (3) test that portfolio against current financial theory, traditional metrics of risk and return expectations and traditional diversification standards, (4) seek alignment with the long term goals and objectives of the organization, and (5) meet our fiduciary duty as defined by UPMIFA (Uniform Prudent Management of Institutional Funds Act) and Prudent Investing standards.

Impact Investing

Impact Investors can be classified into three main categories: Impact First (primarily seeking to maximize impact while secondarily expecting financial returns, if any, i.e., the grant); Investment First (fiduciaries primarily seeking market-rate or premium returns and secondarily (if at all) seeking a positive social or environmental impact); and Catalyst First (seeking to give or invest to collaborate to build the Impact Investing industry and infrastructure).

Traditionally, Socially Responsible Investing (SRI) strategies were based on actively excluding companies whose products or activities were contrary to an organization's mission or beliefs. These SRI strategies are primarily limited to the public equity portion of portfolios. SRI has produced a fairly large number of choices of investing options and strategies in its screens or focus (for example, faith based issues or green funds), and account for over 10% of global institutional equity assets.

Impact Investing is a more proactive, intentional strategy seeking to find investments that offer both a strong financial return as well as a positive social and/or environmental impact. Impact investing strategies can be implemented across all asset classes in a variety of investment vehicles, with varying degrees of liquidity, performance expectations and impact. Equity investors that seek impact can apply Environmental, Social and Governance (ESG) factors and screens and research corporate sustainability reports (CSR) in their analysis to build portfolios of companies that are aligned with a particular mission or goal. Equity investors can also impact corporate behavior through shareholder activism and proxy voting. Fixed income investors can identify impact more directly than equity investors, particularly through the community development and affordable housing bond markets, which are some of the earliest, largest and most successful examples of impact investing. Long term investments in infrastructure would have alignment and impact with many missions for healthy and diverse communities and economic development. Real Estate and Private Equity /Venture Capital can have some of the greatest impact through direct private equity and private debt, but often with less liquidity and transparency. Global impact investment opportunities in all asset classes can have a huge impact on the "Bottom-of-the-Pyramid", the poorest and most vulnerable in our world, while also delivering strong financial returns, as shown by micro-finance/micro-lending. Regionally-based impact investments for place-based missions can also be effective as well as prudent and provide an opportunity to track impact locally. Taking a whole portfolio approach, as directed by UPMIFA and prudent investor standards, organizations and fiduciaries of institutional assets can build impact into any or all parts of a portfolio with the appropriate intention, due diligence and oversight.

For our research, we determined that there are several characteristics to achieve to assure our fiduciary standards were upheld: (1) have low fees, (2) use a rules-based and objective process, (3) be implemented through professional (conflict-free) registered investment advisors, (4) be monitored through a prudent, standard due diligence process based on traditional benchmarks, and (5) expect market-like returns. By following a step-by-step process, beginning with a clear definition of the goals and mission of the UWBA, we identified a number of investment themes that would be aligned with a poverty alleviation mission.

Impact Investing Process*	UWBA Research Process
Articulate Mission and Values	UWBA goal: Reduce Poverty in the Bay Area by ½ by 2020
Impact Themes	Community Development, Affordable Housing, Job Training, Employment
Define Impact	Quantify jobs and growth, unemployment rates decline, affordable housing units built, transportation funding, etc.
Develop Impact Investing Policy	Develop Investment Policy: asset allocation, liquidity requirements, risk budgeting, spending, monitoring, etc.
Generate Deal Flow	Gather universe of ESG/Impact investment managers in all asset classes, model portfolios
Analyze Deals and Evaluate Impact	Perform due diligence, monitor financial results and social impact, test for comparable performance and risks

Source: Solutions for Impact Investors: From Strategy to Implementation, Rockefeller Philanthropy Advisors

We were able to draw on UWBA staff, research and its roadmap as it achieves its goals to reduce poverty. That helped us identify the social drivers that help to alleviate poverty, like job creation and affordable housing. Corresponding objective criteria were identified that could act as proxies for reducing poverty. We also were limited to the liquid public markets in stocks and bonds because the endowment fund at UWBA is relatively small. The United Way 'brand' is typically funded through workplace giving by corporate and philanthropic partners and passed through as grants and support instead of through raising and maintaining a large endowment fund.

