



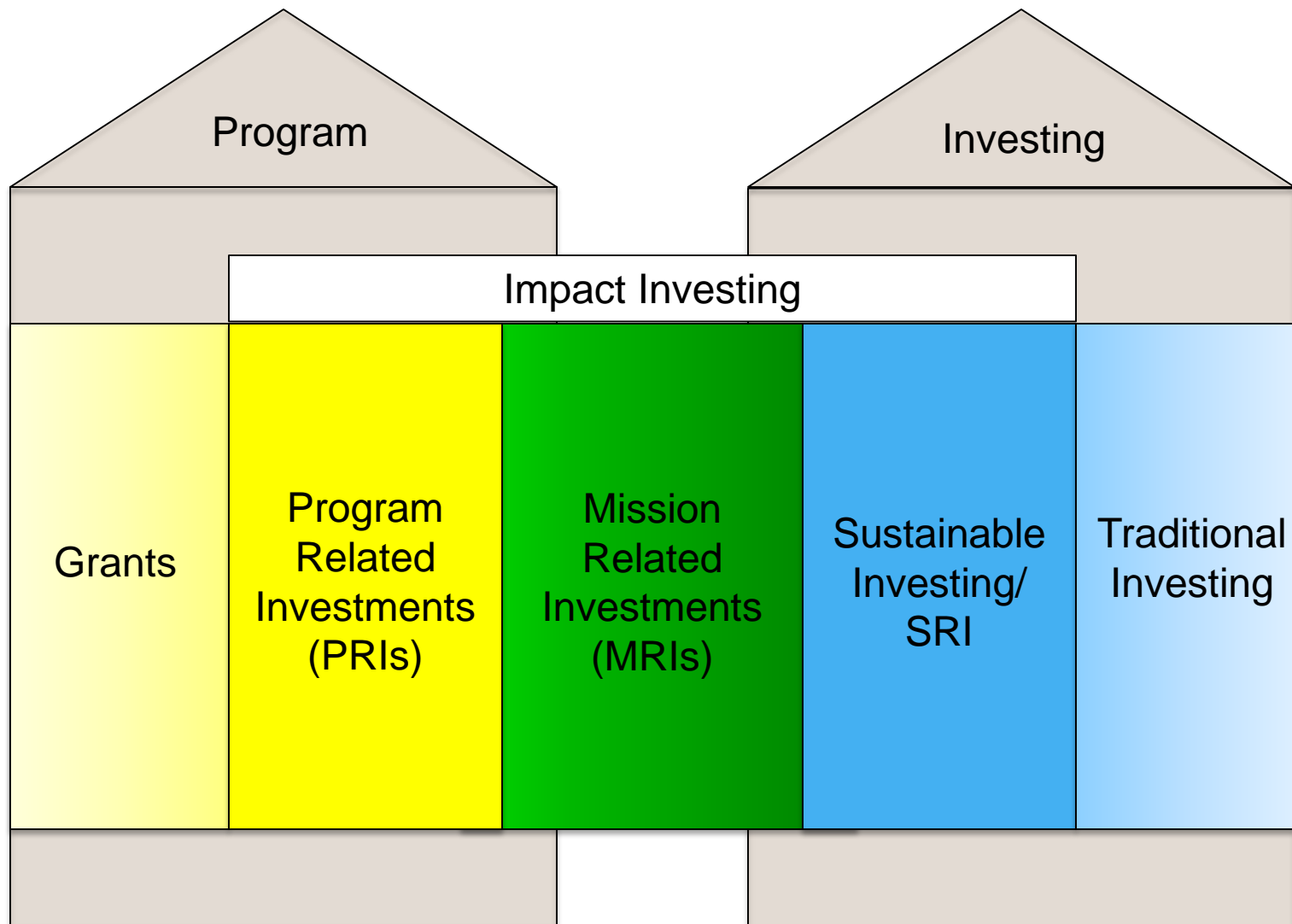
# Impact Investing Update November 10, 2017

