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The U.K. Social Investment Market: The Current Landscape and a Framework for Investor Decision Making

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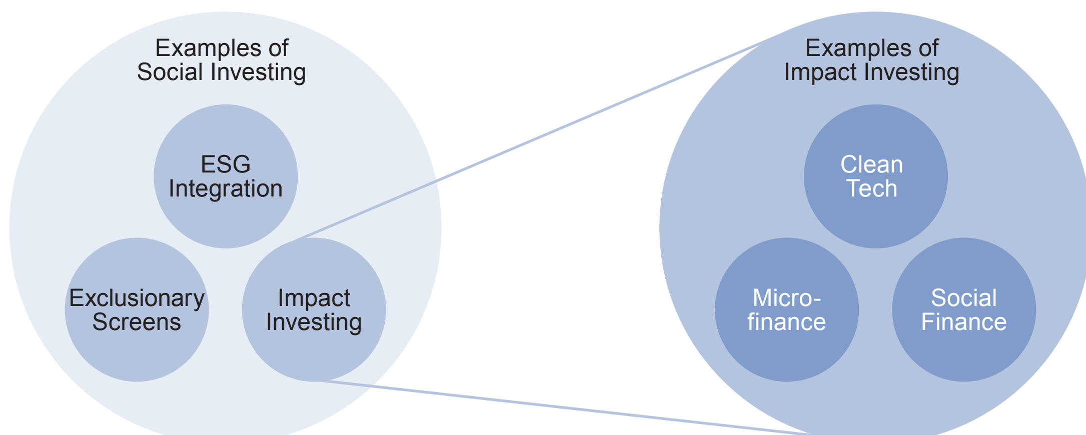
At Cambridge Associates, we have been an advisor to mission-based non-profits for over 37 years and have served the various social investment needs of clients throughout our history. Our dedicated Mission-Related Investing Group began working more closely with clients in 2008 and we have observed increased interest in the space over the past few years. We have published three previous reports in the area of social investment, *Social Investing* (2007), *Investing in Clean Energy and Technology* (2007), and *Environmental, Social, and Governance (ESG) Integration: For Performance, For Ethics, or For Both?* (2010).

The goal of this report is to provide a new perspective on the social investment market in the United Kingdom and address the needs of both institutional and private investors. We have observed that investors often do not know where to begin when they are asked about social investing. Admittedly, the term is very broad and the market is always evolving. We define social investments as investments that generate a monetary return while also generating a social return or minimising a social risk. Social investing is a comprehensive term meant to incorporate economic, environmental, health, moral, political, and/or religious factors. Social investments can be made through a wide range of strategies, including negative/exclusionary screening; positive screening, also called ESG integration; and impact investing.

Impact investing is less familiar to many investors than other social investment strategies, and we focus on this strategy in this report, while also discussing most other social investment strategies available in the United Kingdom. We define impact investments as investments made in enterprises that offer market-based solutions to a particular social or environmental challenge of interest to the investor; essentially, using the market to create social change. Impact investors invest in enterprises that proactively use the business to achieve 'good', however defined, at either a below market or market rate return (defined as one that appropriately compensates investors for the risks taken) with the intention of generating a social and/or environmental return. Three common forms of impact investing are clean tech, microfinance, and social finance or social enterprise investment. This third form of impact investing is common in the United Kingdom and refers to investments that provide capital to entrepreneurs and/or entities that have the intent to create a social impact (e.g., a loan to an entrepreneur looking to create a business that solves a social problem like homelessness). Throughout this report, we distinguish this type of investing from broader impact investing strategies by referring to it as 'social finance investment'.



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Organized into three main sections, this report helps to demystify the growing social investment market and guide investors through some of the major steps in exploring social investing and the opportunities available. We discuss:

- the **landscape** of the U.K. social investment market, with a focus on impact investing;
- the **barriers** to the growth of the social investment market and potential solutions; and
- a **decision-making framework** to help investors evaluate and implement social investments within a diversified investment portfolio.

Three appendices provide additional information. Appendix A includes guiding questions for investors to use in conjunction with the steps of our framework to help clarify their decision to make social investments.

In Appendix B, we review the social investment markets in continental Europe and the United States. We would highlight that because U.K. foundations are not required to pay out 5% of their assets each year and U.S. foundations are, there are significant differences in how foundations in the two countries can think about investing and spending. Arguably, U.K. foundations have more flexibility to incorporate below market rate investments in their portfolios, as their spending for grant making is more flexible. U.S. foundations must consider the risk of losing purchasing power if below market rate investments are housed within the main endowment fund. This difference has also contributed to the relative popularity of programme-related investments (PRIs) in the United States. PRIs count towards a U.S. foundation's 5% annual payout and are typically made from programmatic rather than endowment funds.

Finally, as any discussion of social investing involves a myriad of new terms, organisations, and acronyms, the glossary in Appendix C provides definitions of terms and descriptions of investments and organisations mentioned in this report.

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Section I: The Landscape of the Social Investment Market in the United Kingdom

Current Market Size

Many reports cite the United Kingdom as the strongest market for acceptance of ESG integration into investment decision-making processes and for engaging with companies on ESG issues. At the end of 2009, £938.9 billion was invested in various traditional forms of social investment (e.g., exclusionary screens, ESG integration) in the United Kingdom, accounting for approximately 28% of the £3.4 trillion in total assets managed in the United Kingdom.[1] According to one report, as of 2008 the assets invested in broad social investing strategies in the United Kingdom represented 41% of total assets managed in Europe using broad social investing strategies.[2]

Two key developments have helped establish the United Kingdom as a leader in social investing. First, a law passed in 2000 requires occupational pension funds to disclose the extent to which they incorporate responsible investment policies. Second, in July 2010, the Financial Reporting Council published the U.K. Stewardship Code, which aims to foster effective dialogue on governance issues between investors and listed companies. The Code outlines how institutional investors should disclose their engagement and voting policies.[3]

The impact investing side of the U.K. social investment market is still young and undercapitalised, although many recognise it as the most developed impact investment market in Europe. In the United Kingdom, impact investing is largely focused on social finance investment in locally based enterprises. In 2010, approximately £190 million was committed to social finance investments.[4] To date, demand for capital by social entrepreneurs/social enterprises exceeds the supply, as a limited number of impact investors are active in the market. In 2010, the top ten providers of social finance invested 96% of the £190 million in capital.[5] In a recent report, NESTA, an independent charity, estimated that the demand for social finance capital over the next few years will be between £615 million and £820 million[6] and the Boston Consulting Group estimated a market of up to £1 billion by 2016.[7]

In the coming years, the supply of capital may catch up with demand, with the launch of Big Society Capital (BSC) on 4 April 2012. An independent financial institution formed to develop a sustainable social investment market in the United Kingdom, BSC was funded from £400 million in dormant bank accounts and with £200 million from the four major high street banks (Barclays, HSBC, Lloyds, and the Royal Bank of Scotland). Most of BSC's £600 million in capital is slotted for

[1] Eurosif, *European SRI Study*, November 2010, p. 53.
[2] International Decision Strategies, *Environmental, Social and Governance Investing in Europe: A Review and Analysis*, April 2009, p. 28.
[3] For more on the history of the United Kingdom's social investment market, please see the report *Social Investment Ten Years On*, which provides a concise overview of the important milestones in the U.K. social investment market over the past ten years (available at www.socialinvestmenttaskforce.org).
[4] The £190 million was determined from a survey of 'social venture intermediaries' conducted by the Young Foundation. This number is exclusive of opportunities available to retail investors, such as deposits in social banks like Charity Bank. Cynthia Shanmugalingam, Jack Graham, Simon Tucker, and Geoff Mulgan, *Growing Social Ventures: The Role of Intermediaries and Investors: Who They Are, What They Do, and What They Could Become*, NESTA and The Young Foundation, February 2011, p. 31.
[5] Ibid., p. 8.
[6] Iona Joy, Lucy de Las Casas, and Benedict Rickey, *Understanding the Demand For and Supply of Social Finance*, NESTA and New Philanthropy Capital, April 2011, p. 9.
[7] Adrian Brown and Adam Swersky, *The First Billion: A Forecast of Social Investment Demand*, The Boston Consulting Group and Big Society Capital, September 2012, p. 8.

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investments in social finance investment intermediaries and it is expected that many new funds focused on social investments will launch in anticipation of obtaining an investment from BSC.

Current Opportunities

Based on our research, we would make three key observations about the current state of the U.K. impact investing market in the United Kingdom.

