Lessons from the Social Impact Investment Taskforce:

Asset Allocation Working Group

HARVEY MCGRATH
BIG SOCIETY CAPITAL
12 DECEMBER, 2014
Rationale
Why should policymakers encourage Social Impact Investment?

Policymaker benefits

Incremental resources to address tough societal challenges:

✓ Increases financial capital to support/scale sustainable solutions to pressing social needs

✓ Increases human capital to drive greater innovation

✓ Encourages/enables policymakers to procure against measured outcomes, to share risk and to test and adapt interventions real-time

✓ Increases positive investment/business externalities

✓ Decreases negative investment/business externalities
How can Policymakers best encourage greater allocations? What are the key barriers to take-off?

<table>
<thead>
<tr>
<th>Key Barriers</th>
<th>Asset Owners</th>
<th>Intermediaries</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Identifying the greatest barriers for each pool</td>
<td>Identifying the most relevant ‘pools’ of capital</td>
</tr>
</tbody>
</table>
# The Challenge

## Constructing a key barrier matrix

<table>
<thead>
<tr>
<th>Key barriers</th>
<th>Asset Owners</th>
<th>Intermediaries</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Conflict of Duty</strong></td>
<td>Fiduciary duty</td>
<td>Pension Funds</td>
</tr>
<tr>
<td></td>
<td>Compliance</td>
<td>“Pension funds often have strict rules about investment size, % holding and management fees”</td>
</tr>
<tr>
<td></td>
<td>Lack of specialist</td>
<td>Advisors</td>
</tr>
<tr>
<td></td>
<td>Lack of appropriate opportunities</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Disproportionate transaction costs</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Capital risk</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Unquantifiable risk</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Exit risk</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Impact risk</td>
<td></td>
</tr>
</tbody>
</table>

**Mass retail | Capital risk**

“For retail, wealth is generally for retirement purposes or for the next generation, making capital preservation, at a minimum, a priority”

**Foundations | Impact risk**

“For foundations, it is critical that impact performance is sufficiently cost-effective to justify diverting funds from existing ‘tried and tested’ investments that optimise surpluses for grantmaking”
# A Solution

## 10 Policy Levers for Change

### Levers

<table>
<thead>
<tr>
<th>Number</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Clarification of fiduciary duty</td>
</tr>
<tr>
<td>2</td>
<td>Fiscal incentives</td>
</tr>
<tr>
<td>3</td>
<td>‘Do or Explain’ rule</td>
</tr>
<tr>
<td>4</td>
<td>‘Opt out’ as standard package</td>
</tr>
<tr>
<td>5</td>
<td>Priority sector lending</td>
</tr>
</tbody>
</table>

### 1. Clarification of fiduciary duty
- Permit (and consider requiring) investors to factor social and environmental impacts into investment decisions
- Require reporting on ESG factors

### 2. 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
- CEDIFs programme, Canada
- Social Investment Tax Relief, UK

### 3. ‘Do or Explain’ rule
- Require all regulated financial and charitable organisations to articulate their contribution to social impact investment
- CSR Clause 135, India
- ERISA legislation, US

### 4. ‘Opt out’ as standard package
- Require all pension fund offerings to include an allocation to social impact investment, unless a pensioner chooses to ‘opt out’
- FCPES offered as part of employees’ savings plan, France

### 5. Priority sector lending
- Require banking institutions to lend to priority sectors
- Community Reinvestment Act, US
- RBI prescription, India

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**Regulation**

- Regulation 28, South Africa
- Brazilian Sustainable Stock Exchange Initiative
- CEDIFs programme, Canada
- Social Investment Tax Relief, UK
- CSR Clause 135, India
- ERISA legislation, US
- FCPES offered as part of employees’ savings plan, France
- Community Reinvestment Act, US
- RBI prescription, India

