

# Impact Investing: Managing Risk and Return

Wednesday, May 4, 2011; 9:30 AM – 10:45 AM

## Moderator:

**Betsy Zeidman**, Senior Fellow, Milken Institute; Director, Compass Program, Robert F. Kennedy Center for Justice & Human Rights

## Speakers:

**Dave Chen**, CEO, Equilibrium Capital Group

**Sir Ronald Cohen**, Chairman, Bridges Ventures and The Portland Trust; Director, Social Finance

**Doris Herrera-Pol**, Director and Global Head of Capital Markets, World Bank

**Erika Karp**, Managing Director, Head of Global Sector Research, UBS Investment Bank

**Richard Woo**, CEO, The Russell Family Foundation

# “Impact investing” goes by many names

- Active investing
- Aligned investing
- Blended value investing
- Double (or triple) bottom line investing
- Environmental, social, and corporate governance (ESG) investing
- Full value investing
- Impact investing
- Mission-related investing
- Mission-based investing
- Mission investing
- Sustainable investing
- Socially responsible investing (SRI)
- Ethical investing
- Targeted investing



## The premise

- Investments can generate collateral benefits – or costs – in addition to financial returns (or costs)
- Social, environmental and governance factors can positively (or negatively) affect the performance of the financial asset
- Investment decisions (particularly for long-term investors) are better when based on financial returns and extra-financial impacts

# Impact investing

## *Definition*

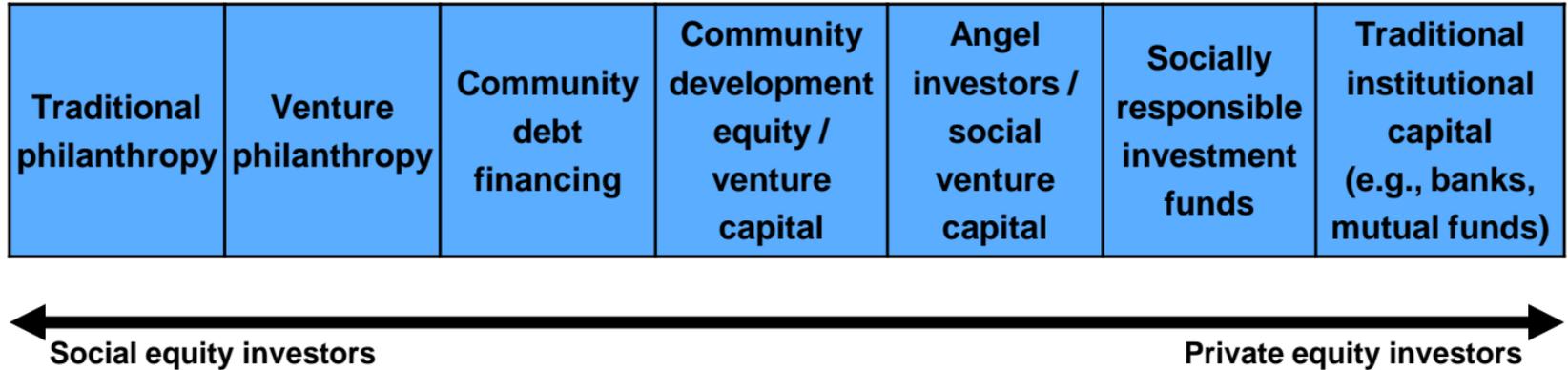


“Actively placing capital in businesses and funds that generate **social and/or environmental good and a range of returns**, from principal to above market, to the investor”

Source: The Parthenon Group and Bridges Ventures. “Investing for Impact: Case Studies Across Asset Classes” (March 2010).



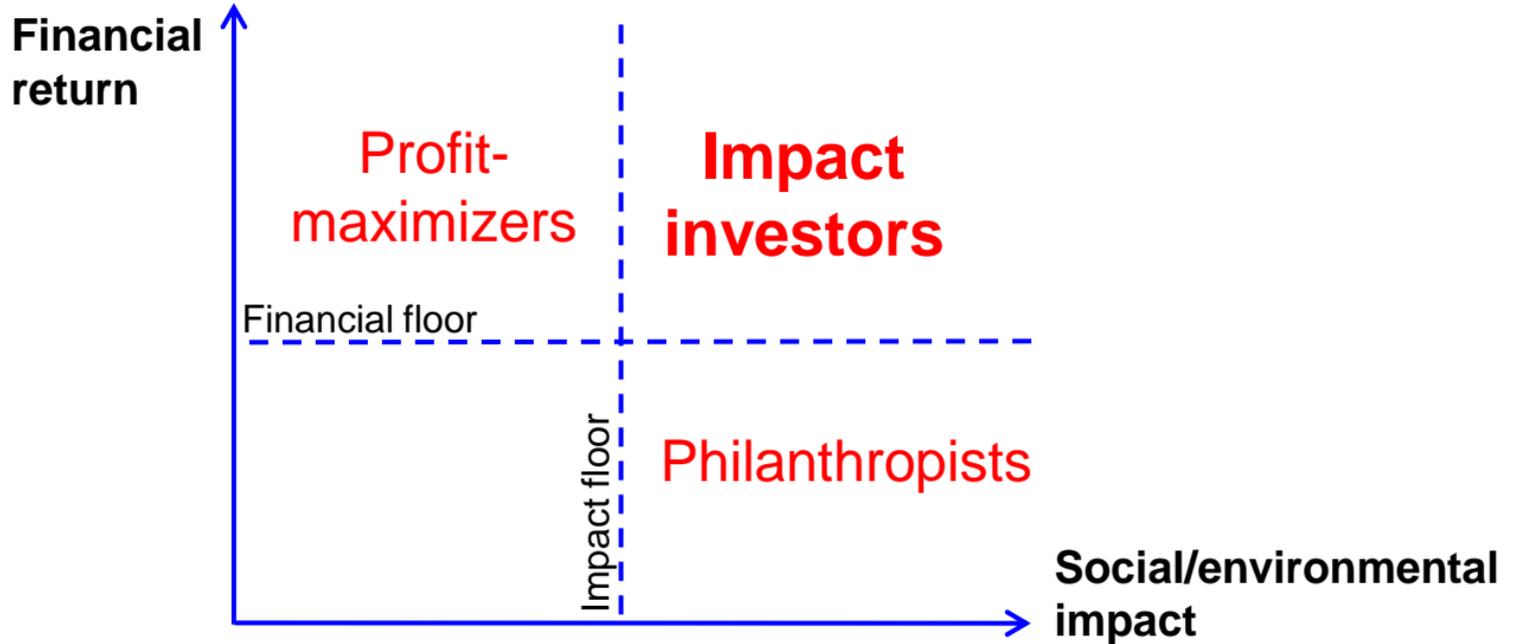
# Spectrum of investors



Source: Jed Emerson, based on the work of Shari Berenbach and Timothy Freundlich, 2000.