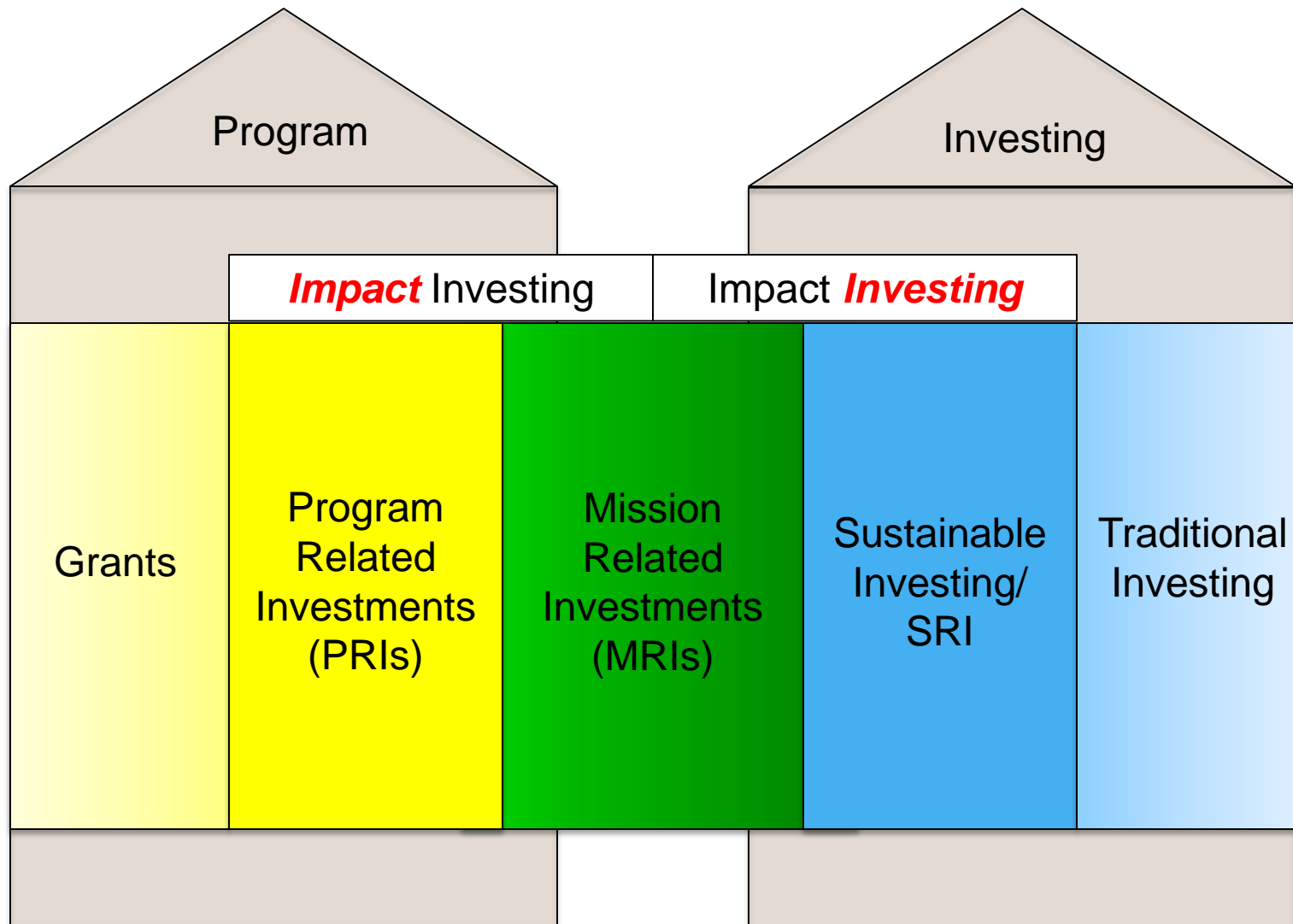
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# What is impact investing?

“Investments made into companies, organizations, and funds with the intention to generate measurable social and environmental impact alongside a financial return.”

-- The Global Impact Investing Network (“GIIN”)





	Grants	PRIs	MRIs	Sustainable Investing/SRI	Traditional Investing
Impact	Must further charitable purposes, other restrictions	Primarily for charitable purposes, other restrictions	Charitable and financial purposes	Primarily for financial return, plus impact/ not harm	Often unknown (Impact not considered )
Financial Return	No return, principal lost	Generally below market	Market or below market	Generally market rate	Market rate returns
Tax/ Fiduciary Rules	Program distribution/ no UPMIFA	Program distribution/ no UPMIFA	Investment/ maybe UPMIFA	Investment/ UPMIFA	Investment/ UPMIFA
Recent Guidance		PRI Regs = new examples	MRI Notice 2015-62	DOL IB-2015-1, DOL IB-2016-1	

## IRC Section 4944

- Section 4944 of the Internal Revenue Code imposes an excise tax on a foundation that makes a “jeopardizing investment” – an investment that jeopardize the carrying out of the organization’s charitable purposes
  - Determination is made at the time of the investment, taking into account the entire portfolio
  - Jeopardizing investment is one in which managers did not use ordinary business care and prudence in making investment
  - Additional managers taxes may also apply
- Program-related investments are NOT jeopardizing investments

# Program-Related Investments (PRIs)

- A PRI is an investment where:
  - The **primary purpose** is to accomplish a charitable purpose; ***and***
  - **No significant purpose** is financial profit (“production of income or appreciation of property”); ***and***
  - **No purpose** is lobbying or participation in political campaigns
  
- PRIs are “grant equivalents” for tax purposes
  - treated as grants for the 5% distribution requirement (§4942)
  - exempt from the excess business holdings rules (§4943)
  - not jeopardizing investments (§4944)

(Note: expenditure responsibility required if PRI is not to a public charity and self-dealing rules apply)

