

ALLOCATING FOR IMPACT

Subject Paper of the Asset
Allocation Working Group

**SOCIAL IMPACT
INVESTMENT TASKFORCE**

Established under the UK's
presidency of the G8

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This report has two key audiences. It is for Chief Investment Officers and Investment Managers, who we hope will find it a helpful guide for how to integrate impact investments across a balanced portfolio. It is also for policymakers and, in particular, those within government who are responsible for designing financial policies that can enable the capital markets to play a powerful role in how we address pressing social and environmental issues.

EXECUTIVE SUMMARY

Despite increases in aggregate global wealth, levels of inequality and environmental degradation in many countries continue to rise. To help tackle this, impact investment¹ aligns the positive power of private capital with the social and

“ Impact investment aligns the positive power of private capital with the social and environmental needs of society at-large. It is for this reason that this report has two key audiences: both investors and policymakers. ”

environmental needs of society at large. This makes impact investment a critical tool for the policymaker, bringing cost-effective solutions and incremental capital to some of our most intractable societal challenges, from life-saving vaccines to affordable housing.

It also provides investors with a compelling opportunity: to align their investment strategy with their societal values, to spot areas of rapid growth (supported by a favourable policy environment) and even to identify potentially less correlated investment propositions.

To solve problems on a global scale, we need global capital pools to respond. This means that, alongside the pioneering investors already allocating for impact, we need impact investment to find its formal place within institutional portfolios.

This will happen when Chief Investment Officers and Investment Managers recognise that a diversified and thoughtful allocation to impact investments can fit with their fiduciary responsibilities, and when governments use well-designed policies to encourage and support such allocations.

This paper presents a series of frameworks to help both investors and policymakers do just that.

In Chapter 1, we describe the various **features that make impact investment an attractive proposition**, for both governments and investors.

In Chapter 2, we clarify the various terms used in the market and **position the investment choices available**. This chapter aims to help investors identify the opportunity set that can best meet their societal and financial goals. It also provides policymakers with a view of the impact investment universe, which they can influence and incentivise to meet their development agendas.

In Chapter 3, we propose a **framework for including impact investments across a balanced investment portfolio, without compromising the financial goals and fiduciary responsibilities of Chief Investment Officers and investment managers**. This chapter is clearly relevant for investors but it is also aimed at policymakers, since it lays the groundwork for later policy recommendations.

In Chapter 4, we **assess the key barriers to making impact investments** for a wide range of investors and intermediaries. These barriers fall into three main categories, relating to conflict of duty, to the nascent stage of the industry and to increased risk factors.

¹ Throughout this report, the terms ‘impact’ and ‘societal’ encompass both social and environmental impact

Finally, in Chapter 5, we present a **series of actionable policy recommendations that can address these barriers**, illustrated through examples of equivalent policies already at work around the world. These recommendations call for governments to act in three key ways:

1. MARKET STEWARD

- Clarification of fiduciary duty

Use of fiscal incentives

- Requirement for regulated financial institutions and foundation endowments to articulate their contribution to impact investment
- Requirement that impact investment be included as an optional percentage of pension fund offerings
- Requirement that banking institutions lend to priority sectors

2. MARKET PARTICIPANT

- Issuance of Requests for Proposals to encourage development of impact investment products
- Stimulation of the intermediary market to produce more bundled/ multi-asset products at-scale
- Provision of catalytic capital, such as matching investment, first loss protection or guarantees

3. MARKET BUILDER

- Support for placement and distribution platforms
- Support for an impact investment rating system

Taken together, we hope that the various frameworks and policy recommendations presented in this report have the potential to unlock the financial power of global portfolio investors, bringing widespread solutions to some of our most pressing societal challenges.

About the authors

This report is the product of a series of discussions by the Asset Allocation Working Group of the Social Investment Taskforce, established established under the UK's presidency of the G8 (see Acknowledgements for details).

The Working Group is chaired by Harvey McGrath of Big Society Capital.

The report's lead authors are Clara Barby of Bridges IMPACT+ and Mads Pedersen of UBS.

Please direct any feedback or further enquiries about this report to:

clara@bridgesventures.com and
mads.pedersen@ubs.com

THE ATTRACTION OF IMPACT INVESTMENT

Economic liberalisation and the evolution of the global capital markets have hugely increased wealth and economic efficiency in many countries around the world. However, a continued rise in levels of social inequality and environmental degradation underlines that this progress can come at a high cost to society. The rise of impact investment is showing the power of the capital markets to finance measurable solutions to a wide range of social and environmental challenges, which governments and aid alone cannot solve.

A. THE ATTRACTION FOR POLICYMAKERS

Incremental financial and human capital

Many of the issues that public funders and traditional charities seek to address are also the domain of impact investments, such as inadequate housing, hunger and malnutrition, low educational levels, limited access to clean water, sanitation and hygiene, employment challenges, social protection measures, low levels of agricultural productivity, infrastructure, limited availability of financial and professional services and low levels of productivity in the economy. Impact investment's focus on building financially sustainable and measurable solutions to meet these challenges makes it a compelling proposition for policymakers. It complements public investment by offering incremental financial and human capital to deliver the public agenda, particularly in light of tightening government budgets.²

B. THE ATTRACTION FOR INVESTORS

The case is equally appealing for investors. Impact investments do not just protect and enhance an investment's value through better day-to-day environmental, social and governance (ESG) practices;³ they are distinct in their focus on defining a societal challenge upfront, setting objectives to deliver an intervention and measuring how well they do. As a result, impact investments make a compelling investment proposition for at least three key reasons:

1. Increased options for values-driven investors

The old paradigm of 'two pockets' (making money with regard only to financial return and giving it away with regard only to impact) is rapidly breaking down. The millennial generation⁴ want investments that marry profit with purpose and traditional foundations worldwide are beginning to consider ways that their endowment can further their mission. Impact investment is the strategy of choice for those seeking to align their wealth with their specific social and/or environmental objectives.

² Recent estimates place the total global post-2015 development financing gap at between US\$180 and US\$500 billion annually, of which well over 50% will be required in Africa and South Asia alone (www.odi.org.uk/sites/odi.org.uk/files/odi-assets/publications-opinion-files/8319.pdf)

³ By assessing and measuring for positive social and environmental impact, impact investments can also unearth potential negative impacts that could hurt financial returns. For example, intense review of supply-chain impacts could highlight unsafe factory conditions or risky locations that could significantly disrupt production

⁴ According to the recent survey of millennials by Deloitte, available at: www.deloitte.com/MillennialSurvey

2. Potential for diversification

There may also be purely financial reasons to allocate to impact investment. As impact investment becomes mainstream, and track records develop, we can envisage impact investments across asset classes. Given the emergent return and correlation profile of some of these categories of impact investment (for example, Social Impact Bonds* and Development Impact Bonds,⁵ which will likely sit within absolute return), we see a growing strategic asset allocation logic, based on the potential diversification benefits of including impact investment within a broader portfolio. The combination of improved portfolio risk-adjusted returns, while achieving significant societal impact, could become a powerful driver of asset allocation decisions over time.

3. Potential for growth

Impact investments' focus on identifying solutions to (often large) unmet societal challenges means that, as an investment strategy, impact investment naturally lends itself to identifying areas of new and rapid growth in otherwise mature markets.

“ In addition to producing positive social or environmental benefits, an impact investment strategy may also result in strategic portfolio advantages, including potentially reducing overall portfolio volatility, or seizing opportunities to capture alpha through market inefficiencies and by capitalizing on long-term social and environmental trends. ”

Sonen Capital⁶

Moreover, in an economic downturn, impact investments' focus on addressing the real needs of a real economy (such as delivering life-saving healthcare or meeting a shortfall in affordable housing), can result in continued strong demand, even when the rest of the economy is slowing down.

*Social Impact Bonds and Correlation

Social Impact Bonds (SIBs) are a form of contract in which an outcomes-payer (such as a government commissioner) commits to pay for significant improvement in social outcomes (for example, a reduction in offending rates, or in the number of people being admitted to hospital, who might be treated at home) for a defined population. Through a SIB, private investment is used to fund a service provider to deliver the desired societal outcome(s) and the outcomes-payer delivers financial returns to the investor only if the improved social outcomes occur.

As an innovative investment product, without a proven track record, SIBs have been kick-started by investors that are willing and able to take apparently disproportionate risk (given the capped level of financial return, which is usually set by the outcomes-payer). Over time, however, it is possible that SIBs prove to be an investment opportunity capable of delivering predictable and competitive risk-adjusted financial returns. If so, given the return drivers of many SIBs (an investor's financial return is dependant on whether, for example, children achieve better exam results, rather than on the price of oil), they may have a lower correlation profile to the rest of the market. These features could make SIBs particularly attractive to investors seeking less correlated returns.