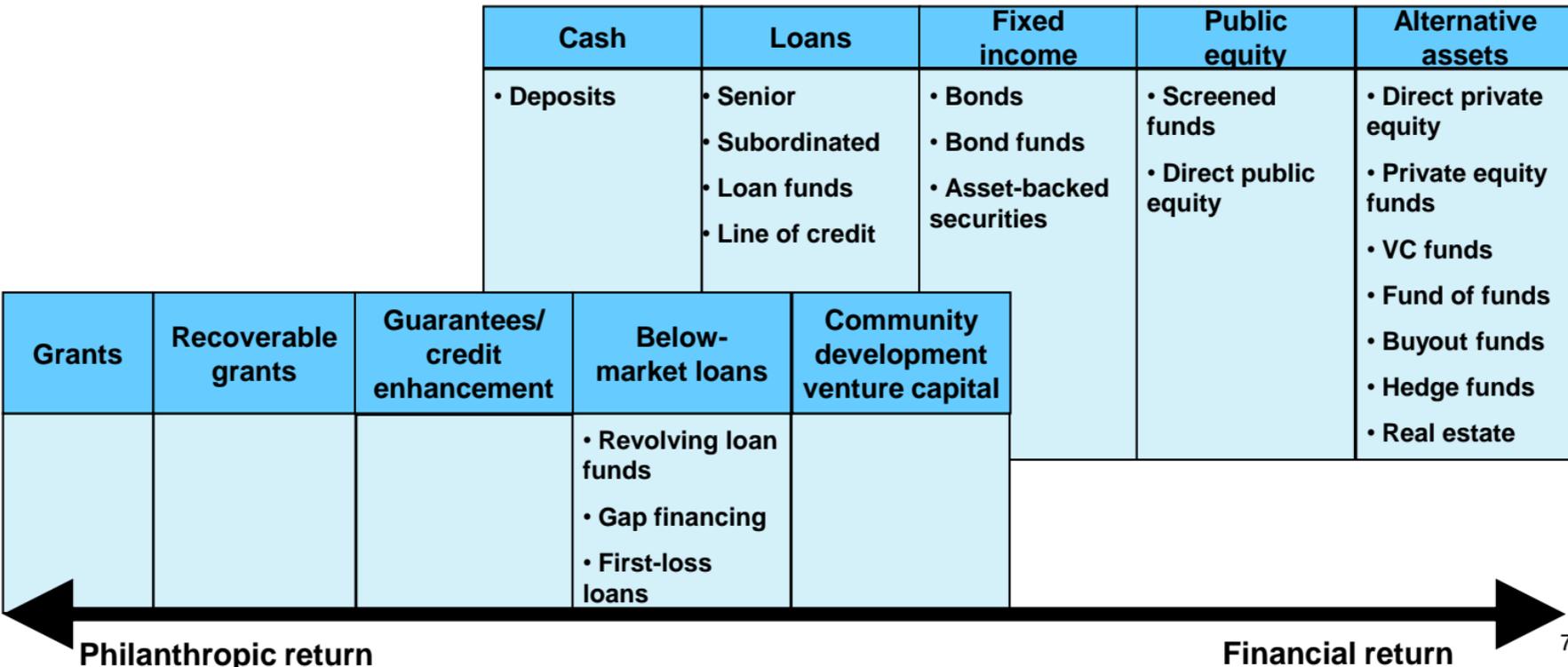
# Impact investing

*Combining financial returns and impact*





# Impact investments across asset classes



# Responsible investments toolbox

## BELOW-MARKET-RATE TOOLS

- Grants
- Recoverable grants
- Guarantees / credit enhancement
- Below-market loans
  - Revolving loan funds
  - Gap financing
  - First-loss loans
- Community development venture capital

## MARKET-RATE TOOLS

- Cash (deposits)
- Loans
  - Senior
  - Subordinated
  - Guarantees
  - Loan funds
  - Line of credit
- Fixed income
  - Bonds
  - Bond funds
  - Asset-backed securities
- Public equity
  - Screened funds
  - Direct public equity
  - Shareholder engagement
- Alternative assets
  - Direct private equity
  - Private equity funds
  - VC funds
  - Fund of funds
  - Buyout funds
  - Hedge funds
  - Real estate
  - Natural resources