- The current opportunity set of local impact investing opportunities in the United Kingdom is rather limited in choice and in size. For example, CAF Venturesome's local impact funds have just £11.5 million under management.
- Many of the impact investing opportunities in the U.K. market are currently structured as individual deals to individual organisations (e.g., the Peterborough Prison Social Impact Bond and the Scope Bond, further discussed in Appendix C), whereas the global opportunities are typically in diversified fund structures that finance multiple organisations.
- Impact investments in the United Kingdom are predominantly in the form of debt rather than equity. In 2010–11, only 5% of social finance investments made in the United Kingdom were categorised as equity or quasi-equity.[8]

Table 1 lists some of the current funds in the U.K. impact investing market. The current intermediary/fund structures available to U.K. impact investors typically take one of the following forms:

- **Venture philanthropy funds**, which are similar to mainstream venture capital funds as managers provide both financial and organisational support (such as management support and specialty expertise), but the focus in venture philanthropy is on social rather than financial returns. We have observed that there are more venture philanthropy funds than market rate social venture capital funds in the United Kingdom.
- **Social entrepreneur funds** that offer financing (both debt and equity) to social enterprises. Social enterprises are profit-making companies whose products or services are scalable and are designed to produce a positive social impact. Our

[8] Adrian Brown and Will Norman, *Lighting the Touchpaper: Growing the Market for Social Investment in England*, The Boston Consulting Group and The Young Foundation, November 2011, p. 3.

Table 1. Representative U.K. Impact Investing Opportunities

Firm	Product	AUM (£ millions)
Bridges Ventures	Bridges Ventures Fund III	100 to 150
	Sustainable Property Fund	28
	Social Entrepreneurs Fund	12
Big Issue	Big Issue Social Enterprise Fund	9
CAF Venturesome	Four Institutional Funds*	12
Social Finance	Social Impact Bond (Peterborough Prison)	5

Notes: Assets under management reflect either the size of the most recent fund raised by the manager or the fund-raising target. Inclusion in this table does not represent a recommendation of a specific fund.
* Includes the Community Land Trust Fund, Social Impact Fund, the Development Fund, and the Innovation Fund.

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observation is that current social entrepreneur funds in the U.K. market do not offer the illiquidity premium expected by most institutional investors.

- Funds offering **recycled loans to charities**. Investors only expect to receive the capital that was initially invested (a 0.0% nominal return) so that the capital can be used again similarly.
- **Community development finance institutions (CDFIs)** and **social banks**, which are financial institutions that provide affordable finance to disadvantaged communities. Impact investors invest in CDFIs or make deposits in social banks, and in return, earn a yield similar to other cash equivalent investments.

Many new organisations and platforms are under development, which should continue to foster growth in the social investment market and affect some of the observations that we make above. Organisations such as ClearlySo, the New Economics Foundation, and the Social Stock Exchange are contributing to the infrastructure of the market. In addition, many interesting and innovative deals have been brought to market or are in development, such as the Scope Bond, the Peterborough Prison Social Impact Bond, and Bristol Together, but lack scale. For example, the first tranche of the Scope Bond raised £2 million and the total pilot programme is only expected to raise £20 million. The creation of diversified funds, especially those offering market rate returns, has seen the least amount of activity. Bridges Ventures is one of the current exceptions to the below market rate trend. More market rate and below market rate fund offerings are expected as BSC continues to make commitments.[9]

[9] For more information on the deals/organisations mentioned in this paragraph, please see Appendix C.

Who Is Investing?

As mentioned above, there are currently a limited number of impact investors among institutional investors. The government has played a large role in the development of the U.K. impact investing market. One report estimates that the government has contributed £450 million in capital in the form of grants, unsecured loans, quasi-equity, and equity.[10] The government's initiatives in the space include facilitating the creation of both BSC and the Social Investment Business Group and investing directly in funds, such as Bridges Ventures. Recently, the Department for Business Innovation and Skills announced the start of the Regional Growth Fund (RGF), which was created to help those areas of the country most impacted by public sector spending cuts. Between 2011 and 2015, the RGF will provide a total of £2.4 billion to businesses across the country that support projects and programmes that use private investment to create economic growth and sustainable employment.

To date, only a few pension funds, high-net-worth individuals, foundations, and universities have been active in social investing. Current investors predominantly utilise traditional forms of social investing, such as shareholder advocacy, the use of negative screens in listed equity strategies, or ESG integration. A few foundations, like the Esmée Fairbairn Foundation, have been important first movers in social impact investing, but the aggregate level of monetary commitment and investment from these organisations is low. To give a sense of the relatively small scale of commitment by foundations, U.K. foundations have invested approximately £50 million in

[10] JPA Europe Limited, *Social Enterprise and the Social Investment Market in the U.K.: An Initial Overview*, July 2010, p. 22.

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impact investments,[11] while total foundation assets in the United Kingdom have been estimated at £78 billion in 2010.[12]

The momentum in the U.K. social investment market is apparent and many of the developments we have discussed in this report are bringing new investors into the space. However, as outlined in the following section, there are still a number of barriers to break down before social investing can move into the 'mainstream'.

[11] ClearlySo, *Investor Perspectives on Social Enterprise Financing*, July 2011, p. 27.

[12] Ruth Sullivan, "Charities Take a New Look at Investment," *Financial Times*, 3 April 2011.

Section II: Barriers to the Growth of the Social Investment Market and Potential Solutions[13]

While there have been many developments in the social investment market in the United Kingdom, we have identified several barriers to growing the field. Broadly, the barriers can be grouped into four categories: common misperceptions about social investing, implementation considerations, lack of suitable investment vehicles, and a need for supporting infrastructure to develop the field. We propose solutions to each of the barriers we have identified, though some barriers will of course be more challenging to overcome than others (e.g., a desire for longer track records cannot be solved in the short term).

Common Misperceptions About Social Investing

Some of the common misperceptions about social investing we have identified include trustee confusion about whether fiduciary duty permits investing charity assets in social investments; a belief that social investing involves a trade-off between return and impact, even for funds targeting market rates of return; and a perception that it takes substantially more effort to research and make social investments compared to 'mainstream' investments. We break down each of these barriers in turn.

First, regarding fiduciary duty, the Charity Commission recently released CC14, which offers decision-making guidance for investing charity funds. The guidance sets out various valid investment approaches and usefully introduces the categories of 'programme-related' and 'mixed-motive' investments. Both of these categories link investments to the direct furthering of a charity's aims and mission, and are therefore

[13] Based on the ideas of Cambridge Associates and others.

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constructive towards the development of a broader and more varied social investment market. Specifically, CC14 states that "Trustees of any charity can decide to invest ethically, even if the investment might provide a lower rate of return than an alternative investment. Ethical investment means investing in a way that reflects a charity's values and ethos and does not run counter to its aims".[14] As part of their governance work, charity trustees can, therefore, evaluate the appropriateness of social investments and work through the process of defining the types of social investments that reflect a charity's values and ethos using CC14 as guidance. Note that CC14 is guidance rather than law, and some trustees and advisors remain unclear about whether, from a legal point of view, charities can invest for social impact rather than purely pursuing financial return. Because of this confusion, some in the field recommend the government introduce a reform of charity law that creates a clear legal and regulatory environment for social investment.

Second, on the belief that social investments will underperform, it is difficult to make blanket statements about the likely performance impact of dedicating some or all of a portfolio to social investments, as the impact will depend on a variety of factors. However, we encourage investors to apply the familiar risk-adjusted returns analysis for social investments, just as they would for all investments in their portfolio. Though some social investments explicitly target below-market rates of return, we actively follow a number of social investing funds that target market rates of return within their respective asset classes and have posted competitive returns relative to their benchmarks. As with any investment, the availability of skilled managers will be a key determinant of performance expectations. In the final section of this report, we propose a framework to assist investors in their decision making as it relates to social investments.

Finally, investors should continue to network and share best practices related to their social investments to help address concerns regarding both the time commitment and performance expectations of these investments. The creation of case studies highlighting successful social funds, for example, would be instrumental in encouraging other investors that remain sceptical about making such investments. In addition, many have called for a U.K. version of the United States' More for Mission Campaign[15] to facilitate and expand the sharing of ideas and opportunities more formally between foundations. While such an entity does not yet exist, there are groups with similar missions in the United Kingdom. For example, the Global Impact Investing Network, which began in the United States, is currently expanding to Europe, and UKSIF (the U.K. Sustainable Investment and Finance Association) is already active in the U.K. social investment market.