⁵ Development Impact Bonds (DIBs) have much in common with the SIB, but with the crucial difference that bilateral aid agencies, foreign aid ministries, multilateral institutions and philanthropists pay for the outcomes delivered, instead of the domestic government

⁶ As described in the report: Evolution of an Impact Portfolio, October 2013, which profiles the impact allocation approach taken by Sonen Capital on behalf of the K L Felicitas Foundation

CLARIFYING THE IMPACT INVESTMENT UNIVERSE⁷

The diversity of opportunities available is an important merit of impact investment. It is also a major challenge. For investors and policymakers looking to determine which impact investment approaches can best meet their goals (both impact and financial), a clear understanding of the relevant landscape is critical. Below, we have taken an empirical view of how the impact investment market is evolving.

A. THE IMPACT INVESTMENT VALUE CHAIN

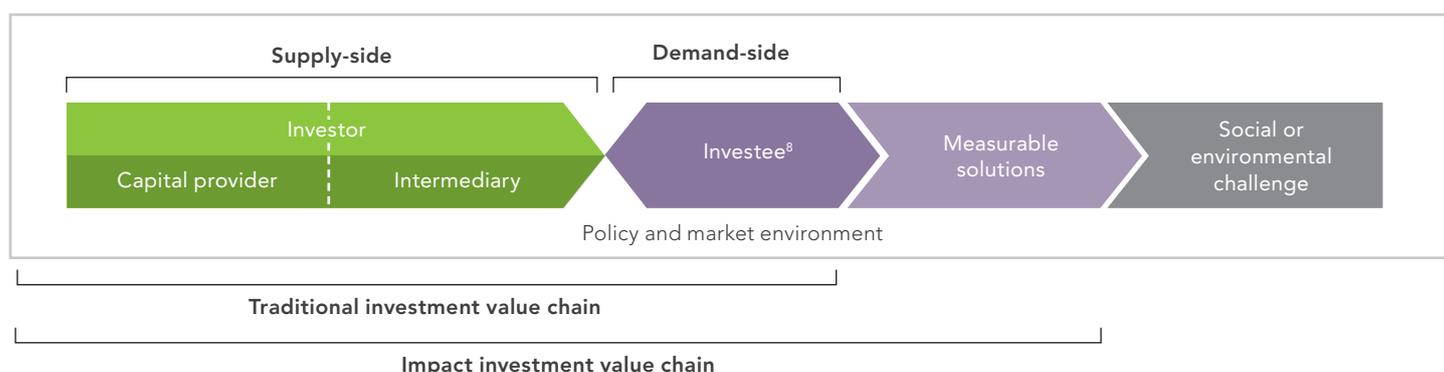
The diagram below shows a simplified version of the traditional investment value chain. This same value chain occurs in impact investment with one distinct difference: while all investments create various impacts (which can be positive or negative), impact investments are distinguished by their deliberate **intention** to generate specific positive social impact, by setting outcome objectives and **measuring** their achievement.

This definition has three important implications. Firstly, impact investments have roots in – but are distinct from – a wider spectrum of investment approaches that integrate societal factors into decision-making. The result is a spectrum of capital, which is explored in more detail in Section B (The supply-side).

Secondly, the investees raising impact investment can take a wide variety of organisational forms, since there is a growing range of approaches to delivering both social and financial returns (ranging from impact-driven businesses to trading non-profits to non-trading charities that engage in SIBs). This variation, and its relationship to financial return for investors, is explored in more detail in Section C (The demand-side).

Thirdly, although impact investments are distinguished by the hallmarks of intention and measurement, these hallmarks may not be shared by every actor in the impact investment value chain: an impact investment can be driven by the investor, by the investee, or by the surrounding

Fig. 1 The Impact Investment Value Chain



⁷ The findings presented in this chapter draw significantly on two reports: 'Investing for Impact: A Strategy of Choice for African Policymakers' (Bridges IMPACT+, in partnership with the African Private Equity and Venture Capital Association, funded by The Rockefeller Foundation, 2014) and 'How we define the market' (Bridges IMPACT+, 2012)

⁸ We use the term 'investee' because, while many impact investment opportunities relate to enterprises, there are also an increasingly number of structured products, including SIBs, DIBs and other bond products.

policy environment – or by various combinations of all three. It is for this reason that we refer to impact ‘investments’ in this report, rather than specifically to the investor or investee. Such variations within impact investment are analysed in more detail in section D.

B. THE SUPPLY-SIDE

A spectrum of capital

The notion that investments cannot operate in isolation from society is not new. Socially conscious investments arguably date back centuries, with religions laying down directives on how to invest according to ethical values. More recently, the social climate of the 1960s, followed by the push from investors to eliminate the institutionalized racial discrimination of Apartheid in South Africa, brought socially conscious investments to the fore. By the 1980s, Socially Responsible Investment (SRI) had a dedicated investor base, focused on systematically ‘screening out’ harmful products and practices (such as tobacco, weapons or oppressive regimes). Back then, this investment

increasing transparency. As a result, the broad category of **responsible** investors today ranges from those which ‘negatively screen’ harmful products or practices, to those which also address ESG risks through active ownership. The extent to which ESG factors are central to decision-making varies widely within this universe of investors.

Taking this further, and building upon “best-in-class” SRI, some investors now deeply integrate social and environmental factors into their analysis and pro-actively screen for ESG opportunities, favouring approaches which they believe will outperform the market because they operate (or have the potential to operate) in a more sustainable way than their peers over time – be it through their environmental management, stakeholder engagement or governance practices. This **sustainable** investing style centres on backing businesses whose ESG practices enable them to flourish in a changing social and environmental landscape, and we distinguish it from responsible investment because it focuses not just on protecting value against risk but also on create additional value, for both shareholders and society.

While sustainable investors focus on progressive ESG practices, **impact** investors go beyond this to focus on solutions to pressing social or environmental issues. Impact investments focus deliberately on one or a cluster of issue areas with the intention to make a positive and measurable societal impact, alongside a financial return. For example, an investment might focus on delivering life-saving healthcare to low-income communities, or address water scarcity, or provide high quality jobs to the long-term unemployed.

Impact and financial returns

Investments that intentionally generate measurable social impact range in their ability to deliver competitive financial returns for investors, giving rise to three broad categories.

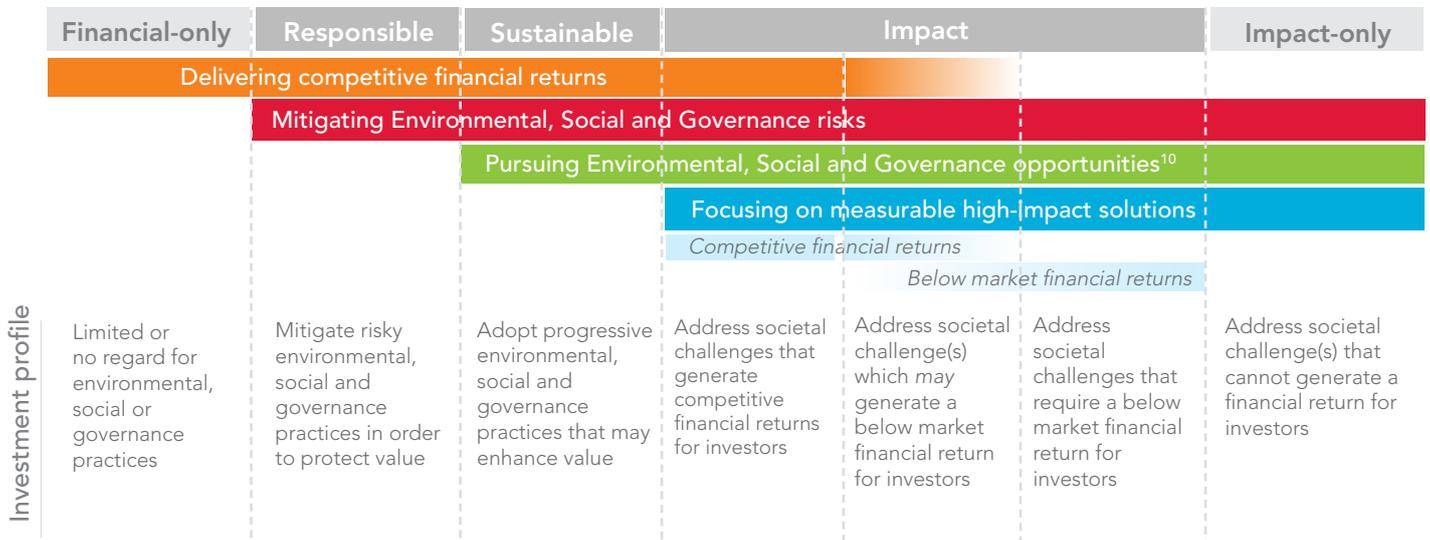
First, there are situations where a social challenge creates an opportunity for investors to deliver positive societal change alongside market rate, or even above market rate, financial returns. A clean energy mutual fund generating carbon off-sets or a microfinance structured debt fund are two such examples.