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**National Treasury**

**SSE Initiative**

**Invest in Your Community**

**HM Treasury**

**Les FCPES solidaires**
## A Solution

### 10 Policy Levers for Change

<table>
<thead>
<tr>
<th>Lever</th>
<th>Description</th>
<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>6. Request for proposals</strong></td>
<td>Challenge product developers to bring forward opportunities with profiles that commissioners/asset owners are looking for</td>
<td>Investing4Growth initiative, UK</td>
</tr>
<tr>
<td><strong>7. Bundling</strong></td>
<td>Stimulate the intermediary market (through co-investment or fund-of-funds) to create more bundled/multi-asset products at-scale</td>
<td>Big Society Capital, UK</td>
</tr>
</tbody>
</table>
| **8. Catalytic capital** | - Provide matching capital, first loss layers positions, guarantees, tax schemes and/or insurance  
- Support enterprises/products to become investment-ready | African Agricultural Capital Fund, Africa  
Investment readiness fund, UK |
| **9. Placement and distribution platforms** | Support platforms that showcase a wide range of social impact investment products, allowing investors to compare, benchmark and even trade | SVX, Canada  
IIX, Asia  
GAX, Ghana |
| **10. Impact rating system** | Support the development of an impact investment rating system, including a formal alliance with a credible global rating agency | Rating initiative, Luxembourg/Switzerland  
GIIRS |
## Rationale

### Why should investors allocate to Social Impact Investment?

<table>
<thead>
<tr>
<th>Responsible investing</th>
<th>Sustainable investing</th>
<th>Social Impact investing</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mitigating Environmental, Social and Governance (ESG) risks</td>
<td>Pursuing Environmental, Social and Governance (ESG) opportunities</td>
<td>Delivering measurable solutions to societal challenges</td>
</tr>
</tbody>
</table>

- **Protects value** due to a wide consideration of ESG factors, often including negative screening of harmful products

- **May enhance value** due to investment selection (choosing investments with positive ESG behaviour/potential) and active portfolio management, including shareholder advocacy

- **Increases options** for asset owners seeking to apply a values lens to their strategic asset allocation

- **May increase diversification** within a broader portfolio due to emergent return and correlation profile of some Social Impact investment categories, e.g. Social Impact Bonds

- **May enhance value** by offering growth opportunities that the market has overlooked
Our report described an emerging ‘Spectrum of Capital’ to help clarify the terms and position the choices available to investors.
Impact investment in our view should be considered a strategy that can be applied across a variety of asset classes. This results in an Impact Allocation Matrix, as shown below.
Based on a series of relatively conservative assumptions, we estimated that an investor with an **8–12% impact investment allocation** 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.

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**Strategic Asset Allocation framework**

**Impact Asset Class (% of total portfolio)**
- Impact Investment Grade Bonds (2%)
- International Diversified Impact Equities (1%)
- Impact Absolute Return (3%)
- Impact Real Estate (3%)
- Impact Private Equity/Venture Capital & Impact Private Debt (3%)

