

Mission-related investing

How non-profits use investments to further their mission

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Whether they are supporting schools' operating budgets, meeting charitable distribution requirements or supporting constituents of specific communities, non-profits have always confronted challenges to the fulfillment of their missions. In recent years, limited grant funding, difficult fundraising environments and complex financial market conditions have only increased the challenges. It is not surprising, then, that many non-profit organizations are expanding their toolkits to incorporate new methods of effecting social change. In addition to traditional grant making, non-profits are increasingly looking to use their investments in a manner intended to maximize the social impact of their total assets. This concept of using investments directly to further the mission of the organization is commonly known as "mission-related investing" (MRI).

Our purpose in this paper is twofold:

1. We want to help establish a common understanding of MRI and of how it fits in the sustainable investing landscape.
2. We will lay out an implementation roadmap and address related concerns and considerations for a non-profit wanting to implement an MRI program.

I. Understanding mission-related investing

Different tools, same purpose

The industry terminology describing various forms of mission-related investing is, at present, confusing. As the practice of MRI continues to mature and evolve, we expect there will be greater uniformity in the terminology across markets, countries and investment categories.

We think it is helpful to take a step back and review the primary dimensions along which this evolving terminology is applied. Traditionally, investments have been chosen for their potential financial return, without any significant expectation, on the investor's part, of social benefit. Grants, on the other hand, have been awarded precisely for their potential social benefit, with little or no expectation of financial gain (or more precisely: with the expectation, on the grantor's part, of pure financial loss). A non-profit's investment committee focuses on the former and the grant-

making committee on the latter, often with minimal interaction.

Mission-related investments, which are expected to provide rewards in both financial and social dimensions, blur this dichotomy. Organizations must decide whether the anticipated financial return (which in some cases is below market rates) is sufficiently attractive when coupled with social benefit, for example, the creation of jobs or housing units.

Another important characteristic of MRI is how directly it is linked to the mission of a particular organization. A charity working to end hunger may satisfy its broad social mandate simply by screening from its investment portfolio any securities it deems objectionable (for example, those of firearms or tobacco manufacturers). On the other hand, it might also lend funds to community soup kitchens to help them upgrade their facilities. The strength of an investment's alignment with a non-profit's mission is often a distinguishing characteristic in the discussion of MRI and in the interpretation of the various terms that describe the practice.

We believe the industry terminology is beginning to settle, but even as it continues to evolve, the need to balance financial and social rewards and the directness of the linkage with an organization's mission are the key characteristics that inform the implementation discussion of Section II.

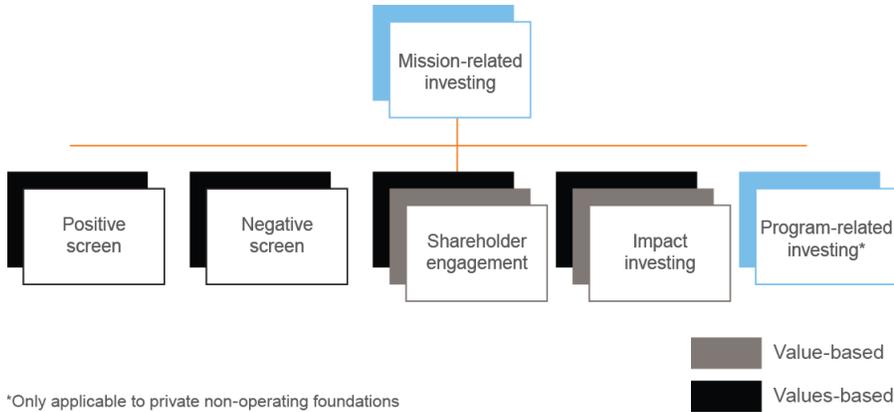
Keeping these dimensions in mind, we now turn to summary definitions of the most common terms relevant to this paper. Despite some overlap, the terminologies imply slightly different practices.

