Impact Investing for Fiduciaries

Foundations, nonprofit and faith-based organizations increasingly seek to invest in ways that reinforce and minimally do not undermine their charitable missions. As fiduciaries, a growing number see aligning their investments with mission as central to their duties of obedience, loyalty and care. Those obligations also entail prudent investing and comprehensive risk management in the stewardship of financial assets. Fortunately, a growing body of research indicates that these goals can be accomplished simultaneously through the discipline known as impact investing. This brief describes the language, practices, performance, and growth of impact investing.

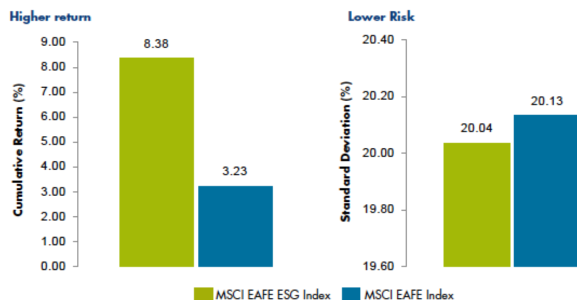
Language

For over fifty years, investors have honed techniques for incorporating social and financial criteria into investment decisions while seeking competitive financial returns. The language describing this practice has also evolved. Impact investing is the most widespread current term, defined as investing into companies, organizations, and funds with the intention to generate measurable social and environmental impact alongside a financial return. While some impact investors limit their activities to a carve-out of assets, an increasing number seek to align 100% of their assets with mission. Here, impacting investing expands to include the practices known as SRI or sustainable and responsible impact investing, as well as ESG—the incorporation of environmental, social and corporate governance criteria into investment decisions.

Practices

Core practices of the field range from excluding objectionable holdings (divestment) to proactively making investments that drive desired social and/or environmental outcomes. Within this spectrum, some practices apply largely to publicly traded securities while proactive impact investing applies largely to privately held investments.

For traded securities, investors may define *exclusionary* screens to divest of companies they view as most egregious within a sector, or to divest of an entire sector. Many impact investors screen tobacco from their portfolios. They may define *inclusionary* screens for best-in-class companies within a sector, or companies that produce some desired outcome. Recently, the McKnight Foundation created a portfolio that invests in the broad U.S. stock market while underweighting inefficient carbon emitters such as utilities over-exposed to coal generation and overweighting companies with lower carbon intensities. In addition, many impact investors engage in active ownership related to their traded securities—the voting of proxies and/or engagement of corporate managers to influence corporate products, processes and practices. For proactive impact investing, investors frequently target investments within certain sectors or geographies. They may structure investments to deliver market- or near market-rate expected financial returns, or to deliver concessionary expected returns if needed to drive charitable purpose. Incourage in Wisconsin Rapids has targeted investment within its region to nurture an entrepreneurial culture and create jobs, affordable housing and green facilities as part of a strategy to build a community that works well for all. It is engaging in a broader strategy to align 100% of investments with mission.



The MSCI EAFE ESG Index has outperformed the MSCI EAFE Index by 5.16% cumulative from 10/01/07 to 03/31/15
Past performance is no guarantee of future results. Index performance is not necessarily representative of Fund performance.

Performance

Continuing growth in the field is fueled by the growing body of research that suggests that there need not be a penalty for incorporating ESG criteria into investment decisions. Indeed, as indicated by the PAX MSCI EAFE ESG Index and many other examples,[1] the practice has the potential to both lower risk and generate competitive or even excess returns. While performance varies by individual manager, and past performance is no guarantee of future results, there is an increasing range of funds and customized portfolio solutions across asset classes that are delivering social and environmental benefits along with competitive financial returns.

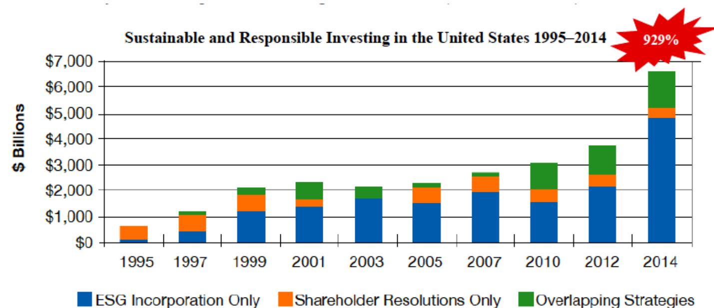
[1] http://www.paxworld.com/advisors/investment-strategies/pax-world-mutual-funds/international-fund, accessed May 29, 2015.

"Sustainable investing strategies are gaining momentum, as performance challenges misperceptions."

The Business Case for Sustainable Investing, Morgan Stanley[1]

Growth

Impact investing has become a global practice that continues to grow rapidly and gain acceptance as a prudent investment discipline. J.P. Morgan and the Global Impact Investing Network's (GIIN) 2014 survey of 125 major fund managers, foundations, and development finance institutions found $46 billion in impact investments under management, up 10% from the prior year, with a planned 19% increase for the coming year.



The Forum for Sustainable and Responsible Investment (US SIF) reports that from 1995 to 2012, the universe of sustainable, responsible and impact investing assets under professional management in the U.S. increased 486%, against a 376% increase in the broader universe of U.S. professionally managed assets. From 2012 to 2014, sustainable, responsible and impact investing grew at a rate of more than 76%, increasing from $3.74 trillion in 2012 to $6.57 trillion as of year-end 2013. This represents more than one out of every six dollars under professional management in the United States today or 18% of the $36.8 trillion in total assets under management tracked by Cerulli Associates.[2]

While the largest growth of SRI/ESG product since 2012 was in mutual funds, alternatives also showed strong growth. The number of U.S. ESG mutual funds grew from 333 to 456 (37%), while their collective assets increased from $641 billion to $1.93 trillion, an over 200% increase. The number of alternative investment funds grew from 177 to 336 (90%), while assets under management increased from $37.8 billion to $224 billion, a 70% increase. Place-based community investments, which increased 47% between 2010 – 2012 through a campaign to shift depositary accounts to community-based institutions, continued their growth at a more modest rate. From 2012 through 2014, community investments in banks, credit unions, loan funds and venture capital funds increased approximately 5% to a total of $64.3 billion.

Equally impressive as an indicator of growth is the mainstreaming of investing strategies that incorporate ESG criteria. Global wealth managers who have begun actively promoting these products include Bank of America Merrill Lynch, BlackRock, Bloomberg, Goldman Sachs, JPMorganChase, Morgan Stanley, Northern Trust, and UBS.

Avivar Capital, an impact investing specialist, and Colonial Consulting, LLC, an independent full service investment advisor, have each worked with foundations and other institutional investors over a period of decades to deliver prudent and diversified investment strategies that support the long-term achievement of mission. As institutions such as Incourage in Wisconsin Rapids increasingly seek enhanced impact and mission alignment within prudent investment strategies, we are pleased to coordinate our expertise to support the design and implementation of customized solutions. For further information, please contact Lisa Richter, lrichter@avivarcapital.com or Michael Miller, mmiller@colonialconsulting.com.

[2] US SIF, http://www.ussif.org/sribasics