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style was driven primarily by ethical motivations, rather than commercial considerations.

Over time, in addition to ethical motivations, many investors have recognised that, by factoring social, environmental and governance risks (ESG) into their investment decisions, they are able to protect value and deliver greater long-term financial returns to shareholders, particularly in a world of

Fig. 2 A spectrum of capital



Second, there are situations where it may be unclear whether an investment’s delivery of positive social change will require investors to accept a below market financial return. Private equity investments into the growing number of ‘mission-locked’ profit with purpose businesses⁹ around the world, whose governance requires them to balance shareholder interest with their mission, are one such example.

Thirdly, there are situations where addressing a social issue requires some financial trade-off. This result is a below market investment opportunity to address some of our most pressing social challenges. One such example is a fund providing unsecured loans or quasi equity to social enterprises and trading charities, which have a lock on their disposal of assets and/or distribution of surplus.

In summary, we have developed the following map of the market (see Fig. 2) to help clarify the terms and position the choices available to investors. We use only dotted lines to distinguish between types, recognising that many investors will transition across categories, or build a portfolio across the

spectrum. For example, a thoughtful institutional investor could allocate their entire portfolio across impact, sustainable and responsible investment products, in such a way as to optimise impact within the bounds of their financial goals and fiduciary responsibilities.

C. THE DEMAND-SIDE

Any impact-driven organisation can be a recipient of impact investment, provided it can deliver social impact and a financial return. The growing impact investment market is showing that a wide range of impact-driven organisations can be fuelled by impact investment, even including charities that do not trade (if they engage in SIBs or DIBs). Connecting this demand with the supply of capital is an increasingly diverse range of investment products, from those suitable for investors seeking competitive financial returns alongside impact, to those suitable for investors willing to accommodate below market opportunities within their portfolio for the sake of impact.

⁹ There are now over 1,000 B Corps seeking to balance shareholders’ interests with a broader stakeholder agenda. Many profit with purpose businesses believe that their commitment to mission creates a competitive advantage due to greater loyalty (from both customers and employees), resulting in market-rate or even market-beating returns for shareholders. For more information, see: <http://www.bcorporation.net/become-a-b-corp/why-become-a-b-corp/protect-your-mission>

¹⁰ This integration of sustainable practices across an organisation’s core business may also be termed Corporate Social Responsibility (CSR), although many organisations have a separate (often philanthropic) CSR ‘carve-out’ that is distinct from their approach to sustainability.

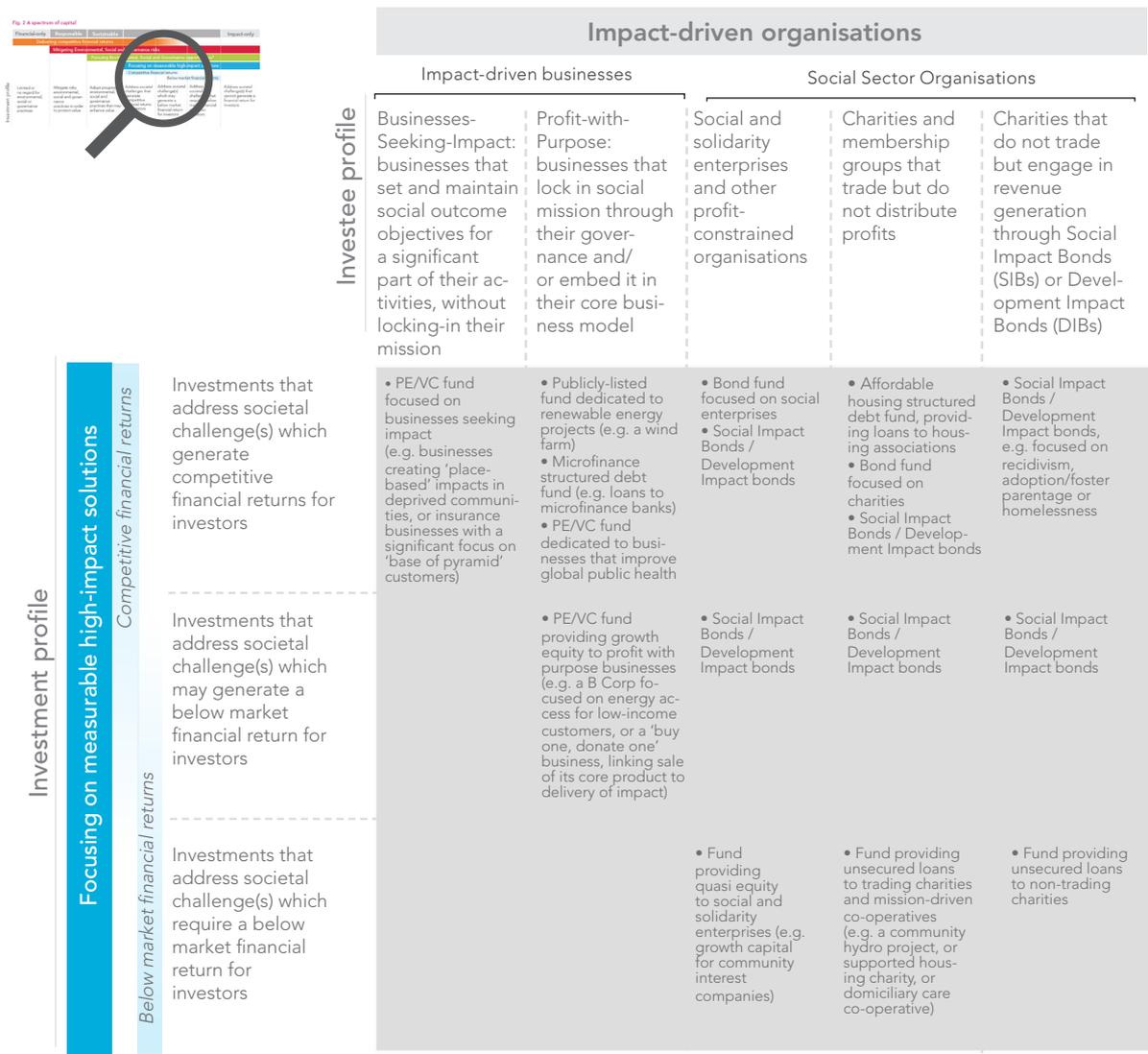
Figure 3 below brings this evolving landscape to life by mapping the range of impact-driven organisations seeking investment (horizontal axis) to a range of illustrative impact investment products, categorised according to their financial risk-adjusted return profile (vertical axis, which represents the impact investment section of the capital spectrum, as shown in Fig. 2). The resulting picture shows the powerful role that private capital can play in financing a wide range of impact-driven organisations to address social problems. It also highlights that the organisational form of the underlying investees need not dictate an investment's ability to deliver either higher impact or competitive financial returns: for example, there are non-trading charities who will access capital

through financially-attractive SIB or DIB investments; there are Profit with Purpose businesses whose mission will prove so central to their commercial success that they generate competitive returns; and there are a whole range of impact-driven organisations that will generate competitive investment opportunities through use of tax credits, guarantees or first loss positions.

D. VARYING MOTIVATIONS

Recalling the Impact Investing value chain (page 3), the intention to generate positive impact may be shared all participants. For example, an impact-driven housing developer may raise capital from an impact-driven investor.

Fig. 3 Matching supply and demand



However, an impact investment can also occur when the intention to create impact (and measurement of it) is not shared by all participants. In fact, there are many impact investments at work around the world where this is the case. For example, a responsible enterprise may not have an explicit intention to address a societal issue but, due to its location in an underserved community, an impact-driven investor may invest in the enterprise as a solution to the pressing issue of local unemployment. Here, the intent lies primarily at the level of the investor, who also tends to drive the measurement of social outcomes that result. This model has historically been used significantly by Development Finance Institutions seeking to generate job creation, increased tax revenue and economic growth in underserved regions.

Alternatively, an impact-driven healthcare enterprise may be set up with the deliberate intention to create access to affordable maternity care for lower-income populations; yet one of its sources of capital as it grows may be a bank, which is attracted to the enterprise as a creditworthy commercial investment, rather than for its impact intention.

There are also situations where the impact intention (and measurement) is catalysed not by an investor or investee but by the surrounding policy environment, which attracts capital and enterprises to deliver societal outcomes that governments can measure. Tax incentives to attract investors and

enterprises to renewable energy projects are one such example, as is the US Low Income Housing Tax Credit, where a combination of policies, the Community Reinvestment Act and the tax code have created a \$6-10 billion annual market for private investors.