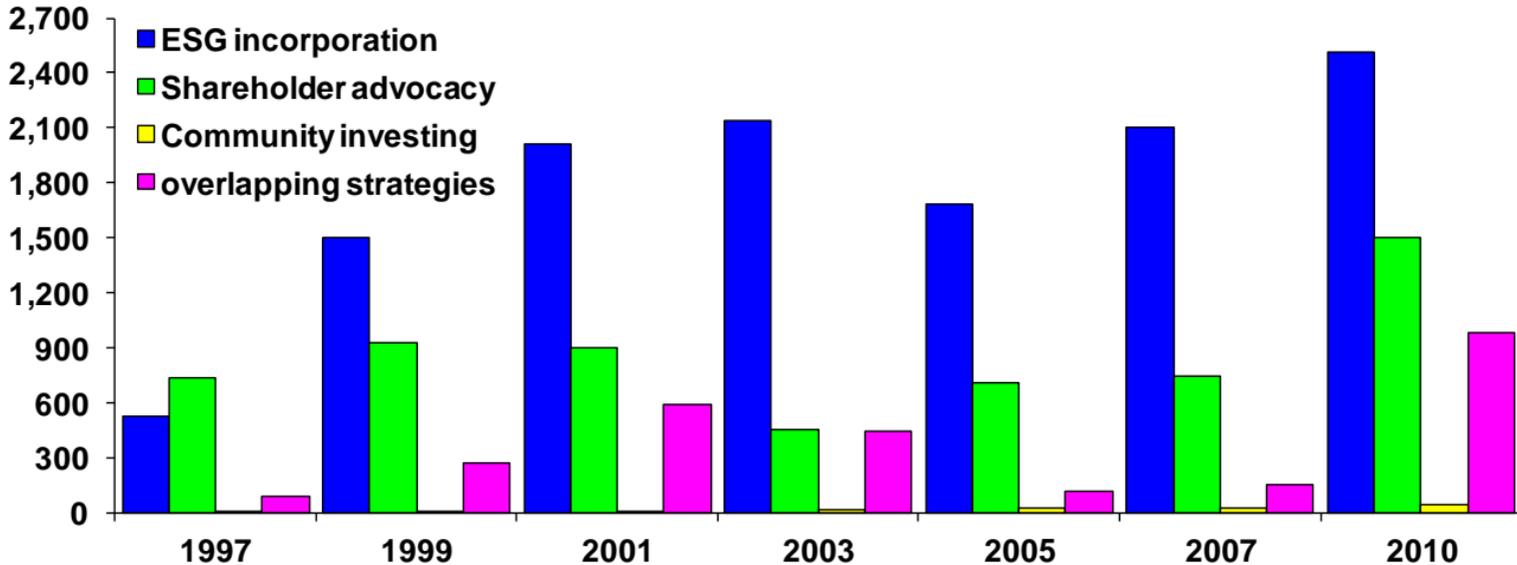


## Select historical events

- 1800s: Quakers and Methodists brought attention to investments in alcohol and gambling; abolitionists used screening to protest slavery
- 1970s: Divestment from South Africa; nuclear power; launch of Pax World Fund, first screened mutual fund
- 1980s: Increasing numbers of mutual funds and issues addressed
- 1990s: Addition of positive screens, community investing, shareowner activism
- 2000s: Corporate scandals increase attention to corporate governance; upsurge in activity by mainstream investors/funds/managers; U.K. law requires pension funds to identify social, environmental or ethical factors considered in investment decisions
- 2006: U.N. launches Principles for Responsible Investment; by 2010, signed by over 800 institutional investors with \$22 trillion in assets
- 2007: Rockefeller Foundation launches initiative to help bolster growth of impact investing
- 2010: Social Investment Forum's "Trends Report" notes \$3.1 trillion (12% of U.S. assets under management) are invested in sustainable & socially responsible investing, up 380% since 1995 and up 13% in current economic downturn

# Socially responsible investing in the U.S. has reached \$3 trillion

Socially responsible investing (US\$ billions)

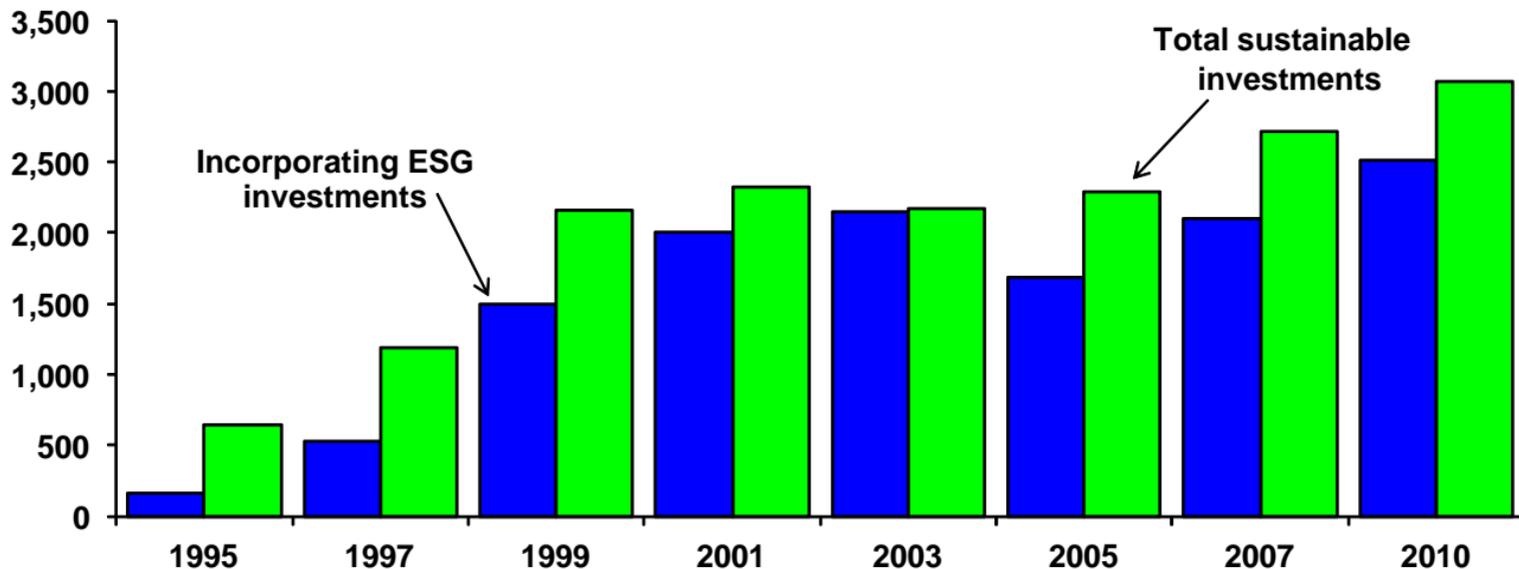


Note: Overlapping assets involved in some combination of ESG incorporation, filing shareholder resolutions or community investing are subtracted to avoid potential effects of double counting. Prior to 2010, assets subject to ESG incorporation were limited to socially and environmentally screened assets.

Source: Social Investment Forum Foundation.

# ESG factors are increasingly important to U.S. investors

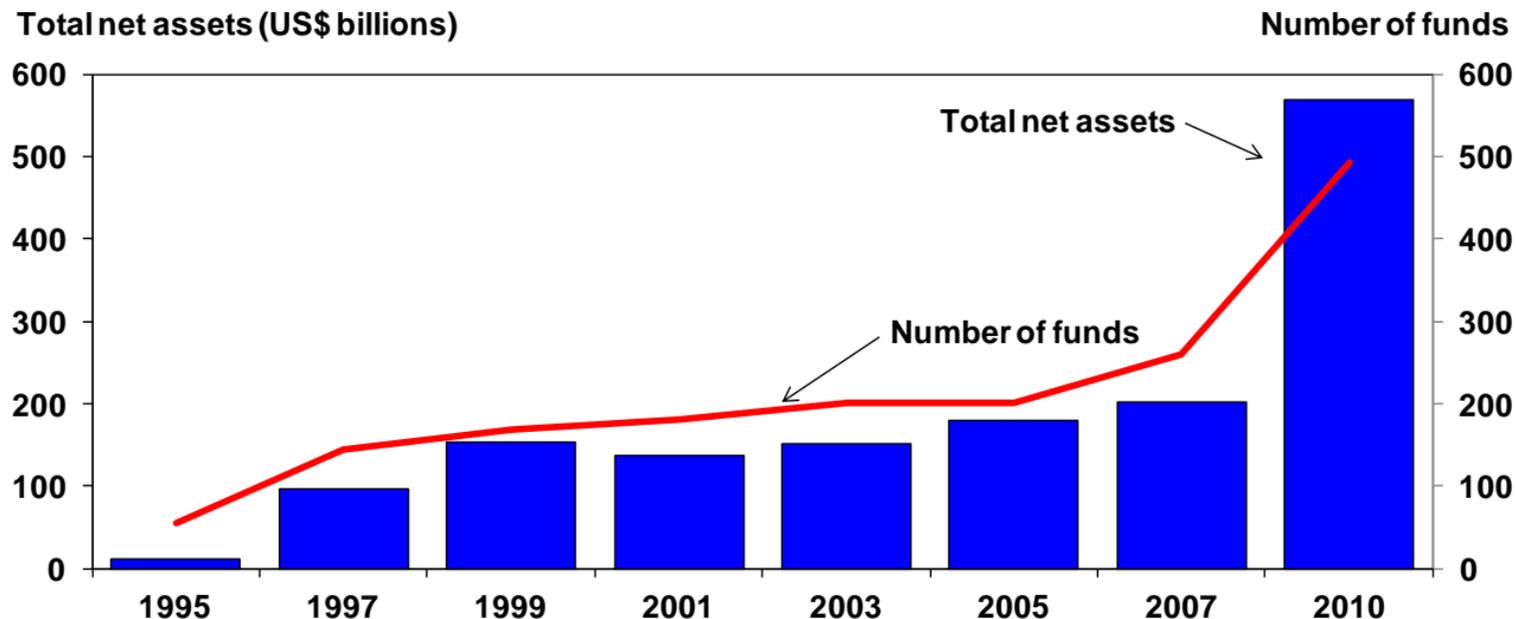
Sustainable investing (US\$ billions)