While there are now new databases and investment vehicles in many flavors of environmental and social criteria and constraints, there were no existing "off-the-shelf" ESG –type equity mutual funds that focused on poverty alleviation with a geographic spotlight on the San Francisco Bay Area. Fortunately, there are many creative and brilliant financial and academic experts in the Bay Area who helped us find our solution. Because job creation and employment reduce poverty, we sought to identify companies in the Bay Area that were 'good' employers, believing that a good job with a good company that offered good salaries and benefits, had good labor relations, and transparent and diverse management and governance structures contributed to poverty reduction through steady employment.

This resulted in our plan to create a 'Bay Area Employers' index of companies headquartered in the San Francisco Bay Area, including large employers who generally support the mission of UWBA. We found that there already exists a Bloomberg Bay Area Index of nearly 400 companies headquartered in the Bay Area, developed by the San Francisco Chronicle and Bloomberg in 2003 (symbol: BBACAX). It is a cap-weighted index, with its top 5 companies representing 50% of the universe: Apple, Chevron, Google, Oracle, and Wells Fargo. The following table shows how much tracking error the cap weighted index had to the S&P 500, so the committee opted to use the index as the underlying universe and optimize that universe against our benchmark rather than to cap-weight or equal-weight in order to minimize tracking error.

Model Portfolios Structure	**Tracking Error to S&P500** **BBACAX + 15**	**Tracking Error to S&P 500** **BBACAX**
Cap Weighted	**5.39%**	**6.17%**
Equal Weighted	**15.68%**	**15.81%**
Optimized	**2.68%**	**2.82%**

Model Sector Allocations

GICS Sector	Optimized BBACAX – HQ	S&P 500
Consumer Discretionary	10.14%	10.60%
Consumer Staples	7.20%	10.50%
Energy	13.18%	13.10%
Financials	16.36%	14.75%
Health Care	13.50%	11.42%
Industrials	5.48%	10.95%
Information Technology	27.09%	18.72%
Materials	0.55%	3.65%
Telecom Services	0.00%	2.93%
Utilities	6.52%	3.37%
Wtd Avg Mkt Cap	$ 84 billion	$ 94 billion

Except for Telecommunications Services, all major industries are represented in the Bay Area. We are overweighted in Information Technology, Financials and Health Care and underweighted in Industrials and Materials. Our surprisingly diverse and remarkably robust region is the 19th largest economy in the world, and is home to the second largest concentration of Fortune 500 companies in the world. We recognized however, that there are some sectors and companies that should be better included in our universe to reduce tracking error and more closely represent some of the largest employers in the Bay Area. Bank of America is no longer headquartered here, nor is Pac Bell, (now ATT) but both, as well as a dozen others companies are significant local employers and supporters of UWBA. Including those extra companies helped create a universe of companies from which we could build a unique portfolio aligned with our social mission and geographic focus, which we call BBACAX + 15.

We determined a series of social criteria that would be proxies for identifying companies that could be classified as being ‘good employers’ (S), having ‘good management’ (G) and behaving as ‘good environmental stewards’ (E) in the Bay Area. We ranked those criteria and used objective data sources to identify companies who rated well in these ESG criteria to create a custom score for each company in the universe. Identifying only the top handful of criteria that are relevant to a poverty alleviation mission meant that we did not dilute the screening intentions with too many factors.

Customized Social Screens

- 25 Categories – Focus Group consensus recommendations
- Alignment with drivers of poverty reduction

Highly Relevant to Poverty	Moderately Relevant	Low Relevance	Not Relevant
Job Creation	**Human and Employee Rights**	**Gambling**	**Tobacco**
			Alcohol
Labor Relations	**Workforce Diversity, including Sexual Orientation**		**Adult Entertainment**
			Animal Testing
Recognition (Corporate)			**Bioethics**
	Environmental		**Firearms**
			Life/Choice
	Corporate Governance Metrics		**Military**
	Auditing Practices		**Nuclear Power**
	Board Accountability		
	Board Composition		
	Board Independence		
	CEO Compensation		
	Company Ownership		
	Shareholder Rights		
	Takeover Defenses		

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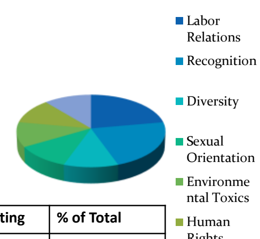
Developing weights for those factors, through a consensus voting process by the committee and staff, we created a custom scoring system unique to our mission. Each company/stock in the universe would be evaluated on is custom ESG score as well as its fit in the portfolio structure as measured by its contribution to diversification and minimizing tracking error.