Even where both the investor and investee do share the intention to address societal challenges, they may differ in their financial motivations. For example, we frequently see impact-only capital (from grantmakers or public funders) being used strategically to support the initial growth of organisations that aim to become financially viable in the long-term but which cannot support capital from financially-motivated investors in the early stages.¹¹

Finally, we also see financial motivations vary among impact co-investors. Many at-scale impact investment opportunities involve layered structures, where one type of impact-driven investor is willing to 'flex' their own financial risk-reward profile (for example, by providing a first loss position or guarantee) just enough to create a market-rate risk-adjusted return proposition, attracting other types of impact, sustainable or even responsible investors, who would not otherwise participate. Through such catalytic behaviour, an impact-driven investor can help attract more capital to impact-driven organisations, significantly furthering their impact.

Intention and measurement by the policymaker

The Federal US Community Reinvestment Act (CRA) states that "regulated financial institutions have continuing and affirmative obligations to help meet the credit needs of the local communities in which they are chartered." The CRA establishes a regulatory regime for monitoring the level of lending, investments and services in low- and moderate-income neighbourhoods typically underserved by lending institutions. Where a regulatory agency finds that a lending institution is not serving these neighbourhoods, it can delay or deny that institution's merger request or approval to open a branch or expand its services.

Layered capital for leveraged impact

The African Agricultural Capital Fund (AACF) is a private equity fund aiming to boost the productivity and profitability of Africa's undercapitalized agriculture sector. Capital in the AACF consists of \$17M in equity investments from the foundations, and an \$8M commercial loan from J.P. Morgan's Social Finance unit. The commercial loan has downside protection from the subordinated equity investments and a 50% loan guarantee from USAID's Development Credit Authority. AACF will also have access to \$1.5M in USAID-funded technical assistance grants. This will include business development services to improve portfolio companies' operations, competitiveness and access to markets, alongside delivering social impact.

¹¹ For further discussion of this topic, see: From Blueprint to Scale, Monitor, April 2011 organisation

A PORTFOLIO APPROACH TO IMPACT INVESTMENT¹²

A portfolio approach to impact investment requires an investor to choose what societal outcomes they wish to deliver, what aggregate financial return, volatility and liquidity profile they wish to achieve and what percentage of their portfolio they wish to allocate to impact investments. These choices are interrelated and will be driven by the investor's particular emphasis

“Impact investment should be considered a strategy that can be applied across a variety of asset classes. At the same time, however, as a nascent strategy, given the additional skills required to analyse social factors alongside commercial factors, some asset owners/intermediaries are choosing to treat impact investment as an asset class, often including it within alternatives.”

on achieving certain forms of societal impact relative to overall financial efficiency or portfolio trade-offs. Based on these decisions, an investor can define the opportunity set that can best meet their various objectives.

A. A STRATEGY ACROSS ASSET CLASSES

In the previous chapter, we described how an investor can categorise investment opportunities according to their impact profile and their risk-adjusted financial return potential (ranging from competitive to below-market). Taking this further, impact investments can also be categorised according to other standard financial drivers, including: the pattern of expected cash flows, the capital gain or principal payback potential/probability, the liquidity (lock-up periods), and the correlation to standard markets. As a result, impact investments can be described as part of the asset class whose features they reflect.

For instance, an investment with a long lock-up period, potentially high upside (if executed well), and significant risk might be categorized as 'impact private equity'. An investment with more stable cash flow and limited upside but a high likelihood of principal repayment after a substantial lock-up period might best be viewed as an 'impact private debt' investment. Should a government or a foundation be willing to guarantee the principal repayment, the instrument might be seen as a substitute for a traditional corporate bond.

Given the above, impact investment should be considered a strategy that can be applied across a variety of asset classes (for example, private debt, private equity or real estate), rather than an asset class itself.

At the same time, however, as a nascent strategy, given the additional skills required to analyse social factors alongside commercial factors (as well as the lack of widespread track record about how social analysis affects investment performance), some asset owners/intermediaries are choosing to treat impact investment as *an asset class*, often including it within alternatives.

This treatment of impact investment as *an asset class* may be useful, since dedicated teams, with an integrated skill set and specific budget to invest, may catalyse greater allocation in the near term. In the longer term, however, our vision is that the strategy of fully factoring social externalities into investment decisions (and the skill-set to do so) will become mainstream across all asset classes.

It is also possible, even advisable, to label any treatment of impact investment as an 'impact

¹² The framework for portfolio construction presented in this chapter has been contributed by Mads Pedersen, Head of Asset Allocation Discretionary at UBS Wealth Management

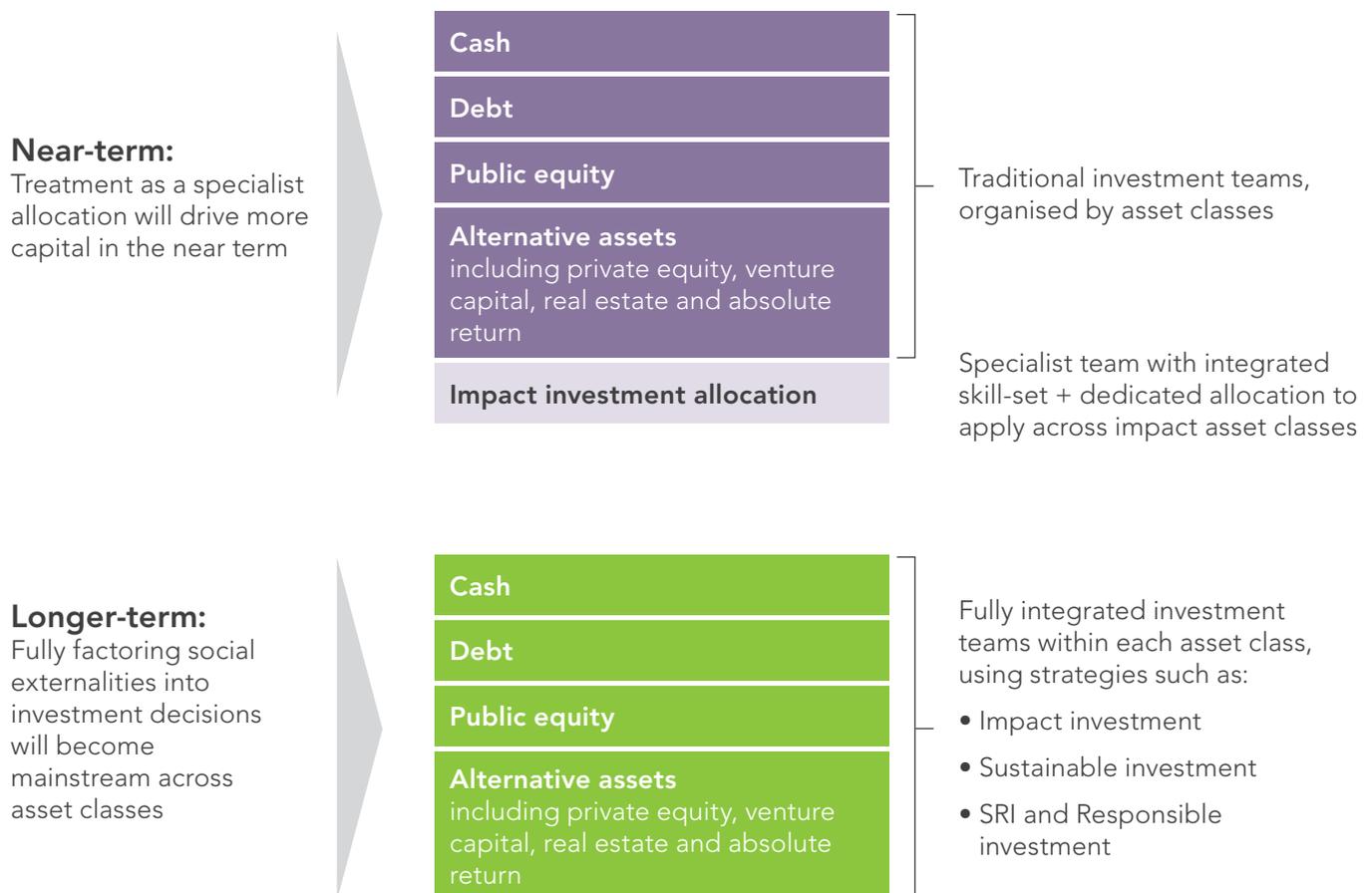
allocation’, equivalent to the proportion of the investor’s total asset allocation that has an impact purpose. This concept would allow an investor to migrate seamlessly from treating impact investment as an asset class to integration across the entire portfolio because it can also capture the intermediate stage when an investor has the expertise to integrate impact investments within certain asset classes, but not others. Retaining the notion of an overall ‘impact allocation’ will enable investors to speak consistently and coherently about how they are approaching impact investing, whilst doing it differently for different asset classes.¹³

Clearly, the size of this ‘impact allocation’ will be a function of an investor’s overall portfolio and, in particular, its objectives and remit. For many institutional investors, it will be important to understand, in the context of that remit, what the return, risk and liquidity trade-offs resulting from the inclusion of impact investments might be.