- **Sustainable investing.** This is the overarching industry term used to describe investments intended to generate both social and financial returns. "Sustainable investing" can refer to all forms of investments, from debt to equity, in public and private markets. Other terms commonly used to describe this approach are "responsible investing"¹ and "sustainable and responsible Investing."²
- **Socially responsible investing (SRI).** This term has evolved to specifically describe the screening of investments in a portfolio. Screening can either be positive (inclusionary) or negative (exclusionary). An example is a screen against alcohol or pornography (considered a "negative" screen) employed by an organization for which such investments are counter to the belief system. The social benefit may not be directly measurable. SRI is also sometimes referred to as "values-based investing," where the end investor has unique beliefs or values beyond financial goals. These values are reflected in the investment decision-making process and criteria for selection.³ Positive screening is also sometimes referred to as "best in class" approach.

- **Mission-related investing (MRI).** MRI Investments can be clearly recognized as directly aligning with the specific mission and social beliefs of the organization. Alignment can be expected to be identifiable prior to initiation of the investment and to have social benefits that are measurable. The support of small businesses in a low-income neighborhood by a local community foundation is an example of MRI. Other commonly used terms for MRI are "mission investing" and "mission-connected investing."
- **Program-related investing (PRI).** This is a form of MRI, but it has a specific IRS definition associated with private non-operating foundations. As per the IRS⁴ definition, PRIs are the loans or capital investments a private foundation makes to further its charitable purposes. Income or appreciation of property is not a significant purpose. PRIs can be used to satisfy a foundation's five-percent spending requirement; they cannot be used to influence legislation or political campaigns.
- **Impact investing.** The Global Impact Investing Network (GIIN)⁵ defines "impact investing" as "investments made into companies, organizations, and funds with the intention to generate measurable social and environmental impact alongside a financial return." The impact sought via these investments is usually specifically targeted to a thematic strategy (health care, clean water, alternative energy, microfinance, etc.) or to a geographical sector.
- **Environmental, social and governance (ESG) considerations.** "ESG" is an umbrella term used to describe the nonfinancial impact of a corporation's action, project or investment. It is often referred to as "value-based" investing, where investors are looking for sustainable financial value by integrating ESG issues within their standard investing framework.⁶
- **ESG Integration.** The explicit incorporation of ESG considerations into investment analysis and decision making process, to identify risks that may impact the financial materiality and long term sustainable financial value of the investments.

The schematic in Exhibit 1 summarizes the relationship between the different approaches and terms discussed above.

Exhibit 1: Sustainable investing



*Only applicable to private non-operating foundations

Approach vs. Tool

Sustainable investing and mission-related investing can be viewed as umbrella terms for **approaches** for investing with a non-financial return in mind. Whereas, Screens, Shareholder engagement, and Impact investing are akin to **tools** or strategies for these approaches.

Rise of mission-related investing

Mission-related investing (MRI) is not new. The F.B. Heron Foundation was one of the earliest champions of mission-related investing back in 1996, and program-related investing (PRI) originated more than 40 years ago. The IRS introduced the term “program-related investments” in the Tax Act of 1969⁷, partly in response to moves made by the Ford Foundation the previous year. According to The Foundation Center⁸, 14% of the approximately 1,200 independent corporate and community foundations that responded to the center’s 2011 survey currently engage in one or more forms of mission-related investing. The survey also found that community foundations are more likely than corporate foundations to adopt mission-related investing. The success stories of these foundations, coupled with increasing awareness and educational efforts across the industry, have led other non-profits to explore MRI.

With the increasing momentum in MRI, more service providers have entered this space – specialist consultants offering guidance and expertise, and specialist money managers offering new social investment products. Increased demand from clients has also driven generalist investment consultants and money managers, including Russell Investments, to develop expertise in determining appropriate MRI strategies and opportunities.