Social & Geographic Criteria

- Focus Group consensus sample criteria recommendations
- **Weightings**: High is 2x Medium, Medium is 2x Low
- **Exclusions:** Gambling (use 20% threshold)
- **Positive Scoring:** based on objective data
  - Job Creation (High): defined by Universe of Bay Area employers



Criteria	Data Elements	Importance	Weighting	% of Total
Labor Relations	Evaluation of Relationships with Organized Labor	High	4	22%
Recognition	Workplace and Diversity	High	4	22%
Diversity	Total Workforce and Management	Medium	2	11%
Sexual Orientation	Non-discrimination Statement Same Sex Benefits	Medium	2	11%
Environmental	Toxic Release Information and Spills	Medium	2	11%
Human Rights	Global Sullivan and Global Compact	Medium	2	11%
Corporate Governance	Governance Metrics Grades.	Medium	2	11%

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Using computer-driven portfolio optimization programs at the Aperio Group of Sausalito, CA (an investment firm that builds custom portfolios) we developed a series of portfolios with varying levels of custom ESG scores and tracking error to the Russell 3000. The goal was to create a model portfolio of stocks that would maximize the aggregate custom ESG score while minimizing the tracking error to the

Russell 3000, thereby balancing idealism with pragmatism. We also tested three different underlying universes of stocks, since we could see that the tracking error resulting from the geographic focus was much greater than the tracking error resulting from the ESG screens. The three universes varied by the degree to which the companies in the universe were headquartered in the Bay Area or not: 100%, 75% or 50%.

Sample Portfolios

	Bay Area 19%	Bay Area Only -100%		Bay Area Co's 75% of portfolio			Bay Area 50% of portfolio	
Screened Portfolio Version	**R3000 Index**	**1**	**4**	**8**	**10**	**13**	**7**	**11**
Benchmark	R3000	R3000	R3000	R3000	R3000	R3000	R3000	R3000
Model Universes	R3000 Index	**BBACAX+15**	**BBACAX+15**	**BBACAX+15 +25% other**	**BBACAX+15 + 25% other**	**BBACAX+15 +25% other**	**BBACAX+15 +50% other**	**BBACAX+15 +50% other**
Universe - Holdings	2,940	252	252	1,982	1,982	1,982	1,982	1,982
Standard Deviation	20.43	20.57	20.65	20.48	20.52	20.49	20.44	20.47
Tracking Error vs. Benchmark, %	**0.00**	**2.41**	**3.02**	**1.36**	**1.95**	**1.64**	**0.67**	**1.32**
Model UWBA Social Score	*46*	*51*	*65*	*50*	*65*	*60*	*49*	*65*
Bay Area Weight%	***19***	***100***	***100***	***75***	***75***	***75***	***50***	***50***
Number of Holdings	2940	126	99	264	178	210	450	294
Average Market Capitalization, $Billions	87.9	80.0	93.2	89.0	89.0	89.5	89.8	91.6