Note: Overlapping assets involved in some combination of ESG incorporation, filing shareholder resolutions or community investing are subtracted to avoid potential effects of double counting. Prior to 2010, assets subject to ESG incorporation were limited to socially and environmentally screened assets.

Source: Social Investment Forum Foundation.

# Growth of investment funds using ESG factors



Note: ESG funds include mutual funds, annuity funds, closed-end funds, exchange-traded funds (ETFs), alternative investment funds and other pooled products, but exclude separate account vehicles.

Source: Social Investment Forum Foundation.

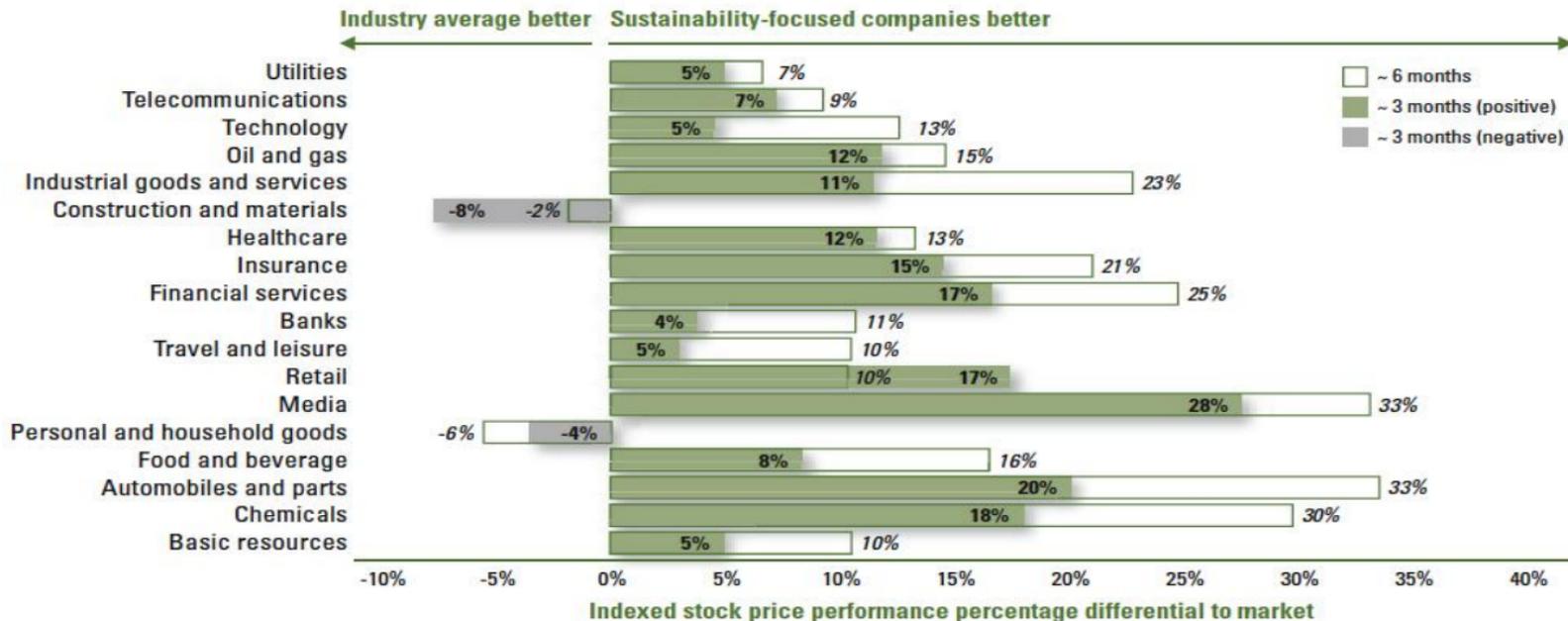
# Potential invested capital to fund selected BoP businesses over the next 10 years



Sector	Potential invested capital required (US\$ billions)	Potential profit opportunity (US\$ billions)
Housing: Affordable urban housing	\$214-\$786	\$177-\$648
Water: Clean water for rural communities	\$5.4-\$13	\$2.9-\$7
Health: Maternal health	\$0.4-\$2	\$0.1-\$1
Education: Primary education	\$4.8-\$10	\$2.6-\$11
Financial Services: Microfinance	\$176	Not measured

# Green Winners: Sustainable companies outperform peers

**FIGURE:** Sustainability-focused companies outperform peers



Note: Indexed stock prices at ~ 3 months = September 8, 2008 and ~ 6 months = May 19, 2008 to current date, November 24, 2008. Percentage performance differential calculated by taking the percentage point difference of averaged sustainability companies' indexed performance to the market indexed performance over the market indexed performance. Sustainability companies include DJSI World 80 2008/2009 + DJSI 2008 Supersector Leaders + Goldman Sachs SUSTAIN focus list for mature industries.