Barrier	Solution
Confusion regarding fiduciary duty.	Look to CC14 for guidance.
Belief that social investments will underperform.	Apply traditional risk/return framework to performance analysis.
Belief that social investing is time consuming.	Education, sharing of best practices, and field building.

[14] Charity Commission, *Charities and Investment Matters: A Guide for Trustees*, October 2011, p. 8.

[15] More for Mission is now known as Mission Investors Exchange after merging with PRI Makers Network in 2012.

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Confusion Regarding Portfolio Construction and Implementation

Confusion as to where social investment fits within the total portfolio context hinders its growth as a market. Any decision to pursue social investments should begin with a dialogue about the organisation's goals for its social investments that engages the leadership. Social investment opportunities can either be housed in a carve-out pool of capital that resides outside the main corpus/endowment money, or alongside the mainstream investments of the portfolio, depending on the investor's preferences. We offer guidance on the decision-making process in the final section of this report.

Confusion can also exist within an organisation's staff over who has responsibility for and ownership of social investments, as investing and charitable activities are typically divided within a foundation. Given the dual purpose of achieving a financial return while furthering the mission of an organisation, organisations could assign dual responsibility for the selection and monitoring of social investments so that both sides are accurately monitored. Generally, members of the investment staff are more adept at analysing prospective investment returns, but they might miss the social benefits of an opportunity. On the other hand, grant-making staff might not be able to understand and negotiate investment terms. Collaboration between the two sides is essential. For example, several U.S. foundations with robust social investing programmes have created a collaborative model, with investment and programme staff working side by side to source and underwrite social investments.

Barrier	Solution
Confusion regarding the role of social investment in a portfolio.	Establish a clear decision-making framework.
Unclear directives for implementation and monitoring.	Encourage collaboration between grant-making and investment staff.

Lack of Suitable Investment Vehicles

While progress has been made in the social investment market, many of the vehicles are inappropriate for or unattractive to mainstream institutional investors, and the small universe of options provides little choice for investors. The social investment market needs to provide investors opportunities with no expected trade-off between return and impact and where risk is mitigated through the aggregation of multiple opportunities. Institutional investors need opportunities to be provided in a diversified fund structure for risk mitigation purposes. Also, many in the industry have discussed the potential for products with tiered financing arrangements that allow investors to choose the most appropriate level of financial return, risk, and impact.

The current market for impact investing funds is largely made up of new and unproven opportunities. Without an adequate track record, mainstream investors may find it difficult to approve an investment in the space. At this point, impact investments are predominantly made by investors willing to be 'first movers'. Angel investors can help bring social enterprises to a level where they are large enough to appeal to venture philanthropy funds or social venture capital funds. If institutional investors with an interest in facilitating the market are willing to take the risk of investing in early funds, more opportunities will grow in size and develop established track records. To incent investors to be pioneers in first- and second-time funds, funds should consider allowing investors to influence the terms of the fund, and potentially offer a discounted fee schedule to seed investors.

Barrier	Solution
Need for more market rate opportunities.	Create more market rate opportunities.
Funds with unproven track records.	Incent investors to be pioneers in first- and second-time funds.

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Need for Supporting Infrastructure to Develop the Field

There is a clear need for supporting infrastructure to develop the social investment market. Some of the missing pieces include informed gatekeepers, common social impact measurement standards, the ability to price the risk and measure the impact of social investments, and sufficient tax incentives. None of these barriers are insurmountable, and we can make several recommendations to help overcome them.

The current lack of knowledge and acceptance of social investment by investment consultants and advisors that are seen as gatekeepers to capital in this space prevents widespread acceptance and investment on the part of asset owners. Asset managers and consultants should engage in clear communication to ensure the products in development will appeal to institutional investors. For their part, investors should continue to put pressure on their advisors to review the opportunities in this space and develop expertise in this field.

While some funds provide reporting on the social impact of their underlying investments, there is little consistency in the approaches applied by managers. Accordingly, investors often find it difficult to determine the aggregate social benefit their investments generate, and the measurement of a blended financial and social return is nearly impossible at this stage. A few organisations have devoted resources to developing social impact measurement tools, including the global impact investing rating system, social return on investment, and the investing for good impact rating methodology.[16] The success of these standards will be highly dependent on their acceptance and adoption by investors. BSC is attempting to tackle this challenge by collaborating with others in the social investment industry to create an outcomes matrix that would allow mapping and reporting on the social impact created through the day-to-day business activities of a social enterprise.[17] Using a tool like this, an investor could embed social value into the investment decision-making process by having a clearer picture of the impact generated by a business.

Pricing the risk of social investment is difficult at best. Most impact investments have nascent track records, the business model of each social enterprise is unique, liquidity varies, exit opportunities are unknown and unpredictable, and it is difficult to measure the expected and even realized social impact of an investment. The authors of the paper *In Search of Gamma* challenge impact investors to establish key performance indicators within the investment thesis, allowing the impact to be monitored and assessed throughout the life of the investment.[18] The expected impact can be incorporated into the return expectation. While this is not a solution to all the issues related to pricing risk, measuring expected and realised social impact may be one of the most challenging issues for social investing. Clarity on the other issues should be gained as the market matures.

Finally, the United Kingdom has tax schemes that were predominantly designed to encourage investment in mainstream businesses, but these do not translate to most investment opportunities in social enterprises. A 2012 report from the NCVO Commission on Tax Incentives for Social Investment highlights the deficiencies of

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[16] JPA Europe Limited, *Social Enterprise and the Social Investment Market in the U.K.: An Initial Overview*, July 2010, p. 19.

[17] Caroline Mason, Chief Operating Officer, Big Society Capital, interview, 5 October 2012.

[18] Uli Grabenwarter and Heinrich Liechtenstein, *In Search of Gamma: An Unconventional Perspective on Impact Investing*, IESE Business School University of Navarra, January 2011, p. 54.

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the four main tax schemes: Community Investment Tax Relief, the Enterprise Investment Scheme, Venture Capital Trusts, and the Seed Enterprise Investment Scheme.[19] The changes and improvements suggested in the NCVO report should be implemented to encourage further demand for social investments.

Barrier	Solution
Lack of informed gatekeepers.	Increased pressure from investors for their advisors to expand their social investing capabilities and research, as well as clear and targeted communication between asset managers and consultants.
Lack of common social impact measurement standards.	Further development of consistent social impact standards and adoption by investors.
Difficulty pricing social investments.	Establish key performance indicators for impact investments prior to making an investment.
Insufficient tax incentives.	Implement changes to current tax schemes.

Overcoming These Barriers

While the list of barriers may seem long, many of these issues can be readily addressed, and responsibility for these solutions should be shared by all market participants—investors, advisors, and fund managers. Significant progress has already been made in the past several years, as seen through the development of various social and impact investing networks, the establishment of social investment–focused groups at mainstream investment firms (e.g., the Mission-Related Investing Group at Cambridge Associates, Morgan Stanley's Investing with Impact platform), and the proliferation of new funds seeking to generate both monetary and social returns. However, misperceptions and roadblocks still exist, and many investors remain on the sidelines as they grapple with how to approach this somewhat new and unfamiliar field. In the following section, we provide a framework to help investors navigate some of these issues.

[19] National Council for Voluntary Organisations, *NCVO Commission on Tax Incentives for Social Investment*, January 2012. See Appendix C for more information on these schemes.

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Section III: Decision-Making Framework

In this section, we provide an overview of a framework we have developed to help investors evaluate and implement social investments into a diversified investment portfolio.

In our recommended approach, evaluating social investments is an extension of the familiar risk/return analysis applied to *all* investment assets. In this case, however, 'risk' is expanded to **'combined risk'**, which incorporates both financial risk and social risk, while 'return' is broadened to **'combined return'**, which incorporates both financial return and social impact.[20]

It should be noted that traditional portfolio construction best practices still apply when incorporating social investments into the portfolio. For example, there should be a clearly defined role for each type of social investment, sufficient diversification among higher-risk opportunities like equities, and an evaluation of returns relative to the risks taken.

We begin by defining 'combined return' and 'combined risk' as these concepts underpin this decision-making framework.