In the following section, we therefore re-cap a framework for traditional portfolio construction (to facilitate the evaluation of any trade-offs in the context of a financially efficient portfolio) and suggest specific considerations for those seeking to integrate impact investments. *We then offer an alternative illustrative portfolio, which demonstrates that impact investments, if thoughtfully selected, can be included without significantly increased volatility or return dilution but with some increase in illiquidity.*

Many individual investors will have a less structured or optimised approach to the size and content of their portfolios and may, for example, place greater emphasis on the societal impact of their investing than on overall portfolio trade-offs or financial efficiency. Nevertheless, we feel that the analytical framework that follows is of value to these non-institutional investors too.

Fig. 4 Impact investment as a strategy across asset classes



¹³ We are grateful to Greg Davies of Barclays for this additional observation.

Re-cap: Portfolio construction and Strategic Asset Allocation (SAA)

A multi-asset class portfolio approach is based on the principle of diversification of risk and return. The aim is to achieve a long-term investment goal for a reasonable amount of risk and uncertainty (volatility) over a longer period of time (typically five years or more). The most appealing feature is the diversification of risk and return stemming from the fact that, in times of crises and turmoil, different asset classes typically move in different directions: for example, government bonds do well when equities give negative returns. The justification for a well-diversified multi-asset class portfolio comes from the perception that the only free lunch in finance is diversification itself. The building blocks of such a portfolio include the traditional asset classes of public equities, government bonds, investment grade corporate bonds, high yield bonds, private equity and private debt instruments.

In investment language, the Strategic Asset Allocation (SAA), which defines the long-term allocation of the portfolio across asset classes, determines most of the risk and return of the portfolio (subject to any tactical short-term shifts

or instrument selection).

General SAA approach

The SAA structures a portfolio at the asset class level to match the specific investment objectives and risk tolerance of investors. If well structured, it offers the best financial risk/return trade-off for a given level of acceptable risk. Constructing an SAA is both an art and a science; good practice requires a robust quantitative framework and seasoned judgment. The quantitative framework supplies a detailed understanding of the behaviour of financial markets. Qualitative assessments – i.e. the seasoned judgment provided by asset class and asset allocation experts – complement this framework by capturing the subtleties, dynamic nature, structural changes, and likely future developments of various markets. The combination of the quantitative and qualitative inputs results in a set of capital market assumptions (CMAs), representing volatility, correlations, and return expectations for each asset class (equities, high grade bonds, investment grade corporate bonds, etc).

The construction process involves the following steps (see illustration below):

- Establish the objectives of the allocation
- Defining the investment universe
- Estimating the multi-business-cycle “equilibrium” asset class covariance matrix

- Estimating forward-looking, single-business-cycle (five to seven years) asset class returns
- Consolidating asset class estimates for expected risk and return, the so-called capital market assumptions in a consistent way
- Constructing portfolios or SAAs based on optimal risk and return trade-off, including testing portfolios across history and possible future market stress scenarios

To assure reasonable assumptions, SAAs and CMAs should be reviewed on an ongoing basis, say every 18 to 36 months, to assure that portfolios and expected returns are anchored on long-term views and also account for structural market adjustments over time (for example the “new” interest rate environment post the global financial crisis).

An illustration of such a set of portfolios or SAAs is given in table 1, where one sees a set of portfolios split into risk levels from left to right and across asset class from top to bottom, spanning from high grade bonds to equities and then to alternative investments. The columns to the right present what could be realistic return and risk expectations for the individual asset classes in a world where yields are expected to normalize as central banks start to move interest rates up over the coming five years.

Table 1 – SAAs with traditional investments¹⁴

USD reference currency	Client strategies				(Sub) asset classes characteristics		
	Lower risk	→		Higher risk	Hedged	Expected 5 Yrs Return p.a.	Expected Volatility p.a.
	Income strategy	Yield strategy	Balanced strategy	Growth strategy			
Money markets	5%	5%	5%	5%		1.7%	0.5%
Bonds	73%	55%	38%	21%			
High Grade USD bonds 5-7y	40%	25%	20%	11%		3.1%	2.5%
Short-term USD Corporate bonds 1-5yr	10%	8%				2.7%	3.0%
USD Corporate bonds	13%	12%	10%	2%		4.3%	5.5%
US High Yield bonds	5%	5%	5%	5%		4.8%	9.6%
EM sovereign bonds	3%	3%	3%	3%		5.2%	8.7%
EM corporate bonds	2%	2%				5.2%	9.1%
Equities	10%	25%	42%	62%			
USA equities	5%	12%	21%	33%		7.6%	15.1%
Emerging Market equities		4%	6%	9%		10.3%	23.9%
EMU equities		4%	5%	7%	X	7.6%	19.0%
UK equities	3%	3%	4%	6%	X	7.8%	13.5%
Japan equities			4%	5%	X	7.2%	19.5%
Switzerland equities	2%	2%	2%	2%	X	7.3%	14.8%
Private markets – Absolute Return	12%	15%	15%	12%			
Absolute return	12%	15%	15%	12%		4.1%	6.3%
Total	100%	100%	100%	100%			

Traditional SAA:				
Expected 5 yrs Return p.a.	3.9%	4.7%	5.5%	6.3%
Expected Volatility p.a.	3.6%	5.5%	7.5%	10.1%

¹⁴ The return forecast should not be seen as exact numbers but rather as centre point of a distribution of likely returns. Monte Carlo simulations are used for this illustration.

B. HOW TO INTEGRATE IMPACT INVESTMENTS INTO A PORTFOLIO

Since impact investment is a strategy across asset classes, the impact investment universe can be aligned to standard investment practice, which we have categorized as follows: fixed income, equities and private markets (including absolute return, private equity, venture capital, private debt, and private real estate). This can be further broken down to give investors access to such sub-asset classes as impact venture capital or impact absolute return.

Capital market assumptions (CMAs) for impact

As is the case for the standard asset classes, in order to incorporate impact asset classes in a Strategic Asset Allocation/portfolio context, we need to develop capital market assumptions for each impact investment asset and sub-asset classes. The individual or institutional investor can use the expected characteristics of traditional asset classes as a benchmark and decide, asset class by asset class, what constitutes a reasonable financial return, volatility and liquidity profile for both the individual impact investment (relative to a traditional investment in that asset class) and the aggregate portfolio (relative to a traditional SAA).

Some impact investments will have the same characteristics as traditional investments in their related (sub) asset class. However, recalling our earlier framing of the attractions of impact investment, as well as the variations within it, there are often additional considerations for an investor to take into account.

Financial return considerations

Recalling the spectrum of capital shown earlier (p9), investors can consider impact investments' financial return potential relative to standard instruments with the relevant (sub) asset class. There are at least three categories to consider:

1. Investments addressing societal challenges that generate a competitive financial return for investors
2. Investments addressing societal challenges that may generate a competitive financial return for investors
3. Investments addressing societal challenges that require a below market financial return for investors. Although they may not therefore

become standard commercial instruments, they are nonetheless of interest to impact investors.

The extent to which an investor includes more or less of these various categories within a portfolio will depend on their particular emphasis on achieving certain forms of societal impact relative to overall portfolio trade-offs or financial efficiency. For example, one investor may seek a competitive risk-adjusted financial return of, say, 10-15% and only target impact investments with the potential to deliver this. Another investor may view 10-15% as the norm but be willing to accept a financial return of 8%, if the underlying investment employs a cap on distributions in order to cross-subsidise delivery of education to particularly disadvantaged communities.

Risk and diversification considerations

As with financial return potential, some impact investments fall obviously into traditional sub-asset classes and may therefore be viewed as having a similar risk profile to traditional investments. However, many impact investments' revenue streams may actually prove to have a lower correlation to traditional business-cycle driven investments. For example, impact investments' focus on addressing critical societal needs can result in continued strong demand in an economic downturn; or, as is the case with Social Impact Bonds,¹⁵ an opportunity's financial return streams may be linked solely to the delivery of a pre-agreed set of societal outcomes – outcomes not necessarily correlated with traditional investment benchmarks. Investors may therefore wish to categorise impact investments according to their diversification contribution to the overall portfolio.

Finally, it is important to note that some impact investments are novel and somewhat unproven, and may incorporate non-market related risks. Investors can therefore further categorise impact investments according to their development stage. For example, proven instruments versus newer models, which may need "early adopters" before they can become standard instruments.