n=99 sustainability companies

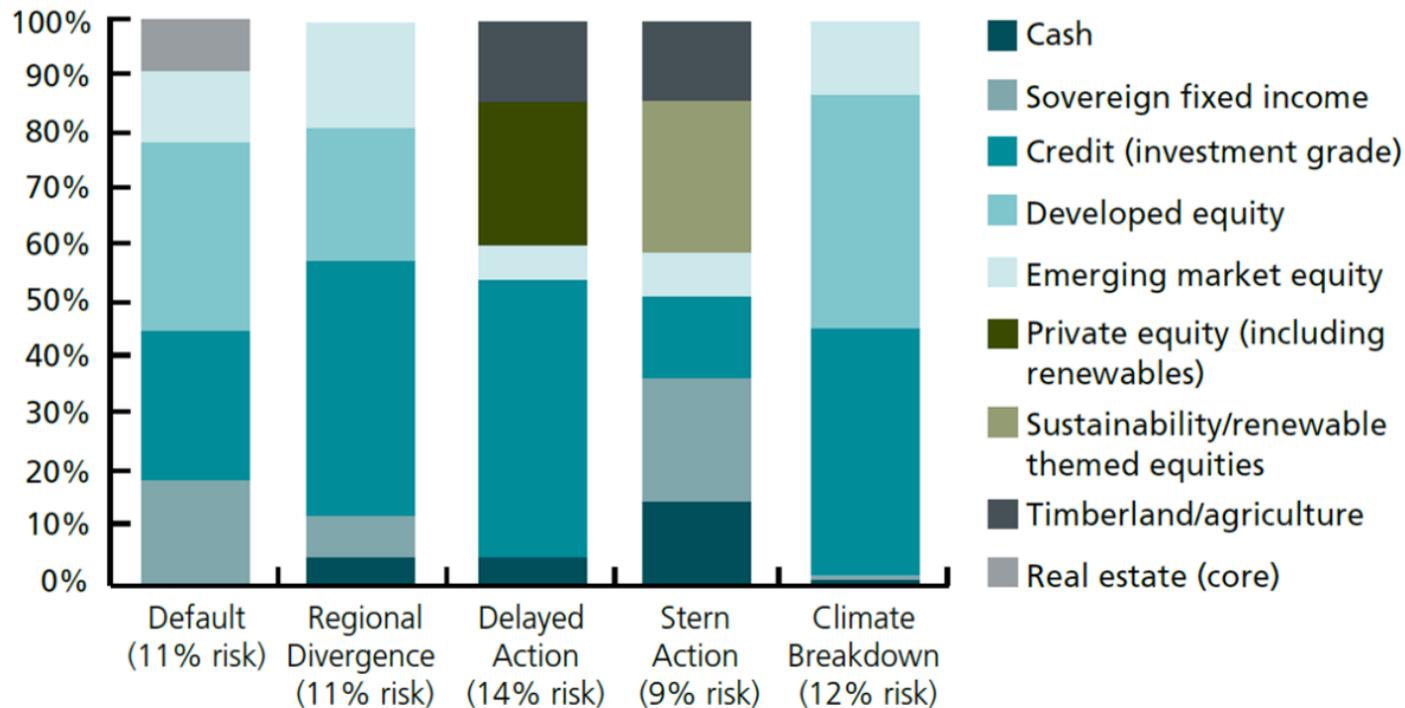
Sources: Bloomberg; A.T. Kearney analysis

# Managing climate change risk across scenarios

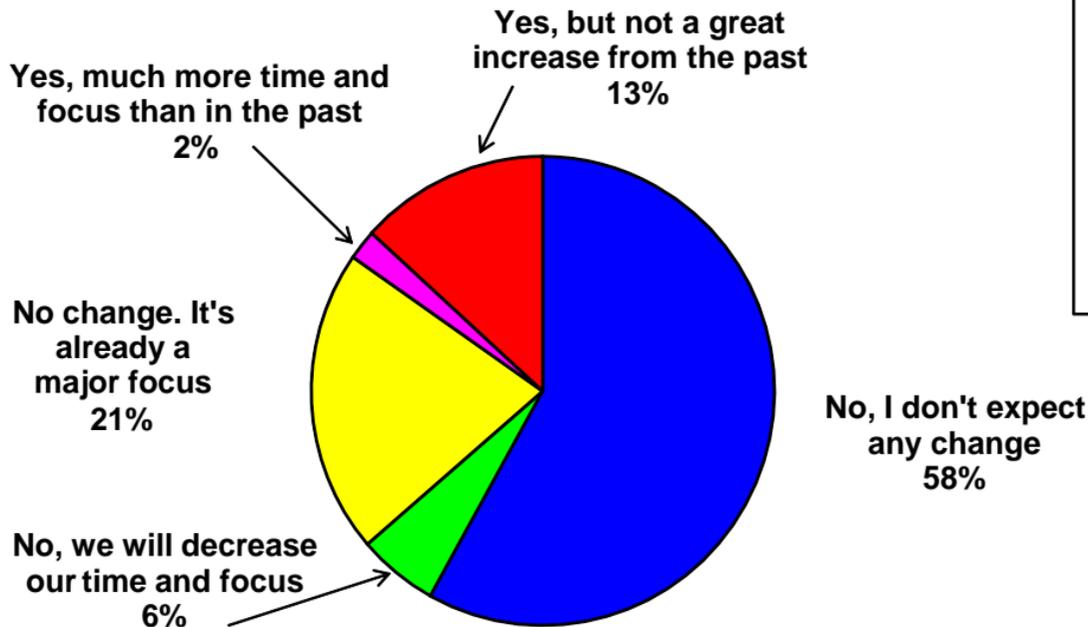
*Portfolio to target 7% return*



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# Directors are not increasing their focus on environmental stewardship

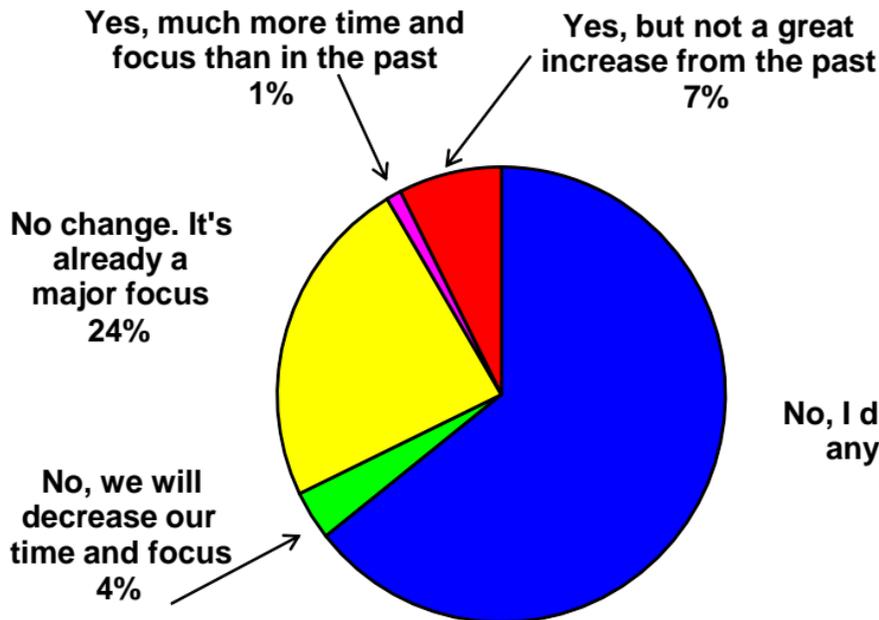


Please indicate if you would like your board to devote more time this year on the **sustainability/ climate change** (% of total 1,104 surveyed directors)

Note: Surveyed companies are the top 2,000 publicly traded firms (by revenue) listed with the NYSE Euronext, the NYSE Amex, and the NASDAQ OMX Group stock exchanges.