Combined Return

Investment funds are not ends in themselves, but are a means to achieving an institution's financial or social objective. Investment assets can help the institution achieve its social objective in two ways—by earning a financial return and by earning a social return, the sum of which is the combined return of an investment. To better illustrate the concept of combined returns, we use as an example an organisation that has the objective of increasing job creation in underserved areas. This organisation will achieve its objectives in two ways:

- by earning a **financial return** that can be used to fund grant making on social objectives (e.g., making grants for job creation programs in underserved areas).
- by earning a **social return** from the underlying investment assets (e.g., impact funds that take equity stakes in new businesses that are creating jobs in underserved areas).

The combined return accounts for both the investment's financial return and any social return that is relevant to the investor's objectives (in this case, job creation).

For example, an investment with an impact fund that creates a below market rate financial return could still have a compelling combined return for this particular organisation because the impact fund also creates jobs in underserved areas.

The important concept here is that the combined returns of all investment opportunities are compared starting from the organisation's objective (in the example, job creation). The ranking and ordering of the investment opportunities is then similar to what any traditional investor would do. The difference with the combined return approach, however, is that investors with distinct objectives and missions will end up ranking investment opportunities differently.

Combined Risk

Similarly, the objective of the combined risk measurement is to provide an assessment of investment risk that includes the social/reputational risk of alienating key stakeholders. Specifically, we define an investment's combined risk as the sum of financial risk and social risk.

Financial risk refers to an asset class' volatility (as measured by standard deviation of returns). This is a fairly standard measure

[20] Cambridge Associates explored the combined return concept in our 2007 paper *Social Investing*. In that paper, we described an investor's "Holistic Total Investment Return" as being equal to the Social Return + the Monetary Return.

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of investment risk used by many investors when evaluating risk-adjusted returns. Financial risk is considered a *compensated risk* as investors expect higher long-term returns in exchange for increased volatility. It is also important to highlight that financial risk measured solely by volatility does not capture all aspects of investment risk and does not address risks that are more difficult to quantify.

Social risk refers to the risk that an institution's investments might alienate key stakeholders and/or compromise the values of the organisation. This is considered an *uncompensated risk* as there is no increased expected return when exposed to this type of risk.[21]

Combining financial risk and social risk into one risk figure is difficult because social risk is not easily quantifiable. When a relevant social risk is identified for an investment opportunity, we recommend that the combined risk measure be increased so that it is meaningfully higher than the financial risk measure. This will make it clear that a strategy with exposure to social risk is less attractive from a risk/return standpoint than a similar approach that is not exposed to the social risk.

For example, a health care foundation that has a goal of maximising returns to support charitable spending might perceive an investment in equity funds that include tobacco companies as an uncompensated risk. This exposure has the potential to alienate key stakeholders and runs counter to the organisation's objectives.

[21] Just as volatility does not capture all aspects of investment risk, social risk, as defined here, does not capture all types of social risks. For example, when making a social investment, there is the risk that the investment may not produce the desired social outcome (e.g., jobs may be lost rather than created). However, this social risk and others may be captured within the combined return framework. When an expected social outcome is not achieved, the ex post combined return would be lower than the expected combined return.

The combined risk of this type of investment is therefore higher than a competing investment with the same financial risk (i.e., volatility) that avoids the social risk by excluding tobacco.

The remainder of this section describes the steps we recommend that investors take to effectively evaluate social investment options within a combined risk to combined return framework.

Step 1. Assess Investor Motivation for Considering Social Investments

Clearly articulating the rationale for social investments is an important first step. This will help the fiduciary focus on the strategies that are most relevant to the institution's objectives and will allow for a more robust analysis of the social investment opportunity set. In Appendix A, we have created a series of 'guiding questions' to help fiduciaries think through these issues by addressing the following topics:

- the organisation's objectives and the role of the investment in achieving those objectives,
- the stakeholder implications of allocating capital to social investments,
- the guidelines the organisation will use in making social investments, and
- the available universe of social investments (funds and direct investments) that are relevant given the organisation's motivation.

In general, we have observed that social investors tend to be motivated either by a desire to maximise social impact or by a desire to minimise social/reputational risks. More specifically, we have found that the four 'investor motivation' categories depicted in Table 2 capture the majority of scenarios where social investments are implemented into a broader portfolio. For each one of these motivation categories, Table 2

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Table 2. Types of Nonfinancial Motivation

<table>
<tr><th>Maximise Impact</th><th>Minimise Risk</th></tr>
<tr><td>Maximise Impact Locally
Examples:
◆ Local organisation wants to coordinate investments with its grant-making to maximise impact.
◆ A foundation that would like to be a ‘first mover’ to help grow the local market for social impact investments.

Types of Investments:
◆ Social PE/VC Funds
◆ Social Impact Bonds
◆ Impact Funds
◆ Social Bank Deposits

Organisation:
◆ The Esmée Fairbairn Foundation</td><td>Minimise Risk Through Exclusion
Examples:
◆ Religious organisation with clear guidelines on a range of investments to avoid that are considered contrary to its principles (e.g., avoiding weapons, gambling, pornography, etc.).
◆ Private foundation has decided to support cancer research and would like to avoid investments in tobacco that would be seen as compromising the intent of its donations.

Types of Investments:
◆ Screened Equity Funds
◆ Screened Bond Funds</td></tr>
<tr><td>Maximise Impact Globally
Examples:
◆ Global organisation seeking to coordinate its investments with its spending/donations to maximise the reach of its impact.
◆ Large public investor wants to use its size to actively influence/change corporate behaviour of its portfolio companies through engagement as part of its responsibility to its stakeholders.

Types of Investments:
◆ EM Development Funds
◆ Impact Funds

Organisation:
◆ Council for World Mission</td><td>Minimise Risk Through ESG Integration
Examples:
◆ Large pension concerned about the risk of alienating stakeholders across a variety of issues.
◆ Environmental organisation wants to limit exposure to investments that could compromise its mission or hurt its reputation.
◆ A university concerned about student body reaction to investment in emerging markets across a range of issues (e.g., labour standards, human rights, environmental).

Types of Investments:
◆ Environmental Equity
◆ ESG Screened Equity Funds

Organisation:
◆ Royal Society for the Protection of Birds</td></tr>
</table>

An investor is not limited to just one of the four categories depicted in this table. For example, the same religious foundation seeking to “minimise risk through exclusion” by investing in a screened equity fund that avoids gambling, alcohol, and tobacco might also “maximise impact locally” by investing in a social impact bond that is aligned with its charitable donation efforts.

Note: A fund’s inclusion in this matrix is not intended to represent a recommendation to invest.

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identifies examples of these nonfinancial motivators, lists organisations currently investing in this manner, and provides examples of funds in each category.

Using Table 2 along with the 'guiding questions' contained in Appendix A should help investors identify the 'motivation category' and the social investment strategies that are most relevant to the overall objectives of the institution's investment pool. We would note that an investor could fit into more than one category.

Step 2. Evaluate Options within the Combined Risk to Combined Return Framework

Once the investor's nonfinancial motivation has been identified, the social investment strategies should be evaluated within a 'combined return' (financial return + social return) to 'combined risk' (financial risk + social risk) framework. This approach starts with mapping investment options onto the traditional financial risk to financial return framework and then makes adjustments to account for any potential social impact or social risk that may be relevant to the institution's nonfinancial objectives.

Step 2.1. Start with the Traditional Financial Risk to Financial Return Framework. In Figure 1 we have mapped various social investment categories onto the traditional financial risk to financial return framework. The objective of the traditional framework is to assess expected financial return against expected financial risk. The circles depict social investments while the triangles depict conventional asset classes that do not have any explicit social objective. The vertical axis represents expected financial returns, while the horizontal axis represents financial risk (e.g., volatility). Investments falling between the dotted lines are considered market rate in that investors are compensated with sufficient financial return for the amount of financial risk taken. Investments falling outside the dotted lines are not adequately compensating investors with a high enough financial return given the financial risk taken.

When looking at social investments using this 'traditional' reference point, we would make the following observations.

- **There is no 'free lunch'.** This framework assumes that asset classes with lower risks have lower expected returns and asset classes with higher risks have higher expected returns. As a result, there is no inherently 'superior' asset class that delivers outsized returns at a lower level of risk. We also assume that a social public equity strategy (e.g., one incorporating exclusionary screens, ESG integration, or best-in-class criteria) and an unscreened public equity strategy that have a similar level of financial risk will have a similar level of expected return.[22]
- **But there may be some 'expensive lunches' (i.e., below market return strategies do exist).** There are some social investment strategies, however, that have expected financial returns that are, by design, lower than other asset classes with comparable financial risk. This implies that investors that decide to allocate to these types of funds are placing some type of value on the fund's social return/social impact in addition to its expected financial return. However, this extra source of return is not accounted for in the traditional risk and return framework of Figure 1.