# New PRI Examples Under § 4944 (Apr. 25, 2016)

- Final regulations, “Examples of Program-Related Investments,” were issued April 25, 2016.
- These regulations did not change substantive tests for PRIs, but provided nine new examples of PRIs, demonstrating:
  - PRIs can be used for various charitable purposes
  - PRIs can be made outside the United States
  - For-profit companies and individuals can be recipients of PRIs
  - PRIs can take a variety of forms, including: equity investments, loans, debt and equity packages, and credit enhancement arrangements (e.g., loan guarantees)



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# Sustainable Investing

- “An umbrella term for all strategies that incorporate ESG factors into investment decisions alongside financial analysis.”
  - World Resources Institute
  
- Includes:
  - Negative screens
  - Positive screens
  - ESG integration
  - Mission Related Investments/ Program Related Investments
  - Shareholder activism

# Uniform Prudent Management of Institutional Funds (UPMIFA) – Standards for Asset Mgmt

- Applies to funds, including endowments, held exclusively for charitable purposes, but **not** to “program-related assets” (assets held primarily for program-related purposes, rather than exclusively for investment)
- When managing/investing assets:
  - Duty of Loyalty / Duty of Care (prudent person) both apply (Note: experts have duty to use their special skills/expertise)
  - Must consider charitable purposes of the organization and of the fund, subject to donor intent expressed in gift instrument
  - Must make reasonable efforts to verify facts
  - May only pay appropriate and reasonable expenses

# UPMIFA – Some Investment Considerations

- Investment decisions made in the context of the whole portfolio and part of an overall investment strategy
- Duty to diversify, dispose of unsuitable assets
- Broad discretion to invest in all kinds of investments
- When investing, must consider (if relevant):
  - General economic conditions, effects of inflation, tax effects
  - Total expected return and role of each investment in portfolio
  - Other resources of the institution and the needs of the institution and fund to make distributions/preserve capital
  - *Asset's special relationship to charitable purposes of institution*

# DOL Interpretive Bulletin 2015-1 (Oct. 26, 2015)

- The Department of Labor issued guidance to ERISA plan fiduciaries regarding economically targeted investments (ETIs), which are selected for the economic benefits they create in addition to the investment return
  - Replaced 2008 guidance which “unduly discouraged” consideration of ETIs and environmental, social, and governance (ESG) factors
  - Fiduciaries may not sacrifice financial returns to “promote social, environmental, or other public policy causes” but may take ESG benefits into account as “tiebreakers” when investments are otherwise equal
  - Noted ESG factors may have a *direct relationship* to the investment’s economic value, in which case ESG issues are “not merely collateral considerations or tie-breakers, but rather are proper components of the fiduciary’s primary analysis”

# DOL Interpretive Bulletin 2016-1 (Dec. 29, 2016)

- The Department of Labor issued guidance to ERISA plan fiduciaries regarding proxy voting and other exercises of shareholder rights
  - Replaced 2008 guidance which had discouraged ERISA plan fiduciaries “from voting proxies and engaging in other prudent exercises of shareholder rights” unless a direct, quantifiable increase in economic value was demonstrated
  - Plan fiduciaries may not increase expenses or sacrifice returns to promote “collateral goals,” but the existence of financial benefits associated with shareholder engagement is suggested by trends in investment management, especially where holding for long-term value
  - Activities monitoring and influencing management of corporations in which the plan owns stock is consistent with fiduciary duties where there is a reasonable expectation that, alone or with others, it is likely to enhance the value of the investment, taking into account the costs

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# Notice 2015-62 (“MRI Notice”)

## *Investments Made for Charitable Purposes*

- IRS Notice 2015-62, published on September 28, 2015, provides guidance to private foundations on investments that further a foundation’s charitable purpose, but may not qualify as PRIs
  - Investments may have both financial and charitable purposes
  - May consider all relevant facts and circumstances, including foundation’s charitable purposes, when making investment decision
  - Foundations are *not* required to select only investments that offer the highest rates of return, the lowest risks, or the greatest liquidity so long as the foundation managers exercise the requisite ordinary business care and prudence
  - Foundations may prioritize charitable returns



## Why Impact Investing?

- Impact investments provide a range of tools for accomplishing charitable purposes. Grants are one tool, but they are not the only tool available to grantmakers to achieve the desired impact.
- In some circumstances, a loan can be as effective as a grant in achieving charitable impact, and if the loaned funds are repaid, they are loaned again or re-granted, increasing the impact.
- An investment may bring additional capital to the charitable work.
- Debt or equity investments can help allocate financial gains resulting from the funded activity. If a for-profit organization is funded, an investment may mitigate private benefits.
- Impact investments may be able to produce collateral benefits that grants alone cannot provide.

# Why Impact Investing?

- A charity's purpose is its mission – both investing and program activities serve that purpose.
- Investing activities shouldn't undercut program goals.
- Investments in companies providing needed infrastructure can facilitate more direct program activities.
- Charitable organizations are engaged in their communities and are well placed to understand the risks and opportunities for making investments “in their own backyards.”
- Why NOT impact investing?
  - Research is showing that taking into account social and environmental factors does *not necessarily* have a negative impact on financial returns, and may actually have a positive correlation with higher returns and lower volatility.