Liquidity considerations

At this stage in the development of impact investing, many opportunities are found in less liquid form within the private markets of the alternative investment (AI) space. Broadly, alternative investments can be said to comprise four sub-categories under private markets:

¹⁵ See page 6 for a detailed explanation

absolute return, private equity/venture capital, private debt and real assets/estate. The AI investment universe is illustrated in figure 5 below. At the current level of development, the absolute return space is where we would allocate Social Impact Bonds (SIBs) and Development Impact bonds (DIBs).

Over time, we envisage that this focus on alternatives will lessen, as impact investment opportunities become widespread across traditional asset classes like corporate bonds and listed equity (for example, those companies listing on the Social Stock Exchange). At the moment, however, it may be sensible for an investor to focus on including impact investments in traditional non-liquid asset classes like private equity and venture capital, private debt and absolute return.

In summary, the traditional framework for portfolio construction can be used as the guide rails for making what an investor considers to be a reasonable allocation to impact investments. However, given the variation among opportunities, as well as the limited evidence base, we advise considering both top-down (macroeconomic, market-specific characteristics and asset class proxy modeling) and bottom-up (security or deal-specific) considerations when creating impact CMAs. As a further caution, we emphasize that portfolio implementation needs to be done deal-by-deal to ensure alignment of security-specific risk/return expectations versus those developed within the CMA framework. Finally, from a top-down perspective, we emphasize diversification across a number of deals or funds even within each sub-asset class (a well-known

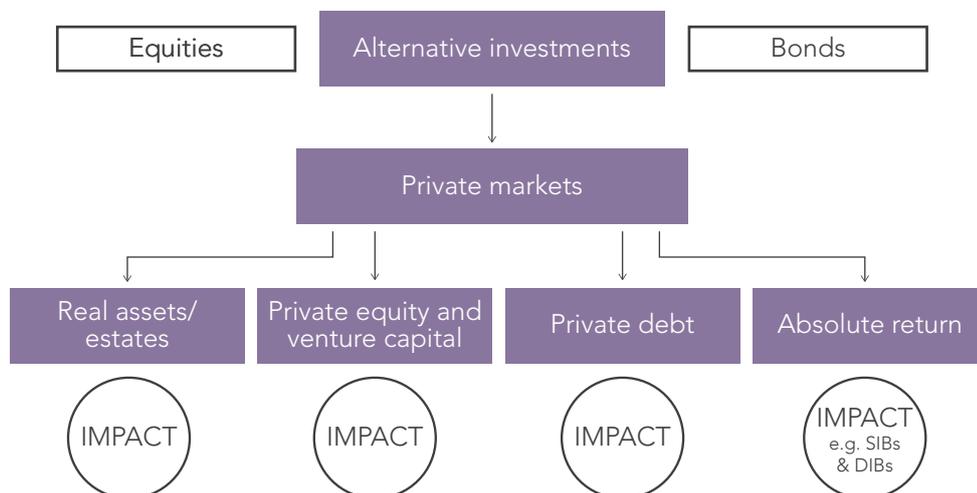
phenomenon from traditional investing, for example, a number of different funds or holdings of US equities).

C. EXAMPLE OF A PORTFOLIO THAT INCLUDES IMPACT INVESTMENTS

In the Re-cap section above, we recommended a starting point for well-diversified portfolios across different risk levels, ranging from an income-focused strategy to one focused on equities. In order to understand the effect that an 'impact allocation' may have on the characteristics of a portfolio, Table 2 on the opposite page shows a similar set of portfolios with a recommended allocation to impact investments across different asset classes.

Given the short track records, nascent nature of the market, and limited evidence base, we caution that this portfolio is illustrative only. However, we have endeavoured to use conservative assumptions for the return and volatility of impact investments for modelling purposes, assuming that, within absolute return, opportunities will be able to deliver a return of approximately 4% with a volatility of a little more than 6%. We have also assumed an initial 20% cut on the return expectations of impact investments in other asset classes, which would represent an investor's desire to include not just impact investments that deliver competitive financial returns but also those that may deliver a below market financial return (and/or even some investments that require one). Finally, we have assumed that an impact executive, looking to allocate across asset classes, will find

Fig. 5 A focus Alternative investments diagram alternative investments



opportunities available in fixed income, equities, real estate, absolute return, private equity, venture capital and private debt but that less liquid asset classes may form a significant percentage (two thirds) of the total allocation to impact investment in the near term.¹⁶

Based on all of these assumptions, we estimate that an investor with an 8–12% impact investment allocation¹⁷ should be able to achieve the same financial return as an investor with no impact allocation, assuming that the dedicated investor is willing to accept a larger share of the portfolio

in illiquid investments. Indeed, by including an impact allocation, such an investor may even see improved diversification and a slightly better expected financial return.

The key is to maintain a diversified and cautious approach to these new investment opportunities and to accept that they involve an increase in illiquidity in the portfolio, which may decrease over time as impact investment opportunities increase in more liquid asset classes, such as public equities.¹⁸

Table 2 – SAAs including Impact Investments

	Client strategies				(Sub) asset classes characteristics		
	Lower risk	→		Higher risk	Hedged	Expected 5 Yrs Return p.a.	Expected Volatility p.a.
USD reference currency	Income strategy	Yield strategy	Balanced strategy	Growth strategy			
Money markets	5%	5%	5%	5%		1.7%	0.5%
Bonds	70%	50%	33%	16%			
High Grade USD bonds 5-7yr	38%	22%	17%	7%		3.1%	2.5%
Short-term USD Corporate bonds 1-5yr	9%	8%				2.7%	3.0%
USD Corporate bonds	10%	8%	6%			4.3%	5.5%
Impact investment grade bonds	3%	2%	2%	2%		3.8%	5.5%
US High Yield bonds	5%	5%	5%	4%		4.8%	9.6%
EM sovereign bonds	3%	3%	3%	3%		5.2%	8.7%
EM corporate bonds	2%	2%				5.2%	9.1%
Equities	10%	22%	38%	56%			
USA equities	5%	10%	19%	30%		7.6%	15.1%
Emerging Market equities		3%	5%	7%		10.3%	23.9%
International diversified impact equities		1%	1%	2%	X	7.2%	23.9%
EMU equities		3%	4%	5%	X	7.6%	19.0%
UK equities	3%	3%	4%	5%	X	7.8%	13.5%
Japan equities			3%	5%	X	7.2%	19.5%
Switzerland equities	2%	2%	2%	2%	X	7.3%	14.8%
Private markets – Absolute Return	10%	12%	12%	12%			
Absolute return	8%	9%	9%	9%		4.1%	6.3%
Impact Absolute Return (including SIBs/DIBs)	2%	3%	3%	3%		4.1%	6.3%
Private markets – Real asset/estate	3%	6%	6%	5%			
Private real estate	2%	3%	3%	3%		10.2%	7.0%
Impact real estate	1%	3%	3%	2%		8.1%	7.0%
Private markets – PE/VC & private debt	2%	5%	6%	6%			
Private equity/venture capital & private debt		3%	3%	4%		9.5%	9.9%
Impact private equity/venture capital & private debt	2%	2%	3%	2%		7.2%	9.9%
Total	100%	100%	100%	100%			
IMPACT assets	8%	11%	12%	11%			

SAA including impact:				
Expected 5 yrs Return p.a.	4.1%	5.1%	5.9%	6.7%
Expected Volatility p.a.	3.6%	5.3%	7.3%	9.7%
Versus:				
Traditional SAA:				
Expected 5 yrs Return p.a.	3.9%	4.7%	5.5%	6.3%
Expected Volatility p.a.	3.6%	5.5%	7.5%	10.1%

16 The portfolios presented in this paper have allocation to alternative asset classes of 15-24 percent. This is probably a reasonable allocation for most private and institutional investors, but for many endowments and Ultra High Net Worth individuals an allocation of 30-40% or more to alternatives will be natural. Assuming that this allocation comes with a tolerance for less liquid assets, we would recommend gradually increasing the impact allocation in line with the overall allocation to alternative investments as impact investment opportunities increase.

17 Depending on the strategy being employed, ranging from income- to equity-focused.

18 We have made only very limited allocations to traditional equities, since this area is in development and any single line holdings of several percentage points would represent a concentration risk, which we try to avoid in both traditional and impact asset classes.

BARRIERS TO GREATER ALLOCATION¹⁹

While there is a compelling case to support the growth of impact investment – and many case studies show ‘success stories’ already at work – the total allocation to impact

“It’s a struggle to see more institutional investors entering this space, when the ticket size is so small.”

Pension fund

investment remains small, relative to the scale of pressing societal challenges that it has the potential to address. Why is this the case and how might policy play a powerful enabling role for greater allocation?

Our analysis has taken a bottom-up approach. First, we analysed which significant ‘pools’ of capital are not (sufficiently) participating in the market today because of a variety of barriers. Second, recognising that barriers to allocation will vary by pool, we analysed existing barriers for each pool. Third, we created a matrix, on which we could highlight the greatest barriers for each pool. This matrix is shown overleaf, followed by a set of corresponding policy recommendations.