If an investor were to look at the universe of investment categories from solely a *financial* risk to *financial* return perspective, the

[22] Note that this does not take a view on any expected extra return based on manager skill (i.e., no 'alpha' is assumed at this stage of the evaluation).

social investment strategies would not be particularly differentiated from the nonsocial investments. In addition, the strategies with below market rates of returns would probably not receive serious consideration from fiduciaries using the traditional financial risk to financial return framework. As a result, an adjustment needs to be made from this reference point.

Step 2.2. Adjust the Framework to Account for Combined Return and Combined Risk. The traditional risk/return framework is then modified to create a combined risk (financial risk + social risk) to combined return (financial return + social return) framework to better evaluate the social investment options. In Figure 2, we depict the adjustments that would be made to the traditional risk/return model. The extent to which investors decide to adjust either the expected 'combined return' or expected 'combined risk' of a particular social investment strategy will largely depend on the investor motivation category identified in Step 1.

When social returns are factored into an assessment of combined return (vertical axis), some asset classes will have a combined return that is higher than their simple financial return. Similarly, when social risk is accounted for in the combined risk measurement (horizontal axis), some of the traditional asset classes may see their combined risk increase above their financial risk measure.

- **For investors primarily motivated by a desire to maximise social impact**, there may need to be an upward adjustment to the expected 'combined return' of certain impact-oriented investments *if* the nature of the impact is relevant to the institution's objectives. In Figure 2, the social impact bond has moved upward relative to its place on the traditional risk/return chart, depicting how an impact-oriented investor might adjust its assessment of this investment when considered from a combined risk to combined return perspective. In this example, an investor believes that an investment in a below market rate social impact bond will create a social outcome that is in line with the organisation's objectives, therefore creating a compelling 'combined return' (financial return + social return) relative to the risks taken.
- **For investors motivated by minimising social risk**, adjustments may need to be made to the 'combined risk' to account for the added social risk of investing in an unscreened strategy, which would highlight the relative advantage of investing in a fund that explicitly screens on social issues relevant to the organisation.[23] In Figure 2, the unscreened equity fund has moved to the right relative to its place on the traditional risk/return chart, depicting how an investor primarily motivated by a desire to minimise social/reputational risk might adjust its assessment of an investment when considered from a combined risk to combined return perspective. In this example, when the social risk of investing in an unscreened equity fund is considered, the expected combined return is no longer compelling because its combined risk is too high.

Once the investor has narrowed the universe to those strategies that meet the combined risk to combined return threshold, the next step is investment selection and position sizing.

[23] In this context, any adjustment to the 'combined' risk does not assume that the social strategy is changing the financial risk of a strategy. The social risk adjustment is based on whether the strategy addresses (or fails to address) the social/reputational risk that is relevant to the investor's nonfinancial motivation. In this framework there is not a view about ESG integration lowering the downside risk or volatility of a particular fund.

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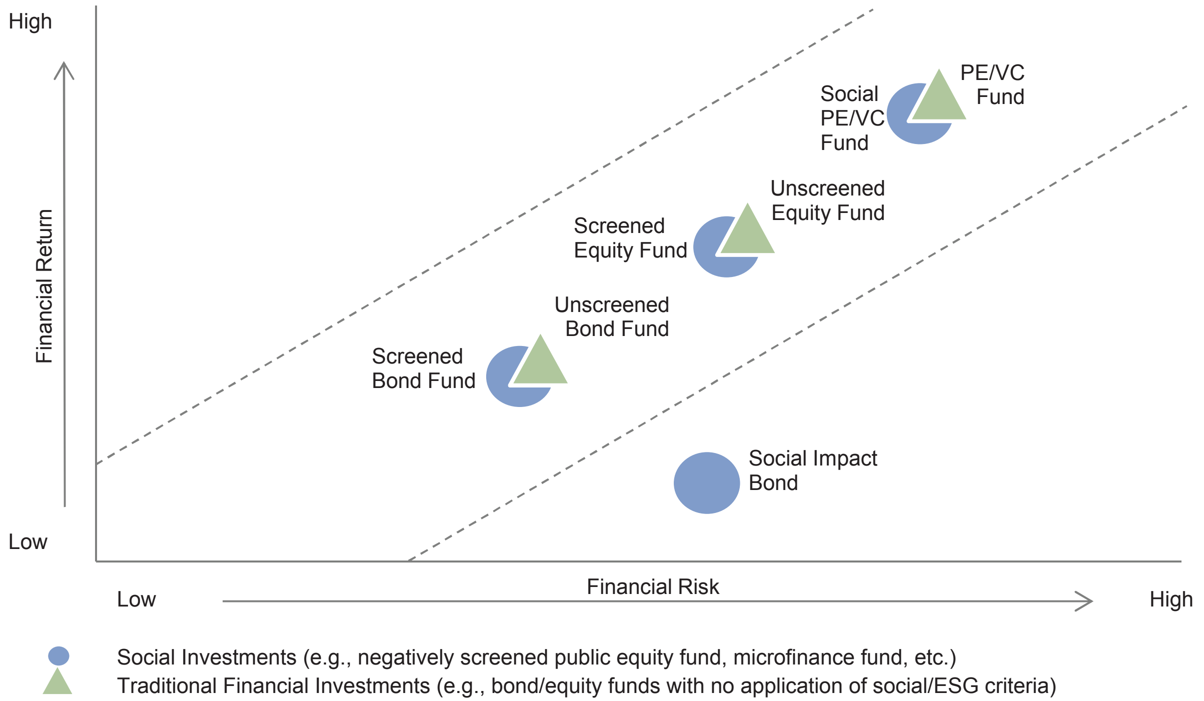
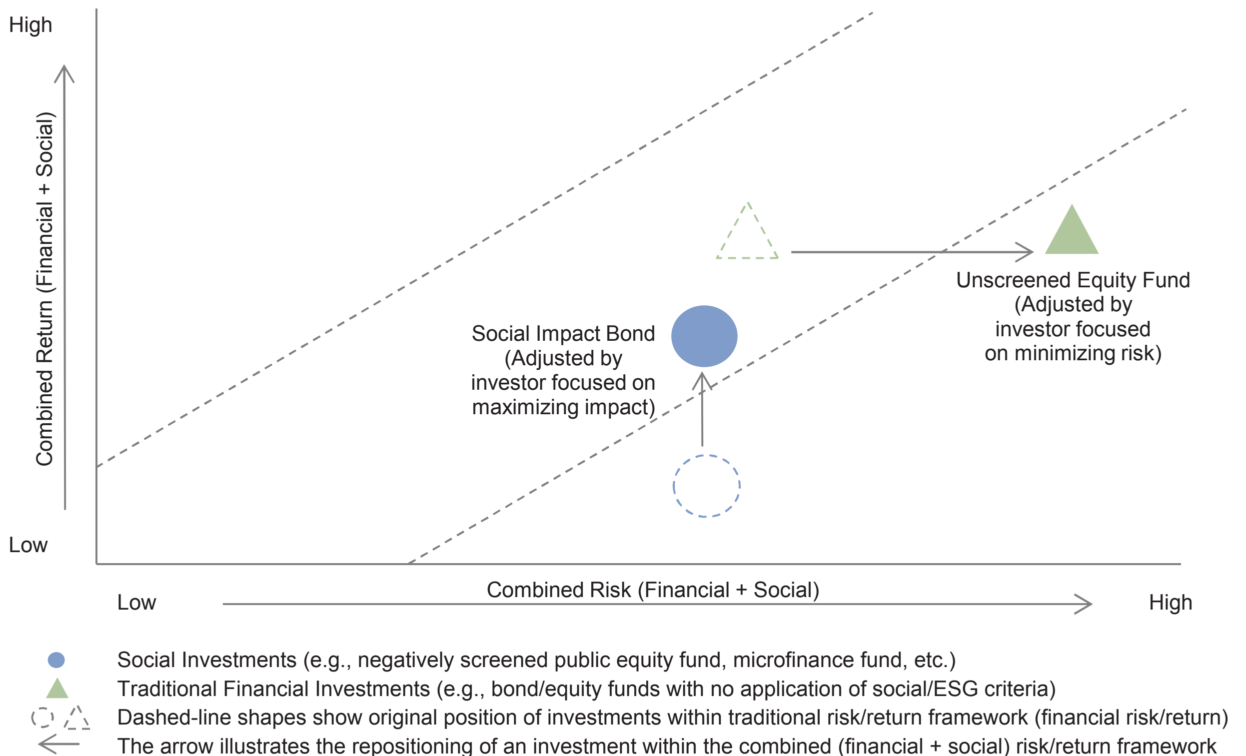
Figure 1. Traditional Risk/Return Profile



Social Investments (e.g., negatively screened public equity fund, microfinance fund, etc.)
Traditional Financial Investments (e.g., bond/equity funds with no application of social/ESG criteria)

Figure 2. Combined Risk/Return Profile



Social Investments (e.g., negatively screened public equity fund, microfinance fund, etc.)
Traditional Financial Investments (e.g., bond/equity funds with no application of social/ESG criteria)
Dashed-line shapes show original position of investments within traditional risk/return framework (financial risk/return)
The arrow illustrates the repositioning of an investment within the combined (financial + social) risk/return framework

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Step 3. Select Investment and Determine Sizing

As with any prospective investment, selecting the most appropriate social investment will require further assessment of the strategy, team, and organisation. Investors should understand the investment's competitive advantage, its likely performance in different market environments, and determine how investment and social performance will be evaluated (and over what time frame).