Source: PwC, "Annual Corporate Directors Survey 2010" (formerly titled "What Directors Think").

# Most directors do not expect their board would increase focus on social responsibility issues



Please indicate if you would like your board to devote more time this year on the **social responsibility issues** (% of total 1,106 surveyed directors)

Note: Surveyed companies are the top 2,000 publicly traded firms (by revenue) listed with the NYSE Euronext, the NYSE Amex, and the NASDAQ OMX Group stock exchanges.

Source: PwC, "Annual Corporate Directors Survey 2010" (formerly titled "What Directors Think").

# Mission-related investment (MRI)

## *Definition*



- Investing a foundation's endowment with the intention of:
  - Advancing the foundation's mission
  - Earning a market-rate financial return
- Using both investment and grant dollars increases impact
- Funds are recycled, extending reach of philanthropist

# Program-related investment (PRI)



## *Definition*

- Concessionary investment made by foundations to support charitable activities
- Examples: Loans, loan guarantees, equity investments, recoverable grants, among other financial tools
- PRI has a legal definition for private foundations; they can use PRIs toward their annual required 5 percent payout if:
  - Primary purpose is to advance the foundation's charitable objectives
  - Production of income or appreciation of property is not a significant purpose
  - Funds are not used to lobby or for political purposes



# Global Impact Investing Network (GIIN)

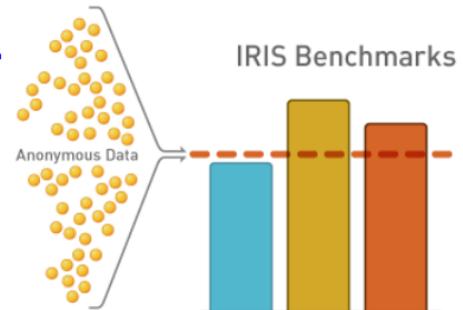
- Nonprofit dedicated to increasing the effectiveness of impact investing
- Goal: “To help foster a coherent impact investing industry that channels investment capital efficiently to accelerate the development of solutions to pressing social and environmental problems”
- Developing industry infrastructure, including Impact Reporting and Investment Standards (IRIS), a framework for measuring impact investments’ social and environmental performance



Source: Global Impact Investing Network website.

# Impact Reporting & Investment Standards (IRIS)

- IRIS is effort to provide a common reporting language for impact-related terms and metrics.
- Framework aims to increase value of an access to non-financial data by enabling performance comparisons and benchmarking.
- Key stakeholders: Investors in funds, direct investors, companies, and member organizations/intermediaries.



# Global Impact Investing Rating System (GIIRS)



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## Features

- Company Ratings and Fund Ratings
- Ratings in developed and emerging markets globally
- Aggregate ratings, as well as ratings within numerous impact areas and industry sectors
- Social and environmental performance metrics and key performance indicators specific to different industries, impact areas, and investor preferences
- Benchmarking and analytics for longitudinal comparability

The logo for the Global Impact Investing Rating System (GIIRS), with the letters 'GIIRS' in a bold, sans-serif font. The 'I' is red, while the other letters are black.

GLOBAL  
IMPACT  
INVESTING  
RATING  
SYSTEM

# Community Reinvestment Act



## *Definition*

- Passed in 1977
- U.S. federal law designed to encourage commercial banks and savings associations to meet the needs of borrowers in all segments of their communities, including low- and moderate-income neighborhoods

# New Markets Tax Credit (NMTC)



## *Definition*

- Established in the Community Renewal Tax Relief Act of 2000
- Provides investors (e.g., individuals, financial institutions, corporations) with a tax credit for investing in communities that are economically distressed or consist of low-income populations

# Low-Income Housing Tax Credit (LIHTC)



## *Definition*

- Tax credit created under the Tax Reform Act of 1986
- Gives incentives for the utilization of private equity in the development of affordable housing aimed at low-income Americans

# Community development venture capital (CDVC)



- Definition: Investment of equity capital in businesses located in underinvested markets, seeking financial returns and the creation of good jobs, wealth, and entrepreneurial capacity
- Capital under management in CDVC funds was \$2 billion in 2009 (vs. \$179 billion for the VC industry as a whole; therefore, CDVC funds represent just 1 percent of total VC assets)



# Community Development Finance Institutions

- Definition: For-profit or nonprofit entity that has a primary mission of community development, is predominantly a financing entity, provides development services in conjunction with financing, and principally serves and is accountable to a target market; certified by the U.S. Department of Treasury
- 862 certified CDFIs in the U.S. as of May 2010
- In 2008, 495 surveyed CDFIs reported holding over \$29.4 billion in assets and, during the year, investing \$5.5 billion in their communities. These investments:
  - Created or maintained 35,624 jobs
  - Financed the construction or renovation of 60,205 units of affordable housing
  - Provided 16,405 responsible mortgages to homebuyers



# B Corporations

- A certification system designating socially responsible businesses
  - Companies are independently assessed on their level of social responsibility.
  - Requires that a business rewrite its articles of incorporation to state that it considers stakeholders' interests, in addition to shareholders'
- Over 400 companies in 28 states have become B corporations since B Lab's creation in 2006.
- Vermont, Maryland, New Jersey and Virginia have laws backing B corporation structure.

Source: B Lab website.