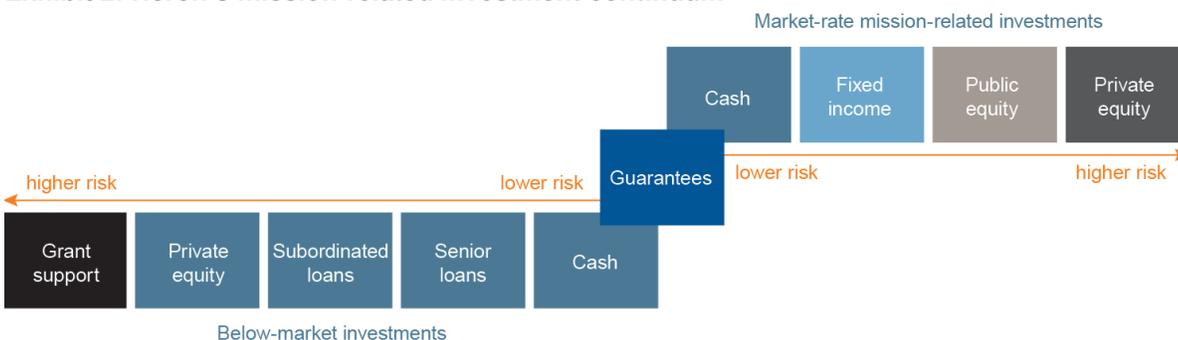
Different forms of mission-related investing

Mission-related investments are those where the objective is essentially to achieve both financial and nonfinancial returns simultaneously. The nonfinancial returns can be in the form of social or environmental impact that directly aligns with the mission or the social beliefs of the organization. The financial returns may or may not be market-level returns, depending on the form of MRI. The F.B. Heron Foundation has developed a framework⁹ (see below) for MRIs that lays out investment options on a continuum from below-market¹⁰ investments (such as grants, below-market private equity investments, loans and guarantees) to market-rate investments (such as cash, fixed income and public and private equity).

There are various approaches to implementing MRI. The most common form is program-related investing (PRI). Revisiting the roughly 1,200 foundations The Foundation Center surveyed in the study⁷ mentioned above: of the 14% of respondents (representing \$119.2 billion in assets) that engage in MRI, 50% implemented PRI, 28% invested in both MRI and PRI, and about 22% engaged in MRI excluding PRI.

PRIs have specific application to private non-operating foundations only. The primary objective of program-related investments is a charitable instead of a financial return. As

Exhibit 2: Heron’s mission-related investment continuum



a result, PRIs are almost always below-market investments. They are required to meet certain specifications, defined in the IRS tax code, in order for a foundation to maintain its tax-exempt status. PRIs serve an important purpose of recycling charitable dollars, which results in a multiplier effect on the social impact per grant dollar invested. In addition, PRIs may offer further benefits to the beneficiaries of the investments, such as providing access to capital the recipient would not otherwise have been able to access and they may provide credit standings that can open doors to attracting additional commercial capital.

A study conducted by FSG Social Impact Advisors¹¹ describes three approaches foundations use to implement MRI, either individually or in some combination: (a) screening, (b) shareholder engagement and (c) impact investing.

- **Screening.** With this approach, a non-profit can avoid select investments in sectors or companies that are not aligned with the organization’s social mission (known as negative screening) or can proactively seek out sectors or companies that *are* aligned (also called positive screening). This screening approach can be applied to the entire pool of assets or to select portions. Screening is also typically implemented on a publicly traded equity portfolio. [Note that many refer to screening as “socially responsible investing” (SRI).]

- **Shareholder engagement.** Another approach is to further the mission of the organization through active shareholder engagement in the companies in which the non-profit invests. Through proxy voting, shareholder resolutions and direct engagement with the management of the companies, non-profits can influence publicly traded companies to address governance, environmental and social concerns and to incorporate appropriate disclosures in the companies’ annual reports.