The sizing of the selected investments in the portfolio will likely be influenced by the size and characteristics of the opportunity, which can vary considerably for each type of investor motivation category (Table 2).

For investors motivated by **'minimising social risk'**, individual position sizing is not likely to be particularly constrained as a result of two characteristics of the opportunity set.

- **Liquid and publicly traded.** Many of the exclusionary-screened and ESG-integrated funds trade in very liquid, publicly traded markets. From the manager's perspective, investing in these very liquid markets means that these funds are less likely to be capacity constrained and should be able to handle sizeable inflows from large investors.
- **Diversified holdings.** Funds that apply either exclusionary screens or qualitative screens incorporating ESG tend to have more diversified, core exposure (in general). The opportunity set of available funds will likely include both active and passive diversified options that can be held as a relatively large 'core' holding in the portfolio.

For investors motivated by **'maximising social impact'**, position sizing in the portfolio may be more limited due to three characteristics of the opportunity set.

- **Illiquid and smaller scale.** Impact-oriented strategies are more likely to be illiquid and smaller scale. For example, a locally focused impact investment strategy may have a limited number of underlying opportunities to put capital to work. As a result, smaller, less liquid impact investments may have a limited amount of money that they can accept given the nature of their underlying opportunity set. These investments are also likely to have higher limited partner concentration.
- **Limited number of relevant investments.** For impact-oriented investors, the actual number of investment opportunities meeting the institution's combined social and investment objectives may be quite small. The Social Investment Business Group's 2011 report *Making Good in Social Impact Investment* found that there were only about 12 social impact intermediaries and fund managers in the United Kingdom at that time.[24] This small number may make it difficult to build a sizable allocation to the category.
- **Potential for concentrated financial risk at the manager level.** These strategies may also be quite concentrated (i.e., less diversified) and many investors may want to limit any individual holding in such a strategy to a certain percentage of total assets purely from a risk-management perspective.

While manager-sizing constraints will vary by strategy, it is also important to consider how these strategies will interact with the broader portfolio's asset allocation targets.

[24] Rupert Evenett and Karl Richter, *Making Good in Social Impact Investment*, The Social Investment Business and TheCityUK, p 25.

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Step 4. Implement Social Investments into the Strategic Asset Allocation

We conclude our portfolio construction framework process by describing two ways to incorporate social investment strategies into the portfolio's long term strategic asset allocation policy. One approach fully integrates social investments within the asset allocation, while the second approach treats social investments as a separate carved-out asset class.

Under the **integration approach**, the overall portfolio's asset allocation targets are maintained when adding a social investment strategy. In this case, investors would typically fund a new social equity investment by reducing an equal amount of equity exposure from another strategy to maintain the overall target exposure to equity. Similarly, to add a social fixed income investment, investors would reduce exposure to other fixed income assets to maintain the overall target exposure to fixed income.

Under the **carve-out approach**, social investments are viewed collectively as a separate asset class. In this case, the social investment allocation would be funded pro rata from across the nonsocial investment asset class allocations. As a result, the relative weights (and risk/return characteristics) of nonsocial investments are retained, but the risk/return characteristics of the overall portfolio (social and nonsocial investments) may change depending on the composition of the social investment portfolio.

To compare how the two approaches would differ in practice, we use as an example an investor that currently has a strategic asset allocation policy of 60% equities, 30% fixed income, and 10% alternatives. After going through Steps 1–3, this investor has identified two 'core' social investments—one social equity fund and one social bond fund—and plans to make a 10% allocation to each. In Table 3, we depict how the two approaches would incorporate the new social investments into the strategic asset allocation.

From a practical perspective, the 'integration' approach tends to be more useful for investors focused on minimising social risk. The more diversified, liquid social investments associated with this motivation category can be integrated into the relevant traditional asset class categories with minimal impact on the expected risk and return of the overall portfolio.

The carve-out approach tends to be more relevant for investors looking to maximise social impact, as these funds tend to have a more unique risk/return profile and are more difficult to integrate into traditional

Table 3. Example of Integration vs Carve-Out Approach to Social Investment Implementation

Current Asset Allocation	Integration Approach	Carve-Out Approach
60% Equity	50% Equity **10% Screened Equity**	48% Traditional Equity
30% Fixed Income	20% Traditional Fixed Income **10% Screened Fixed Income**	24% Fixed Income
10% Alternatives	10% Alternatives	8% Alternatives
		20% Social Investments

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asset classes without distorting expected performance characteristics. Carving out impact funds may simplify performance measurement as the portfolio investment performance could be evaluated on an 'ex social investment basis' while the social impact allocation could be evaluated using a combined financial and social return analysis.

We would note that an investor's spending policy and overall liquidity constraints are also important factors to consider when determining the most appropriate implementation approach. For example, if a very large carve out to illiquid impact investments is being proposed, implications for how this might affect the overall spending/distributions from the total investment pool should be carefully considered.

Conclusion

The momentum in the U.K. social investment market is notable and we have observed many interesting investment opportunities that are either available today or in development. This report aimed to guide investors through some of the major steps in exploring social investments. The sections describing the landscape of the market and the barriers to its growth provide background and perspective for investors new to this market. Once investors decide to commence social investing, they can use the decision-making framework to help assess and implement social investing opportunities. ■

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Guiding Questions

1. What is the objective of the organisation, and what is the role of the investment pool in achieving it?

- What should the relationship be between investment assets and spending policy/grant making? Is the role of the investment assets purely financial (i.e., maximise risk-adjusted financial return so that the amount available for spending is maximised), or could the investment assets supplement/add to the social impact of the organisation's grants/distributions?
- If an investment could deliver a social return that is aligned with the social/environmental objectives of the organisation's distribution/spending policy, how should the social impact of the investment be measured?
- Is the social objective of current grant making/spending policy focused on local impact or is the objective to have a broader, more global reach? Should topics/issues that are broader in scope than the stated social objective of the asset pool's spending policy be considered when assessing an organisation's potential social impact?

2. What are the stakeholder implications for these types of investments?

- Who has raised the possibility of integrating social/nonfinancial factors into the investment decision-making process? What is their relationship to the organisation? What issues are they concerned about/interested in?
- Is the desire to integrate these factors due to concern about a particular risk? Or to a desire to generate a positive social impact?
- Who are the organisation's key stakeholders? What are their views on using nonfinancial criteria (social, environmental, governance, etc.) as part of the investment decision-making process? Do any of these stakeholders have opposing views?
- Are there types of investments that could alienate a key stakeholder? If so, what would the consequences be if such an investment were made? Is this type of risk being factored into the investment evaluation process?

3. What guidelines is the organisation following?

- Is there any existing language in the organisation's Investment Policy Statement relating to the consideration of nonfinancial criteria when making investment decisions?
- What is the understanding of the current rules on fiduciary responsibility as they relate to the consideration of environmental, social, and/or governance issues in the investment decision-making process?