A. ‘POOLS’ OF CAPITAL

The ‘pools’ of capital that our Working Group considered most relevant included mass retail, foundations, High Net Worth Individuals (HNWIs), single and multi-family offices, pension funds, banks and insurance companies. We also included the intermediaries who act as ‘gatekeepers’ to large pools of capital, including retail advisors, HNWI advisors and institutional advisors.

Our analysis recognises that foundations can make various allocations: either through grants (taking the form of catalytic philanthropy to support impact investment), through programme-related investment (carve-outs from their grantmaking) or through their endowment (in the form of mission-related investment). Likewise, banks can behave as asset owners (investing their own balance sheet) or as intermediaries, investing on behalf of their clients.

B. KEY BARRIERS

The following key barriers were identified by the Working Group, with support from additional market research.* Barriers were assumed to be ‘key’ when they were considered significant for a range of capital pools. They fall into three main categories:

Conflict of Duty

- **Fiduciary duty**
Perception that impact investing cannot deliver appropriate risk-adjusted financial returns
- **Compliance**
Perceived conflict with internal/external rules and regulations

¹⁹ The findings and quotations presented in this chapter draw significantly on a report by Bridges IMPACT+: ‘Shifting the Lens: A De-risking Toolkit for Impact Investment’, published January 2014, which was commissioned by the Bridges Charitable Trust and funded by Bank of America Merrill Lynch

“Without liquidity, or the perception of liquidity, huge sections of the investing community will not be able to participate in the impact investment market.”

Investment bank

“Impact risk is particularly real for those whose existence depends on achieving targeted societal outcomes.”

Foundation

Nascent sector

- *Lack of specialism*
Traditional asset allocation frameworks, team structures and skill sets not designed to incorporate impact investment strategies
- *Lack of appropriate opportunities*
Lack of suitable investment options in terms of sector (target outcome/beneficiary), geography, size or asset class, as well as lack of intermediaries to support origination
- *Disproportionate transaction costs*
Transaction costs out of proportion with potential financial returns

Risk factors

- *Capital risk*
Loss of some or all of the original investment amount
- *Unquantifiable risk*
Lack of track record: While all investments carry risk, unquantifiable risk applies to situations in which the investment profile is not well-known. Since impact investment is not yet a mainstream strategy – in terms of its investment products and investment teams – asset owners can find quantifying the level and type of risk involved particularly challenging.
- *Exit risk*
Investments not sufficiently liquid to meet uncertain cash flow demands
- *Impact risk*
Impact evidence not sufficiently robust to justify diversion of funds from other impact-creating opportunities

A note on our approach

We recognise that this is not a comprehensive list of barriers to allocation. For example, we have not included a discussion of important barriers such as market risk, operational risk or currency risk. This is because, while these barriers are relevant to impact investments, the addition of an impact lens was not cited as significantly increasing the importance of these barriers.

C. Key Barrier Matrix

		Asset owners			
		Mass retail	Foundations and Endowments		Single family offices & HNWI's
			Programme-Related Investment (PRI)	Mission-Related Investment (MRI)	
Conflict of duty	Fiduciary duty	See Advisors	N/A	Trustees continue to be concerned as to whether mission-related investment falls within charitable regulation and tax code	See Advisors
	Compliance	See Advisors	Concern that the use of grant funds for investment may result in private gain that is in conflict with public benefit duty	See above	See Advisors
Nascent sector	Lack of specialism	See Advisors	The typical separation of the grantmaking team and investment team can make assessment of opportunities that require the skills of both a challenge		See Advisors
	Lack of appropriate opportunities	Lack of suitable investment options in terms of sector (target outcome/beneficiary), geography, size or asset class, as well as lack of intermediaries to support			
	Disproportionate transaction costs	Require transaction costs to be sufficiently low so as to be in proportion to smaller investment	Willing to tolerate higher transactions costs, providing the social impact is sufficiently high	Require sufficiently large capital outlay to justify expenditure on due diligence, structuring and management of impact investments	Willing to tolerate higher transaction costs, providing the social impact is sufficiently high
Risk factors	Capital risk	Generally wealth is for retirement purposes or for the next generation, making capital preservation, at a minimum, a priority	Intention to re-cycle funds for leveraged impact can make (some level of) capital preservation a priority	Concern about erosion of capital base (ability to generate income for grantmaking) makes capital preservation, at minimum, a priority	Demonstrated willingness to forgo some financial return for the sake of impact but typically not prepared to absorb capital losses
	Unquantifiable risk	See Advisors	Willingness to venture into uncharted territory depends on potential for impact 'upside'	Unfamiliar products require trustees to play a more active role in decision making, since ability to calculate risk is viewed as core to fiduciary duty	For those HNWI's investing directly, willingness to venture into uncharted territory depends on potential for impact 'upside'*
	Exit risk	Requirements vary within this group, although uncertain cash flow demands can make liquidity a top priority	Short-term liquidity not a priority but goal of re-cycling capital for leveraged impact does require a defined exit strategy within a reasonable timeframe	Liquidity not a priority (buy-to-hold investments have a place in these portfolios)	Buy-to-hold investments have a place in these portfolios. However, see Advisors
	Impact risk	Impact performance must be sufficiently transparent and easy to understand to justify opportunity cost of capital (diverting funds from either grantmaking or traditional investment)	Critical that impact performance is sufficiently cost-effective to justify opportunity cost of capital, i.e. to justify diverting funds from grantmaking	Critical that impact performance is sufficiently cost-effective to justify diverting funds from existing 'tried and tested' investments that optimise surpluses for grantmaking	Impact performance must be sufficiently compelling to justify transaction costs

		Asset owners			Intermediaries
		Multi family offices	Pension funds	Banks and Insurance Cos <i>Own balance sheet</i>	Advisors <i>Retail advisors HNWI advisors Institutional advisors</i>
Conflict of duty	Fiduciary duty	Advisors typically do not ask family members whether they wish to invest in line with their values (See Advisors)	Societal duty to maximise people's future pensions creates a fear of any additional investment criteria that may inhibit maximising financial value	N/A	Very few advisors have asked their clients whether they wish to invest in line with their values. Consequently, advisors typically see their duty as solely to maximise financial risk-adjusted returns and fear that the addition of an impact lens may inhibit this
	Compliance	See Advisors	See above	Capital requirements (e.g. Insolvency II) can include investment liquidity considerations, which conflict with many less liquid impact investments	See above
Nascent sector	Lack of specialism	See Advisors	Where someone/a team may be leading on impact investments, they tend not to have any specific budget for allocation		Little incentive (from a fee or liability perspective) to develop impact investment expertise
	Lack of appropriate opportunities	Lack of suitable investment options in terms of sector (target outcome/beneficiary), geography, size or asset class, as well as lack of intermediaries to support			
	Disproportionate transaction costs	Require sufficiently large capital outlay to justify expenditure on due diligence, structuring and management of impact investments	Can have strict rules about investment size, % holding and management fees	Require sufficiently large capital outlay to justify expenditure on due diligence, structuring and management of impact investments	Typical fee structures do not cover additional due diligence of impact factors
Risk factors	Capital risk	Demonstrated willingness to forgo some financial return for the sake of impact but typically not prepared to absorb capital losses	Role as conscientious 'steward' of people's pensions makes protection against losses a priority	Lack of clarity about whether competitive risk-adjusted financial returns are widely achievable has led to a focus on limiting downside	See relevant asset owners
	Unquantifiable risk	See Advisors	Many pension funds rely on external advisors (See Advisors)	'A 'testing the water' attitude can mean a willingness to venture into uncharted territory, providing capital risk is reduced (see above). However, see Compliance	Unfamiliar products are a challenge for Independent Financial Advisors (from a liability and fee perspective), who want to show clients a product with track record and to benchmark that product within conventional portfolios
	Exit risk	Buy-to-hold investments have a place in these portfolios. However, see Advisors	Liquidity not a top priority, although exit path must be clearly defined	Financial institutions lending for fixed terms are less concerned about liquidity. However, see Compliance	Flexibility to sell a security can be a key requirement for advisors considering whether to invest a client's money
	Impact risk	Impact performance must be sufficiently compelling to justify transaction costs	Protecting against (the reputational risk of) poor impact performance often viewed as priority	Impact performance has to be sufficiently compelling to justify transaction costs (see Transaction cost risk above).	Advisors will consider credible impact performance as key to product offering for clients (impact risk therefore linked to reputational risk)

POLICY LEVERS FOR CHANGE

Using this matrix of key barriers, we have identified 10 key policy levers that can address the greatest number of barriers for the greatest pools of capital (represented by the grey squares on the preceding page). Importantly, these levers were identified based on real examples; they are actionable recommendations.