- **Impact investing.** In this approach, a non-profit typically allocates a portion of its portfolio to social-impact investments. As an example, and in line with the GIIN definition discussed earlier, these investments can either be direct equity or debt investments in a social venture, or indirect investments through intermediaries such as community-development financial institutions (CDFIs) or diversified thematic funds (microfinance, social funds or funds-of-funds).

The table below compares each of the above approaches and gives implementation examples for each:

Exhibit 3: MRI implementation approaches

	SCREENING	SHAREHOLDER ENGAGEMENT	IMPACT INVESTING
Examples	<p>Negative screening: Avoid companies that do not comply with mission or violate it (e.g., tobacco companies, firearms and weapons companies)</p> <p>Positive screening: Proactively invest in sectors or companies aligned with the mission (e.g., affordable housing, health, education, etc.)</p>	<p>Shareholder activism by a non-profit to influence a publicly held company to:</p> <ul style="list-style-type: none"> • Address labor and human rights conditions • Disclose climate risk • Incorporate ESG disclosures in its reports 	<p>Below-market investments (PRIs):</p> <ul style="list-style-type: none"> • Low-interest or zero-interest loans to small businesses • Loans for affordable housing construction • Equity investment in early-stage social ventures <p>Market-rate investment, including:</p> <ul style="list-style-type: none"> • Any investment (debt; equity; real assets, either direct or through intermediaries) that seeks to directly further the mission while still pursuing a market-rate return
Consideration’s from the non-profit’s perspective	<ul style="list-style-type: none"> • Lowest impact on the mission relative to the other two approaches • Least resource-intensive in terms of staff and expertise required to implement and monitor • Easier to implement on a traditional portfolio; harder to implement on nontraditional asset classes 	<ul style="list-style-type: none"> • Higher (direct) impact in terms of change; for a small equity share, investors can effect big changes¹² • Higher resource requirements in order to actively follow and engage with companies’ management • Need for shareholder activism expertise, such as in negotiation, potential litigation and publicity campaigns, etc. 	<ul style="list-style-type: none"> • Higher impact relative to screening, although this comes with higher risk • Highest cost in terms of resources, oversight and due diligence • Hardest to implement relative to other approaches, and often requires finding a specialist provider or partners to seek social-investment opportunities • May provide opportunity to attract private investors

II. Implementing mission-related investments

Despite the steady increase in the adoption of MRI, a lack of expertise and experience within organizations – especially within smaller non-profits – is cited as a significant barrier to implementing the approach. Many of the larger foundations active in MRI that do have in-house resources nonetheless collaborate with partners, their investment consultants or their money managers to build robust pipelines of potential investment opportunities and to get assistance with sourcing and evaluating these opportunities.

The roadmap below should prove useful to a non-profit assessing its readiness to embark on the implementation of an MRI program. We note also that in 2008, Rockefeller Philanthropy Advisors published a detailed policy and implementation guide that is a very useful resource for foundation trustees; it gives more detailed guidance on some of the steps we list here.¹³