# Sir Ronald Cohen's slides

# Who is social finance?



*Mobilizing investment capital to drive social change*

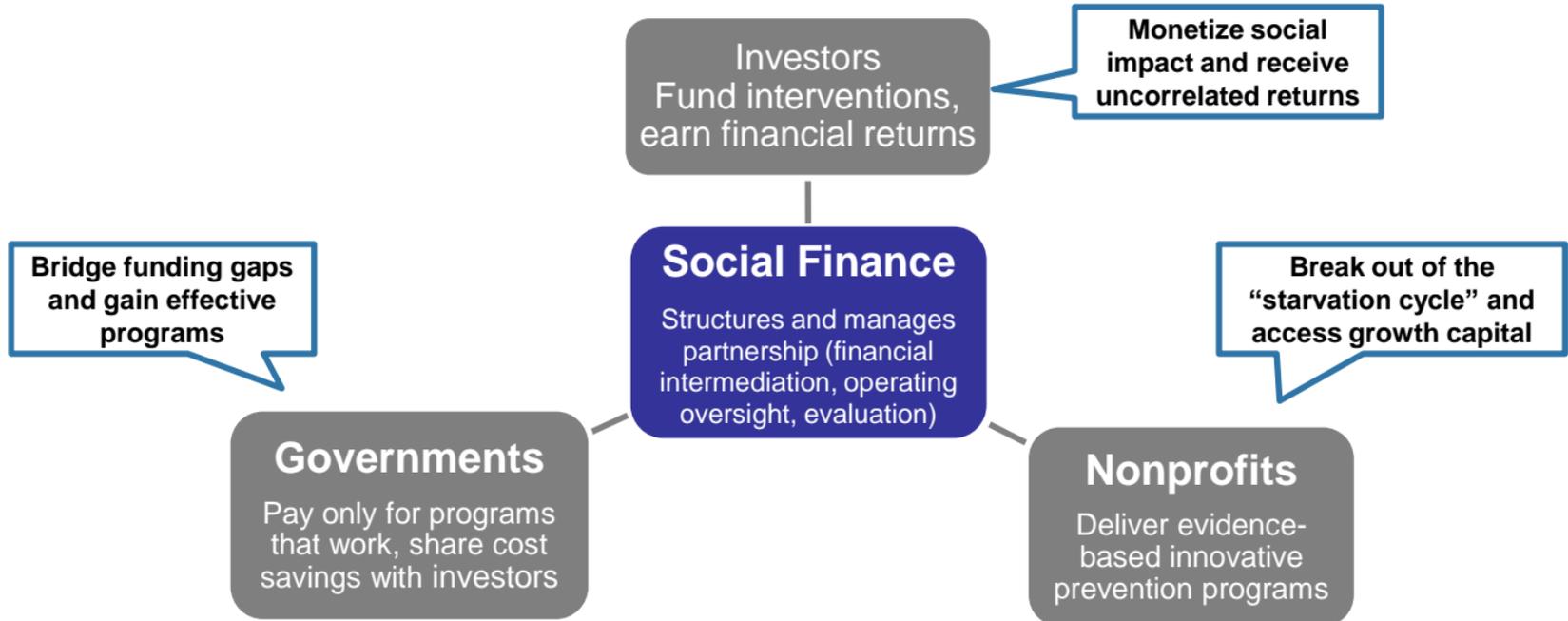
**Social Finance is a nonprofit organization working to connect the social sector with the capital markets by structuring and managing innovative investment instruments that both generate meaningful social impact and provide a financial return.**

- Founded in January 2011, Social Finance is bringing to the U.S. the pioneering work of our UK sister organization, and building on the momentum of the first-ever Social Impact Bond launched in March 2010
- Our aim is to open up new pools of capital to finance effective social enterprises and drive social progress
- We believe social impact can be monetized, creating an ROI for investors
- Our initial work is centered on the Social Impact Bond, a public-private-nonprofit partnership organized to produce shared economic and social value

# Social impact bonds (SIBs): An innovative public-private-nonprofit partnership



Social Impact Bonds, also called Pay for Success Bonds, employ private investment capital to pay for intervention programs delivered by nonprofit service providers. The government pays investors their principal and a rate of return, only if the programs achieve predefined metrics.



# SIB version 1.0 and beyond



## SIB Version 1.0

### • Grants, program-related investments

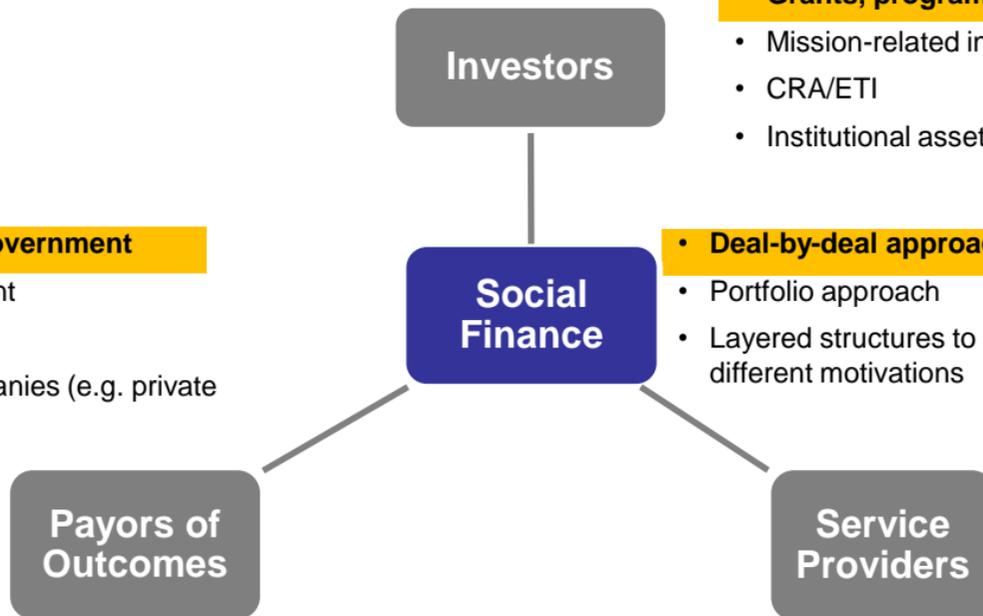
- Mission-related investments
- CRA/ETI
- Institutional assets (fiduciary duty satisfied)

### • State and local government

- Federal government
- Large foundations
- Fortune 500 companies (e.g. private health insurers)

### • Deal-by-deal approach

- Portfolio approach
- Layered structures to attract investors with different motivations



### • Nonprofits

- For profits



**Doris Herrera-Pol's slides**  
**World Bank**  
**GREEN BONDS**

[treasury.worldbank.org/greenbonds](https://treasury.worldbank.org/greenbonds)

# The World Bank

- ...is a development cooperative owned by 187 member countries
- ...works with members to achieve economic growth and social and environmental sustainability
- ...is rated AAA/Aaa
- ...bonds support member efforts to achieve economic growth, a cleaner environment, and poverty reduction
- ...works towards the Millennium Development Goals as key pillars of international development



# Millennium Development Goals

The World Bank and its member countries are working towards these 8 specific, measurable targets, which aim to reduce poverty by half by 2015

1

Eradicate extreme poverty and hunger



2

Achieve universal primary education



3

Promote gender equality and empower women



4

Reduce child mortality



5

Improve maternal health



6

Combat HIV/AIDS, malaria, and other diseases



7

Ensure environmental sustainability

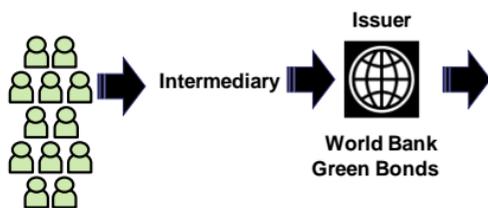


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Develop global partnerships for development