4. What is the investment opportunity set that incorporates the issues/objectives that are relevant?

- Are there funds/investments available that minimise exposure to social/reputation risks we are concerned about? Are they of institutional quality?
- Are there funds/investments available that could help us achieve our social impact objectives? Are they of institutional quality?
- Does the organisation have sufficient in-house talent to source direct social investments? ■

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Comparison to Other Social Investment Markets

United States

Many draw comparisons between the U.K. and U.S. social investment markets. However, drawing comparisons between the two may not be worthwhile, as there are many structural differences in the capital markets, legislation, and government of each country. These differences have resulted in the formation of different social investment opportunities in each country. For example, the following list outlines some of the major catalysts to the U.S. social investment market. As these are unique to the United States, the opportunities that stemmed from them are not likely to be replicated in the U.K. market.

- **Community Reinvestment Act (CRA).**[1] The CRA has supplied the U.S. social investment market with opportunities in fixed income, social venture capital, and affordable housing real estate funds, among others. Since CRA credits are in demand by large banks, the products available tend to be more viable strategies due to the institutional client base and level of assets.
- **More Support for Small Businesses.** In the United States, the Small Business Administration facilitates capital to small businesses through financial intermediaries and acts as an advocate for entrepreneurs. In the United States, small business owners also have greater access to alternative forms of finance such as peer-to-peer lending. In general, U.K. small businesses have a harder time obtaining outside capital.[2]
- **Bond Markets Are More Conducive to Community-Oriented Investments.** The fixed income market in the United States is conducive to community-oriented investments. There is a robust mortgage-backed securities market and a large municipal bond market that supplies mission bond managers with high-quality low- and moderate-income single family mortgages, affordable rental housing (multifamily) mortgages, and other bonds targeting urban revitalisation and rural development. The United Kingdom has neither a robust mortgage-backed securities market nor a large muni market.
- **More Privately Owned Affordable Housing.** While social housing in the United Kingdom is supplied by local authority public housing and nonprofit housing association dwellings, approximately half of the affordable housing stock in the United States is owned by profit-making companies and individuals that receive a government subsidy for offering rent at a below market price. Since the private sector owns much of the social housing stock in the United States, there are more opportunities for market rate affordable housing investment funds.
- **New Markets Tax Credits.** The United States started the New Markets Tax Credit (NMTC) program in 2000 to help revitalise low-income communities. NMTCs give individual and corporate taxpayers a credit against federal income taxes for making qualified equity

[1] The Community Reinvestment Act is intended to encourage depository institutions to help meet the credit needs of the communities in which they operate, including low- and moderate-income neighbourhoods, consistent with safe and sound banking operations. The CRA requires that each insured depository institution's record in helping meet the credit needs of its entire community be evaluated periodically. That record is taken into account in considering an institution's application for deposit facilities, including mergers & acquisitions.

[2] Hannah Kuchler, "Poor Access to Cash Limits SME Growth," *Financial Times*, 11 March 2012.

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investments[3] in qualified community development entities. This program has been successful at generating investment into low income areas. The New Market Tax Credit Coalition reports that NMTCs have created or retained up to 500,000 jobs and generated almost $50 billion in financing to businesses in low income areas.[4]

- **Programme-Related Investments (PRIs).** Since U.S. foundations are required to pay out 5% of their assets each year PRIs count towards the 5% payout, below market rate return products have a designated 'bucket' in U.S. foundation portfolios, which eliminates the question of where a below market rate social investment belongs in an institutional portfolio.

Continental Europe

The social investment market in continental Europe has a strong foundation as well. Traditional forms of social investment are well established in many countries and impact investing opportunities in areas such as microfinance, cleantech, and social finance are gaining traction. *It is difficult to make generalisations about interest and activity in the broader European market as tax law, culture, and some legislation is unique to each country.* However, it is worth noting a couple of the influential regulations and tax schemes.

- **The New Economics Regulation Law.** This law was passed in France in 2001 and requires listed French companies to publish social and environmental information in their annual reports.[5] Many mainstream investment managers in France have begun to include environmental, social, and governance company analysis into their research. This law served as a catalyst for managers to start including this 'extra financial' analysis, as the data was made easily accessible.
- **The Green Funds Scheme.** In the Netherlands, individuals are eligible for a tax credit for investing in specific green funds at designated banks. According to the European Commission, the Green Funds Scheme has contributed more than €6.8 billion since 1995 for financing of 5,000 projects that may not have existed otherwise.[6]

These are just two of many important incentives developed by European nations to encourage further social investment. ■

[3] To be considered a qualified equity investment, substantially all of the equity investment must be used to provide loans to, or make investments in, low-income communities.
[4] New Markets Tax Credit Coalition, *The New Markets Tax Credit 10th Anniversary Report*, December 2010, p. 2.

[5] Eurosif, *Socially Responsible Investment among European Institutional Investors: 2003 Report*, September 2003, p. 47.
[6] European Commission, "State Aid: Commission Approves Dutch Green Fund Scheme for Environmentally-Friendly Investment Projects", press release, 14 October 2009.

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Glossary

This glossary defines terms used in this report and also provides additional background on and descriptions of the deals, managers, and organisations mentioned in the text.

Below Market Rate Investments have expected financial returns below risk-adjusted market rate levels.

Best-in-Class refers to the investing approach that seeks the best companies in each sector relative to peers along pre-determined environmental, social, and corporate governance (ESG) metrics.

Big Issue Invest is the social investment arm of *The Big Issue*, a magazine that supports homeless people. Big Issue Invest provides loans and investments (not grants) from £50,000 to £1 million to social enterprises, charities, and businesses that are socially driven.

Big Society Capital (BSC) is an independent financial institution formed to develop a sustainable social investment market in the United Kingdom. BSC was funded from £400 million in dormant bank accounts and with £200 million from the four major high street banks (Barclays, HSBC, Lloyds, and Royal Bank of Scotland). Most of BSC's £600 million in capital is slotted for investment in social finance investment intermediaries.

Bridges Ventures is a private investment firm founded in 2002 focused on making investments that achieve both a financial return and a social/environmental return. The firm has three sustainable growth funds, two property funds, and a social entrepreneur fund totalling approximately £275 million in assets under management.

Bristol Together is a social enterprise based on the provision of construction work, experience, and training for ex-offenders, the homeless, and long-term unemployed people (socially excluded populations). Properties in need of refurbishment are purchased and restored by the targeted groups. To minimise the need for specialist help, properties requiring low-skilled work are purchased. Once the refurbishment is complete, the properties are marketed and sale proceeds are used for the purchase of new properties for renovation, creating more employment opportunities.

CAF Venturesome provides unsecured loans (of up to five years) of between £25,000 and £250,000 to charities, social enterprises, and community groups that have been operating for at least one year. Its investments are designed to meet a range of financial needs, from working capital for cash flow support to growth capital for transition or development.

A **Carve-Out Approach** refers to an asset allocation approach to social investing. In this approach, social investments are viewed collectively as a separate asset class. The social investment allocation is funded pro rata from across the nonsocial investment asset class allocations. As a result, the relative weights (and risk/return characteristics) of nonsocial investments are retained, but the risk/return characteristics of the overall portfolio (social and nonsocial investments) may change depending on the composition of the social investment portfolio. This approach tends to be more relevant for investors looking to maximise social impact as investment opportunities used within a carve-out approach tend to have a unique risk/return profile and are more difficult to integrate into traditional asset classes without distorting expected performance characteristics.

CC14 is guidance provided by the Charity Commission, the regulator of charities in England and Wales, which covers the legal and good practice framework for the investment of charity funds. It sets out various

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valid investment approaches and introduces the categories of ‘programme-related’ and ‘mixed motive’ investments.

The **Charity Commission** registers and regulates charities in England and Wales.

Clean Tech can be categorised into three main sectors: clean/alternative electricity, clean/alternative fuel, and other clean technologies. Renewable clean/alternative electricity sources include geothermal power, hydropower, landfill gas, solar power, and wind power. Nonrenewable clean/alternative electricity sources include coal gasification plants and other clean coal technologies, natural gas, and nuclear power. Clean/alternative fuel sources are renewable or emit fewer greenhouse gases, including biodiesel, ethanol, and hydrogen. Other clean technologies are varied, but can be split into two categories: clean industrial process technologies and environmentally preferable processes.

ClearlySo is a broker that connects social enterprises and impact investors.

Combined Return, in a risk/return framework, incorporates both financial return and social impact.

Combined Risk, in a risk/return framework, incorporates both financial risk and social risk.

Community Development Finance Institutions (CDFIs) lend capital to businesses, social enterprises, and individuals, typically those who are unable to get financing from high street banks and loan companies.

The **Community Investment Tax Relief (CITR)** scheme was devised in 2002 to encourage private investment into CDFIs. The CITR scheme encourages investment in disadvantaged communities by giving tax relief of 25% over five years to investors who invest in accredited CDFIs.