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**USD Reference currency**

<table>
<thead>
<tr>
<th>Impact allocation:</th>
<th>Lower risk</th>
<th>Client strategies</th>
<th>Higher risk</th>
<th>(Sub) asset class characteristics</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>MONEY MARKETS</strong></td>
<td>5%</td>
<td>5%</td>
<td>5%</td>
<td>5%</td>
</tr>
<tr>
<td><strong>BONDS</strong></td>
<td>70%</td>
<td>50%</td>
<td>3.3%</td>
<td>16%</td>
</tr>
<tr>
<td>High-Grade USD bonds &amp; T+5</td>
<td>35%</td>
<td>25%</td>
<td>3%</td>
<td>6%</td>
</tr>
<tr>
<td>Euro-Libor USD Corporate bonds T+5</td>
<td>10%</td>
<td>25%</td>
<td>6%</td>
<td>6%</td>
</tr>
<tr>
<td>US Sovereign bonds</td>
<td>30%</td>
<td>5%</td>
<td>10%</td>
<td>70%</td>
</tr>
<tr>
<td>US High Yield bonds</td>
<td>5%</td>
<td>5%</td>
<td>3%</td>
<td>6%</td>
</tr>
<tr>
<td>EL sovereign bonds</td>
<td>2%</td>
<td>5%</td>
<td>3%</td>
<td>6%</td>
</tr>
<tr>
<td>EL corporate bonds</td>
<td>2%</td>
<td>5%</td>
<td>3%</td>
<td>6%</td>
</tr>
<tr>
<td><strong>EQUITIES</strong></td>
<td>10%</td>
<td>22%</td>
<td>23%</td>
<td>56%</td>
</tr>
<tr>
<td>US equities</td>
<td>5%</td>
<td>10%</td>
<td>10%</td>
<td>55%</td>
</tr>
<tr>
<td>Japan equities</td>
<td>3%</td>
<td>3%</td>
<td>3%</td>
<td>66%</td>
</tr>
<tr>
<td>Emerging markets</td>
<td>2%</td>
<td>2%</td>
<td>2%</td>
<td>66%</td>
</tr>
<tr>
<td>International Diversified Impact equities</td>
<td>10%</td>
<td>2%</td>
<td>2%</td>
<td>66%</td>
</tr>
<tr>
<td><strong>PRIVATE MARKETS – Absolute Return</strong></td>
<td>10%</td>
<td>12%</td>
<td>12%</td>
<td>12%</td>
</tr>
<tr>
<td>Absolute return</td>
<td>10%</td>
<td>12%</td>
<td>12%</td>
<td>12%</td>
</tr>
<tr>
<td>Impact Absolute Return (including SIBs/DBs)</td>
<td>10%</td>
<td>12%</td>
<td>12%</td>
<td>12%</td>
</tr>
<tr>
<td><strong>PRIVATE MARKETS – Real Asset/Estate</strong></td>
<td>10%</td>
<td>12%</td>
<td>12%</td>
<td>12%</td>
</tr>
<tr>
<td>Private Real Estate</td>
<td>10%</td>
<td>12%</td>
<td>12%</td>
<td>12%</td>
</tr>
<tr>
<td><strong>PRIVATE MARKETS – PE/VC &amp; Private debt</strong></td>
<td>10%</td>
<td>12%</td>
<td>12%</td>
<td>12%</td>
</tr>
<tr>
<td>PE/VC &amp; Private Debt</td>
<td>10%</td>
<td>12%</td>
<td>12%</td>
<td>12%</td>
</tr>
</tbody>
</table>

**TOTAL**

- 100% of total portfolio
- 100% of total portfolio
- 100% of total portfolio
- 100% of total portfolio

**Impact Assets**

- 6% of total portfolio
- 11% of total portfolio
- 6% of total portfolio
- 15% of total portfolio

**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% / 5.3% / 7.3% / 10.1%
Investor recommendations – next steps

We now wish to take this impact allocation framework and ground it in the reality of today’s market, by writing a follow-on technical paper that illustrates the range of products available today within each ‘box’ on the Impact Allocation Matrix.

<table>
<thead>
<tr>
<th>Impact Asset Class</th>
<th>Competitive financial returns</th>
<th>Below market financial returns</th>
</tr>
</thead>
<tbody>
<tr>
<td>Impact Investment Grade Bonds</td>
<td>Address societal challenges that generate competitive financial returns for investors</td>
<td>Address societal challenge(s) which may generate a below market financial return</td>
</tr>
<tr>
<td>International Diversified Impact Equities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Impact Absolute Return</td>
<td></td>
<td>Address societal challenges that require a below market financial return for investors</td>
</tr>
<tr>
<td>Impact Real Estate</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Impact Private Equity and Venture Capital</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Impact Private Debt</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Questions?

Have thoughts or feedback? Email the GIIN: Lgustafson@thegiin.org

Find the full working group report at www.socialimpactinvestment.org

Find the other webinars in this series and further information on impact investing at www.thegiin.org