# The Green Bond story



## Examples of Green Projects in borrowing member countries - Mitigation and Adaptation -



Wind Power



Solar Power



Technologies to Reduce GHG Emissions



Waste Management



Transport Efficiency



Energy Efficiency



Reforestation



Sustainable Forest Management

## Key Benefits for Investors:

- 1) **Green:** Support climate change mitigation and adaptation projects
- 2) **Project selection, due diligence, monitoring and reporting**
- 3) **Credit quality and financial return:** AAA/Aaa bonds at a spread to UST; investors do not assume project or country risk
- 4) **Liquidity:** Bonds can be traded in the secondary market
- 5) **Flexible terms:** Investors choose currency, coupon structure, maturity and other terms

# World Bank Green Bonds and Funds

Since the inaugural green bond in 2008, the World Bank has raised about USD 2.2 billion with 40 green bonds in 15 different currencies

Nikko Asset Management launched two currency-diversified World Bank Green Bond funds



## Green Bond Investors

### USD

California State Treasurer's Office  
 CalSTRS  
 MMA Praxis Mutual Funds  
 New York Common Retirement Fund  
 Sarasin  
 SEB Ethos rantefund  
 SEB Trygg Liv  
 Second Swedish National Pension Fund (AP2)  
 Third Swedish National Pension Fund (AP3)  
 Trillium Asset Management  
 UN Joint Staff Pension Fund

### Other currencies

Adlerbert Research Foundation  
 AP2 – Second Swedish National Pension Fund  
 AP3 – Third Swedish National Pension Fund  
 LF Liv  
 MISTRA  
 Nikko Asset Management  
 Skandia Liv

## Green Bond Issues

Amount	Coupon	Issue Date	Maturity Date
USD 300 million	Floating	2009	2012
USD 180 million	2%	2009	2013
SEK 2.85 billion	3.5%	2008	2014
AUD 30 million	5.4%	2010	2015
MXN 40 million	6.15%	2010	2015
MYR 12 million	1.375%	2010	2015
ZAR 25 million	7.2%	2010	2015
USD 10 million	Floating	2010	2015
USD 50 million	1.375%	2010	2015
USD 10 million	1.5%	2010	2015
USD 10 million	2.05%	2010	2015
NZD 150 million	5.23%	2010	2015
USD 10 million	2%	2010	2016
USD 30 million	2.135%	2011	2016
USD 10 million	Floating	2011	2016
USD 30 million	2%	2011	2016
USD 10 million	1.98%	2011	2016
USD 10 million	2.34%	2011	2016
AUD 255 million	6%	2010	2017
BRL 135 million	9.5%	2010	2017
EUR 2 million	2.5%	2010	2017
HUF 5.7 billion	5.5%	2010	2017
NOK 400 million	3.75%	2010	2017
NZD 50 million	5.625%	2010	2017
RUB 750 million	7.5%	2010	2017
SEK 700 million	3.25%	2010	2017
TRY 50 million	10%	2010	2017
ZAR 550 million	8.75%	2010	2017
ODP 155 billion	8%	2010	2020
JPY 125 million	8.75%	2010	2020
MXN 700 million	7.5%	2010	2020
SEK 100 million	3.5%	2010	2020
USD 5 million	3.32%	2011	2021

## More information...

- **Internet:** <http://treasury.worldbank.org/greenbonds>
- **Phone:** +1 202 477 2880
- **Fax:** +1 202 477 8355
- **Email:** [debtsecurities@worldbank.org](mailto:debtsecurities@worldbank.org)
- **Address:** 1818 H Street, Washington, DC 20433, U.S.A.
- **Pricing Sources:**  
Bloomberg:  
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# The social sector



## USA

- ~ \$700 billion of foundation assets
- ~ 1 million social organizations employing ~10 million people

## UK

- ~ £100 billion of foundation and trust assets
- ~ 200,000 social organizations employing ~800,000 people



# The Social Investment Spectrum



*Purpose-driven  
not-for-profit*

Sources of Capital

*Purpose-driven  
for-profit*

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Foundations  
and  
Trusts

Venture  
Philanthropy

Loans to  
Social  
Organizations

Micro-  
Finance  
Funds

Social  
Entrepreneurs  
Funds

Social  
Impact  
Bond  
Funds

Social  
Venture  
Funds

Social  
Funds  
of  
Funds

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Social Entrepreneurs and Organizations

# Big Society Bank

- Permanent capital of ~ \$1 billion
  - £400m from 15 year-old unclaimed assets of UK commercial banks
  - £200m from UK's Big Four commercial banks
- A financial wholesaler whose main objective is to boost the capability of the social sector to tackle social issues
  - By connecting the sector to the capital markets
  - By providing social entrepreneurs with capital to develop significant scalable organizations



# Bridges Ventures

- Created in 2002 to invest in poorest 25% of UK
- Currently manage 4 funds with AUM of £150m +
  - Venture Funds 1 & 2
  - Social Entrepreneurs Fund
  - Sustainable Property Fund
- Venture Fund 1 (2002) net IRR of 15%-20% vs 10%-12% expected
  - Significant social impact
  - Powerful entrepreneurial role models created
- Raising Venture Fund 3 and Healthcare Property Fund

# Social finance



- Created in UK in 2007, now 22 people in London
- US sister organization set up January 2011 in Boston

## Belief:

*“If social problems are to be tackled effectively, organizations seeking to solve them need sustainable revenues and investment to enable innovation and growth. Our role is to devise the financial structures and raise the capital to enable this to happen.”*

- Developed and launched Social Impact Bond (SiB) in 2010
- Currently assisting in implementation of SiBs in UK, US, Australia and Israel

# Social impact bond (SiB)

- Contract between public sector bodies or foundations and investors who commit to fund interventions by not-for-profits to achieve measurable social outcomes
- First SiB was launched in September 2010 by Social Finance UK and Ministry of Justice (MOJ)
  - Funds not-for-profit organizations working to reduce the reoffending rates of short-sentence male prisoners leaving Peterborough Prison
  - MOJ will make payments to investors according to social outcome achieved over SiB's 8-year life:
    - If reoffending is reduced by less than 7.5%, investors lose their investment
    - If reoffending is reduced by 7.5% to 15%+ , MOJ repays capital and a variable yield of 2.5%-13%, paying out an estimated 1/3 of expected savings
- Obama administration has included in its current budget \$100m for SiBs', aka "Pay-For-Success Bonds"