Evaluate driver(s)	Evaluate the driver(s) for adopting MRI. Is the process being driven primarily by peer pressure or the values of a few board members? Assess whether and how your organization's current investments are complying with and/or deviating from its mission and social beliefs. Be explicit about the expected outcomes, in terms of both the mission-related impact and the impact on the investment program.
Seek buy-in from stakeholders	Get buy-in from board members, the investment committee and the program staff (in the case of PRI) for pursuing MRI. Everyone needs to be on board, and to ensure smooth implementation, the investment and program committees should be on the same page. While broad buy-in is important, so is identifying specific champions for the efforts. In addition, a separate MRI committee, with membership from both investment committees and program coordinators, can be established by the organization's board.
Seek expertise	Seek expertise on implementation approaches, either internally (if such expertise exists within the board or the investment committee) or externally (by hiring a qualified consultant or investment manager).
Evaluate MRI approaches	Evaluate approaches to implementing MRI that best fit your organization's needs and objectives, as well as benefits in terms of alignment with mission and the resulting impact. What portion of your organization's assets will be allocated to MRI and to each of the different approaches, if applicable? Some organizations have slowly increased their allocations to MRI as their knowledge and expertise have grown. Consider cost in terms of resources and the skills required to implement the selected approaches.
Update the Investment Policy Statement	Update the Investment Policy Statement and, if necessary, create a supplemental procedures document for MRI. This would include incorporating targeted asset classes or investment vehicles; amending asset allocation and reassessing risk tolerance, if necessary; clarifying the funding and size of the investment, and determining the timeline for implementing MRI.
Identify investment opportunities	Identify potential investment opportunities within the selected investment approaches. For example, in the case of screening, the companies or sectors to be excluded or included will need to be identified. In the case of themed investments, the sectors or securities most relevant to the organization's mission will need to be identified. Oftentimes, this is the step where non-profit organizations most need help, due to a dearth of in-house expertise in searching for suitable investment opportunities, and where working with an external advisor can thus be helpful. Coordinating and partnering with other community organizations to stay abreast of latest developments and to build an active pipeline for potential investment opportunities can also be helpful.

Develop measurement criteria	Develop appropriate criteria for measuring the social impact of investments, and identify these metrics <i>prior</i> to making an investment. While most organizations have used their own proprietary methods of measuring social impact, there has recently been a globally coordinated initiative to create standardized metrics. Managed by the Global Impact Investing Network (GIIN) and known as the Impact Reporting and Investment Standards (IRIS), ¹⁴ these metrics enable assessment of the performance of a social investment and of its impact relative to industry peers. IRIS also provides the option to select a subset of sector-specific metrics relevant to an organization's mission.
Integrate reporting and communication	Integrate reporting and communications to constituents – the board, investment committee and donors– as to the ongoing progress of the investments. Reports should include the financial benefits to recipients and social outcomes as they become known. Any financial impact on the investment program should also be tracked.
Conduct risk analysis	Identify the risks of implementing – or not implementing – an MRI program that are of most concern to your organization. For instance, with an MRI program, is there potential for degradation of returns to your portfolio? Without an MRI program, is there potential for adverse community sentiment or negative press? The risks specific to MRI program implementation need to be addressed in the non-profit's broader risk management program.
Fulfill fiduciary and governance duties	In line with the Uniform Prudent Management of Institutional Funds Act (UPMIFA), ¹⁵ trustees must still carry out their duty of care, prudence and good faith in evaluating MRIs in the context of the total portfolio's risk/return objectives.

Concluding thoughts

If the goals of an MRI program are to be achieved without inappropriate financial cost, sound implementation is essential. Non-profits should carefully evaluate the considerations and steps to implementing an MRI program before they set out on this path. The convergence of investment and social objectives can help non-profits scale the impact of their total assets. If implemented correctly, an MRI program can help non-profits further their mission while still achieving a financial return.

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⁴ U.S. Internal Revenue Service (IRS) website, <http://www.irs.gov/Charities-&-Non-Profits/Charitable-Organizations/Examples-of-Program-Related-Investments-by-Private-Foundations-%E2%80%93-Proposed-Regulations#>

⁵ Global Impact Investing Network, <http://www.thegiin.org/cgi-bin/iowa/resources/about/index.html>. Accessed May 29, 2013.

⁶ Please see endnote 3.

⁷ Section 4944(c) of the U.S. Internal Revenue Service Tax Act of 1969.

⁸ Copyright 2011 The Foundation Center - Key Facts on Mission Investing (October 2011)

⁹ Michael Swack, Jack Northrup and Janet Prince, "A Case Study—Expanding Philanthropy: Mission-Related Investing at the F.B. Heron Foundation," Southern New Hampshire University, School of Community Economic Development (January 2007).

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¹⁵ The Uniform Prudent Management of Institutional Funds Act, which harmonizes the standards of prudent management of charitable funds, regardless of the legal form of the non-profit.