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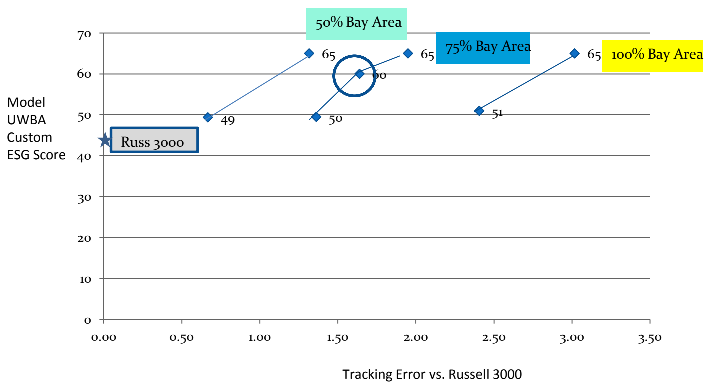
Graphing the various portfolios that demonstrated the trade-off between tracking error and high-to-low ESG scores, over the three universes, resulted in three ‘frontiers’. The resulting “middle” equity portfolio (#13 in the chart above) seems to balance the desire for a highly rated ESG portfolio with the desire to minimize tracking error to the benchmark. In this portfolio, the equity holdings, of which 75% are headquartered in the Bay Area, compared with the Russell 3000 where 19% of the companies are headquartered in the Bay Area. This model portfolio is tilted towards the companies whose practices were aligned with positive employee relationships, good governance and good environmental practices. Being optimized against our benchmark, the portfolio is expected to exhibit sector weightings, risk and performance expectations similar to the Russell 3000, with a tracking error of 1.64%. The screens used in the custom ESG scoring system improved from the basic ESG score for the Russell 3000 of 46 to the model portfolio’s ESG score of 60, a 30% improvement for ESG criteria at a small (less than 2%) cost to tracking the benchmark.

Choosing the parameters for the Model

- Custom ESG Scores, Tracking Error, Geographic Focus



UWBA Model Portfolio: "Impact Bay Area"

– Benchmarks: R3000, Barclays Aggregate

Model Equity Universe	BBACAX+15+ 25% other	Russell 3000 Index
Universe – Holdings	1,982	2,940
Standard Deviation	20.49	20.43
Tracking Error vs. Benchmark, %	**1.64**	**0.00**
Model UWBA Social Score	*60*	*46*
Bay Area Weight%	***75***	***19***
Number of Holdings	210	2940
Average Market Capitalization, $Billions	89.5	87.9

– Fixed Income: Bay Area affordable housing, GNMA and FNMA, corporate and taxable muni bonds

This model equity portfolio is now more aligned with the core mission of UWBA but can be expected to earn market levels of return and experience similar risks as its benchmark. Unexpectedly, the model portfolio outperformed for the two year period ending December 31, 2012, with a 17.71% return versus the Russell 3000 at 10.83%.

The UWBA fixed income strategy was easier to develop and implement. We found an existing fund that was aligned with community development and reinvestment goals nationally. Community Capital Management has a large institutional CRA (Community Reinvestment Act qualified) fund (symbol: CRANX) that could earmark for UWBA a variety of San Francisco Bay Area regional bonds, such as Affordable Housing and Redevelopment Agency bonds, local specific GNMA and FNMA single and multi-family mortgages, some special community development (Small Business Administration), and corporate / regional Salvation Army bonds. Our performance would be that of the entire fund, benchmarked against and tracking the Barclays Aggregate bond index, which addresses our fiduciary duty and meets our goal to align with the mission. With the earmarking process, UWBA would be able to track its local impact footprint.

The San Francisco Bay Area will need to continue to invest in itself to stay competitive and deliver cutting-edge thought, product and service innovation. Identifying how fiduciaries can invest locally, in stocks, bonds, infrastructure, real estate and private markets regionally, can provide a new source of funds for investment in Bay Area competitiveness into the future.

While we recognize that a small portfolio of stocks and bonds would have a limited, indirect impact on poverty at best, we hope that the potential public *conversation* about building a prudent portfolio under current fiduciary standards that is aligned with a specific place-based mission could have a much larger impact on influencing the flow of funds into needed public/private, regional, community-based investment opportunities and perhaps also help to act as a model for other regions. We urge continued collaboration between the participants in all sectors to explore how to use fiduciary capital, in all asset classes (equity, fixed income, infrastructure, real estate and private capital) to transform our economy, to invest in our region, state and infrastructure, and to create a future that will continue to foster prosperity, innovation and shared economic growth in the San Francisco Bay Area for generations to come.

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For a complete list of references, definitions, links, sources, and acknowledgements, please see the full report posted on the website of the Federal Reserve Bank of San Francisco:

http://www.frbsf.org/publications/community/wpapers/2012/wp2012-05.pdf

Please note: The United Way of the Bay Area was the initial seed ground of this study. It has not endorsed and does not support any particular investment strategy at this time.

NOTES