Key barrier Recommended levers

CLARIFICATION OF FIDUCIARY DUTY

Permit (and consider requiring) investors to factor social and environmental impacts into investment decisions

Require reporting on ESG factors

Example(s)

The revised Regulation 28 in South Africa sets well-defined, prudential asset-allocation guidelines for pension funds. South African pension funds are therefore required to take ESG factors into account and responsible investment is linked to the fiduciary duty of pension funds' trustees.

FIDUCIARY DUTY

FISCAL INCENTIVES

Introduce tax relief schemes which, depending on local context, may target social enterprises, investors in social enterprises and/or regulated social investment funds

Example(s)

Having been in existence for over 10 years, the Community Economic Development Investment Funds (CEDIFs) programme, in the province of Nova Scotia, Canada, is an exemplar of a long-term government intervention in support of social enterprise. The CEDIFs provide individual investors a 35% tax credit on investments into local communities and have already directed over US\$ 50 million to support local businesses and social enterprises.

In the UK, the Social Investment Tax Relief (SITR) is intended to encourage investment in social sector organisations by offering tax breaks for investors seeking to support them to create social as well as financial returns.

'DO OR EXPLAIN' RULE

Require all regulated financial and foundation endowments to articulate their contribution to impact investment.

Example(s)

Although not particular to impact investment (nor charitable and financial institutions) the following two examples are very relevant:

Clause 135 of the Companies Bill in India was introduced in 2012 (the "CSR Clause") requiring targeted companies to spend a prescribed formula-based amount (typically 2%, hence the "2% CSR clause") on CSR and to report on these activities, or explain why they failed to spend, in the annual report. There is no penalty for failing to spend on CSR, but there are penalties for failing to explain why CSR spending was not carried out. In the US, in the context of the ERISA regulation, the US Department of Labor enables pension funds to invest in private equity/venture capital, through the definition of two special types of operating companies, viz. venture capital operating companies (VCOCs) and real estate operating companies (REOCs), conditional to fund managers adhering to established prudence norms.

COMPLIANCE

'OPT-OUT' AS STANDARD PACKAGE

Require all pension fund offerings to include an allocation to impact investment, unless a pensioner chooses to 'opt out'

Example(s)

A similar ('opt in', rather than 'opt out') approach has been taken in France. Since 2010, all enterprises that provide an employees' savings plan – effectively, all medium and large enterprises – are obliged to include in their offering at least one communal solidarity fund ("Fonds Commun de Placement d'Entreprise Solidaires (FCPES)"). These FCPES are required to invest between 5% and 10% of their capital in affiliated social enterprises.

LACK OF SPECIALISM

PRIORITY SECTOR LENDING

Require banking institutions to lend to priority sectors

Example(s)

In 1968, the Indian National Credit Council emphasised that commercial banks should increase their involvement in the financing of priority sectors, viz., agriculture and small scale industries. The Reserve Bank later prescribed a modified return for reporting priority sector advances and issued guidelines thereto. Banks were advised to raise the share of these sectors in their aggregate advances to the level of one third, later adjusted to 40%. Sub-targets were later also specified, including for lending to the agricultural sector. In 2011, the revised guidelines set the minimum level of total credit to be lent to the agricultural sector specifically at 18%.

Key barrier

Recommended levers

LACK OF APPROPRIATE OPPORTUNITIES

REQUEST FOR PROPOSALS

Challenge product developers to bring forward opportunities with profiles that commissioners/ asset owners seek

Example(s)

The Investing4Growth initiative is shared by five local UK government pension funds. It targets creating an economic impact as well as positive social and environmental outcomes through its investment activity. Asset managers are invited to put forward for consideration investment opportunities that have appropriate risk and return characteristics, provided that the pension funds' investment is to be deployed for the benefit of the local communities that have contributed to the funds over the years. Investments may include infrastructure, resource management and business development.

DISPROPORTIONATE TRANSACTION COSTS

BUNDLING

Stimulate the intermediary market (through co-investment or fund-of-funds) to create more bundled/ multi-asset products at-scale

Example(s)

In 2012, after more than a decade of cross-party government efforts to strengthen social-investment markets, Big Society Capital (BSC) was established. BSC serves as a "wholesaler" of capital in the UK social investment space, deploying assets to social investment intermediaries, with its ultimate goal being to provide social-sector organisations with access to new sources of finance as well as to support the overarching Government effort to have more services delivered by social sector organisations.

CAPITAL RISK

CATALYTIC CAPITAL

Provide matching capital, first loss layers positions, guarantees, tax schemes and/or insurance

Support enterprises / products to become investment-ready

Example(s)

The UK's Big Lottery Fund has provided a £10 million fund to help social sector organisations in England to become 'investment ready'. The ultimate aim of the fund is to improve the sustainability, capacity and scale of social sector organisations. The programme complements the UK Cabinet Office's Investment and Contract Readiness Fund.

To catalyse the African Agriculture Capital Fund (AACF), USAID has provided a 50% loan guarantee, in addition to subordinated equity investments, through its Development Credit Authority. The AACF is a private-equity fund launched in 2011 with the purpose of boosting productivity and profitability of Africa's undercapitalised agricultural sector.

UNQUANTIFIABLE RISK

PLACEMENT AND DISTRIBUTION PLATFORMS

Support platforms that showcase a wide range of social impact investment products, allowing investors to compare, benchmark and even trade

Example(s)

In Canada, SVX, led by the MaRS Centre for Impact Investing in Toronto and supported by the Government of Ontario, has been set up as a private investment platform to connect impact ventures, funds and investors. In Europe, the Social Stock Exchange (SSE) has been set up to showcase publicly-listed 'Social Impact Businesses' that evidence their societal impact. Among others, the SSE is supported by the London Stock Exchange, the City of London Corporation, Big Society Capital and The Big Lottery Fund.

EXIT RISK

The Government of Ghana's Venture Capital Trust Fund (VCTF) has been instrumental in the creation of the Ghana Alternative Market (GAX), launched in 2013 and specifically targeting SMEs. Entry into the primary market exchange tends to be prohibitively costly for SMEs within the African context. The GAX offers SMEs a more viable and accessible option to access investment.

IMPACT RISK

IMPACT RATING SYSTEM

Support the development of an impact investment rating system, including a formal alliance with a credible global rating agency

Example(s)

With the support of the Government of Luxembourg and the Swiss Development Cooperation, the Rating Initiative was launched to promote the use of financial and social ratings in the microfinance industry. The Rating Initiative works with both specialised and mainstream agencies, with a threefold goal of: a) contributing to the establishment of a healthy global microfinance rating market in underserved regions for both financial and social ratings; b) addressing the lack of available, transparent information on MFIs and c) ensuring the availability of market information on the microfinance rating sector in general.

CONCLUDING REMARKS

We hope that the frameworks presented in this report provide a useful lens through which both investors and policymakers can assess the potential for impact investment to contribute to their agendas.

In particular, we hope that investors will recognise that impact investments can fit comfortably within a traditional portfolio framework. We encourage further research to size the current available universe and substantiate capital market assumptions. We also encourage policymakers to recognise their opportunity to use well-designed financial policies to harness the power of private capital for public good. It is already evident in a range of countries that well-targeted policies can broaden capital flows and encourage a wide

variety of market actors to behave in the interest of society at large. Individual countries can learn from others' successes and build on this momentum.

We do not argue that impact investment is a panacea and that it should be supported at the expense of charitable approaches or public funding initiatives. Rather, it is a complementary tool in a broader toolbox of approaches available to wealthholders and policymakers who wish to tackle social issues. As the social challenges of the 21st century unfurl globally, philanthropy and government spending will be more important than ever, but the scale of the challenges ahead will necessitate private capital to be harnessed. We hope that this report provides some of the groundwork for how this might be achieved.

ACKNOWLEDGEMENTS

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The Working Group also received input from many other experts and practitioners from across the world, for which we are indebted.

The members of the Working Group are listed below and include leading thinkers in finance and impact investment, with representatives across sectors and geographies and with a diversity of perspectives:

Chair

Harvey McGrath Big Society Capital

Members

Abigail Noble	World Economic Forum
Bill Young	Social Capital Partners
Brian Bailey	Social Finance
David Blood	Generation Investment Management
David Chen	Equilibrium Capital
Fran Seegull	IMPACT ASSETS
Josh Gotbaum	Pension Benefit Guaranty Corporation
Julie Sunderland	Gates Foundation
Lisa Hall	Anthos Asset Management
Mads Pedersen	UBS
Martin Rich	Social Finance
Michael Drexler	WEF
Michael Schneider	Deutsche Bank AG, Asset & Wealth Management
Michele Giddens	Bridges Ventures
Sandra Odendahl	RBC
Sean Greene	Revolution / Case Foundation
Stephen Fitzgerald	Future Fund
Terri Ludwig	Enterprise Community Partners
Uli Grabenwater	European Investment Fund

Observer

Andre Perold HighVista