The **Community Reinvestment Act** is a U.S. federal law that provides a framework for financial institutions, state and local governments, and community organisations to promote banking services to all members of a community. The CRA prohibits redlining (denying or increasing the cost of banking to residents of racially defined neighbourhoods) and encourages efforts to meet the credit needs of all community members, including residents of low- and moderate-income neighbourhoods.

The **Enterprise Investment Scheme (EIS)** provides some tax relief to individuals that purchase new shares in higher-risk trading companies, potentially helping such companies raise capital. The tax relief is available only to individuals and is 30% of the cost of the shares, which is set against the individual’s income tax liability for the tax year in which the investment was made.

ESG Integration refers to the practice of integrating environmental, social, and corporate governance factors into the investment decision-making process. ESG factors can include a wide range of indicators pertaining to a corporation’s impact on its various stakeholders—those affected by a corporation’s operations.

Exclusionary Screens describe social or environmental criteria that, if not satisfied, eliminate companies from consideration in an investment universe. Some of the more widely used screens include ‘sin stocks’ (tobacco, gaming, and alcohol), significant polluters, weapons manufacturers, religious screens, and companies doing business in Sudan and/or Iran.

The **Global Impact Investing Network (GIIN)** is a nonprofit organisation working to increase the scale and effectiveness of impact investing. Founded in the United States, the GIIN builds infrastructure and supports activities, education, and research that help accelerate the development of a

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coherent impact investing industry. The GIIN appointed two European liaisons in 2012 to deepen its local presence to help support Europe's impact investor community.

The **Global Impact Investing Ratings System (GIIRS)** is a system for assessing the social and environmental impact of companies and funds with a ratings and analytics approach analogous to Morningstar investment rankings and Capital IQ financial analytics. GIIRS is a project of the independent nonprofit B Lab.

Impact Investing generally describes investments made in enterprises that offer market-based solutions to a particular social or environmental challenge that is of interest to the investor.

The **Integration Approach** is an asset allocation approach to social investing that maintains the overall portfolio's asset allocation targets when adding a social investment strategy. In this case, an investor would typically fund a new social equity investment by reducing an equal amount of equity exposure from another strategy to maintain the overall target exposure to equity. Similarly, to add a social fixed income investment, investors reduce exposure to other fixed income assets to maintain the overall target exposure to fixed income. The Integration Approach tends to be more useful for investors focused on minimising social risk. The more diversified, liquid social investments associated with this motivation category can be integrated into the relevant traditional asset class categories with minimal impact on expected risk and return of the overall portfolio.

The **Investing for Good Impact Rating Methodology** was developed by Investing for Good, a specialist social finance intermediary, to measure the social and environmental impact performance of an investment. The process involves qualitative analysis of key indicators, the outcome of which is a Confidence, Return, and Impact (CRI) rating.

Market Rate Returns appropriately compensate investors for risks taken.

Microfinance targets the economically disadvantaged who, under normal conditions, would have no access to financial services. These microfinance 'clients' are given access to loans through microfinance institutions. Microfinance includes a broad range of services, such as savings, insurance, payment transfer, and remittance services.

Mission-Related Investing/Mission-Connected Investing generally refers to the practice of using investments to directly achieve, or be aligned with, an institution's mission goals; it is a term commonly used by foundations.

Mixed Motive Investments are defined by CC14 as investments that trustees can justify making on the basis that they combine a financial return with a contribution to furthering their charity's aims. These are investments that cannot be wholly justified as either a financial investment or a Programme Related Investment (PRI).

The **More for Mission** campaign was introduced by three U.S. foundations in 2007. The goal of More for Mission is to catalyse foundations into mission investing and offer access to research on the field, implementation tools, and links to potential investment opportunities. In 2012, More For Mission merged with PRI Makers to create a new organisation, the Mission Investors Exchange.

NESTA is a U.K.-based charity that seeks to advance the study of innovation by providing investments and grants and supporting or publishing research. NESTA has published a number of reports on social investing, particularly impact investing.

The **New Economics Foundation** is an independent 'think-and-do' tank that aims

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to improve the quality of life by promoting innovative solutions that challenge mainstream thinking on economic, environment, and social issues.

New Markets Tax Credits provide a credit against U.S. federal income taxes of 39% over seven years to taxpayers who make qualified equity investments (investments where substantially all of the equity investment is used to provide loans to, or make investments in, low-income communities), in a community development entity (CDE). CDEs use the capital from investors to provide financing to businesses located in low-income communities. The program was authorised by the Community Renewal Tax Relief Act, which was signed into law in December 2000.

The **Peterborough Prison Social Impact Bond** launched in September 2010 and is the first social impact bond (SIB). It was created to decrease recidivism rates among short-sentenced prisoners in Peterborough prison. SIBs are payment by results contracts that are designed to increase funding for preventative services that improve social outcomes. The financial return is dependent on the degree to which outcomes improve.

Positive (ESG) Screens used by investment managers generally favour companies and sectors that score positively in environmental, social, and governance (ESG) areas, such as emissions reduction, human rights issues, and labour practices.

Programme-Related Investments are investments made with the intention to further a charity's goals while also producing some financial return for the charity. If a charity can show that an investment is a PRI, it is not bound by the principles or laws that apply to traditional financial investments.

The **Scope Bond** is a £20 million bond programme initiated by Scope, a U.K.-based charity that works with disabled people and their families. The Scope bond will be offered in sterling bond tranches at varying nominal amounts, maturity dates, and coupon rates. Scope partnered with Investing for Good, a specialist social finance intermediary, to launch the programme, which aims to allow the charity to generate more unrestricted voluntary income to expand activities.

The **Seed Enterprise Investment Scheme (SEIS)** launched in April 2012 with the aim of stimulating entrepreneurship and kick-starting the economy. Investors are offered tax breaks of up to 78% on £100,000 investments in earlier stage companies raising equity. The scheme is for companies raising no more than £150,000 and is expected to be used by 'friends and family' of existing entrepreneurs.

Social Enterprise is a broad term used to describe a business operating for a social purpose. The business reinvests its profits for that social purpose instead of redistributing them. Certain social enterprises are also registered charities.

Social Finance/Social Enterprise Investment is a sub-category of impact investing that refers to investments that provide capital to entrepreneurs and/or entitues that have the intent to create a social impact (e.g., a loan to an entrepeneur looking to create a business that solves a social problem like homelessness).

Social Investing is a broad-based approach to investing that considers both the investor's financial needs and an investment's impact on society.

The **Social Investment Business Group** is made up of a charity, the Adventure Capital Fund, and a social enterprise, the Social Investment Business. The Social Investment Business is one of the United Kingdom's largest social investors, having made over 1,300 investments in civil society organisations ranging from £5,000 to almost £7

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million. SIB invests in viable, non-bankable projects. Most of the current capital being invested is from government entities.

Social Finance Investment Intermediaries attract money from social investors and use it to make direct investments in social ventures.

The **Social Return on Investment (SROI)** is a principles-based method used to account for the social, environmental, and economic value of an organisation's outcomes. It helps organisations determine how to measure value and forecast social returns.

The **Social Stock Exchange**'s aim is to become an FSA-authorised and regulated investment exchange for trading in securities of social enterprises and other social purpose businesses. The targeted sectors are smaller, high-growth companies in the health, educational, and environmental markets, including social and affordable housing, social transport, green and ethical consumerism, clean tech, green-tech, waste, water, recycling, regeneration, education, public health, sustainable forestry and organic agriculture, and 'base of the pyramid' interventions.

The **Stewardship Code**, published in July 2010, outlines how institutional investors should disclose their engagement and voting policies, with the aim of fostering effective dialogue on governance issues between investors and listed companies.

The **U.K. Sustainable Investment and Finance Association (UKSIF)** is a membership network for sustainable and responsible financial services in the United Kingdom. The organisation promotes responsible investment and other forms of finance that support sustainable economic development, enhance quality of life, and safeguard the environment.

The **Venture Capital Trust (VCT)** is a tax incentive that allows investors to offset 30% of the cost of shares in a VCT against individual income tax liability, as well as relieving the income tax burden on dividend income.

Venture Philanthropy Funds are funds that work to build stronger social purpose organisations by providing them with both financial and nonfinancial support to increase their societal impact. The venture philanthropy approach includes both the use of social investment and grants, thus targeting below market rate returns. ■

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