Accelerating Impact Investing: A Framework for U.S. Policy Innovation

Working Draft for Comment

February 25, 2014

Accelerating Impact Investing Initiative

Convening Partners of the AI3

INSIGHT AT PACIFIC COMMUNITY VENTURES

Enterprise

INITIATIVE FOR RESPONSIBLE INVESTMENT

Introduction

Public policy plays a key role in shaping impact investing markets, incentivizing investor behavior, developing investable products, and directing capital towards activities that serve the public good.[1]

The history and scope of impact investment in the United States – from low-income housing and urban and rural redevelopment, to finance for small businesses and women- and minority-owned enterprises, to private capital investment in climate mitigation and adaption – reveal a reality of continuous interplay among the public and private sectors, and civil society.

Recently, the role of public policy in promoting impact investing has received increased attention. The range of new investment products built on public-private cross-sector development, such as infrastructure banks, pay-for-success finance models, and new tools for credit enhancement, has bolstered the connections between investors and policymakers. And investors themselves – retail, high-net-worth, endowments and institutions – are searching for opportunities to invest in products that deliver both social and financial returns.[2]

But too often discussions about developing these types of innovative public-private partnerships are limited to sector-specific policies; absent is the supporting context of a broader impact investing policy landscape. We need a better way to identify, evaluate, and promote policies that effectively utilize private capital investment to create intended social benefits – with the goal of increasing cross-sector capacity for effective policymaking and implementation.

The Accelerating Impact Investing Initiative (AI3), a collaboration among Insight at Pacific Community Ventures (PCV), Enterprise Community Partners, and the Initiative for Responsible Investment at the Hauser Institute for Civil Society at Harvard University (IRI), was formed to address this need for coordination, and to shift the focus from one-off policies to a systemic view of the U.S. domestic impact investing policy arena.

With a broad view of the spectrum of U.S. public policy initiatives guiding private sector capital to public purpose, the AI3's goals are to:

1. Identify and highlight the existing and potential policymaking tools available to support impact investment;
2. Develop criteria for evaluating the value of policies that motivate private capital to public purpose;
3. Design a platform that identifies key impact investing policy proposals;

1 ***Note:*** *Impact investments are made intentionally to generate measureable social benefits, by a variety of investor types (retail, HNW, institutional), across all asset classes, and with a diversity of return characteristics. They encompass multiple sectors – e.g. community development, affordable housing, health, clean energy, energy efficiency, and land conservation – in which there are efforts to motivate private investors to support public benefit through financial mechanisms.*

2 Also see *From the Margins to the Mainstream - Assessment of the Impact Investment Sector and Opportunities to Engage mainstream Investors.* World Economic Forum. September, 2013. Available at: http://www.weforum.org/reports/margins-mainstream-assessment-impact-investment-sector-and-opportunities-engage-mainstream-i;

4. Coordinate a network of impact investing stakeholders who can share efforts to promote the field; and,
5. Create a more robust public discourse around effective impact investing policies.

The AI3 aims to support policymakers and their stakeholders as they evaluate impact investing policies by ensuring that the full scope of impact investing activities is made tangible, and by establishing clearer and more effective linkages between impact investing objectives and appropriate policy channels for their realization. The AI3 will work in concert with policy initiatives that have emerged from ongoing efforts both internationally and domestically – including the G8 Social Impact Investment Taskforce and the U.S. National Advisory Board – to socialize the need for and promote a coherent policy framework for impact investing, drawing on perspectives across sectors.

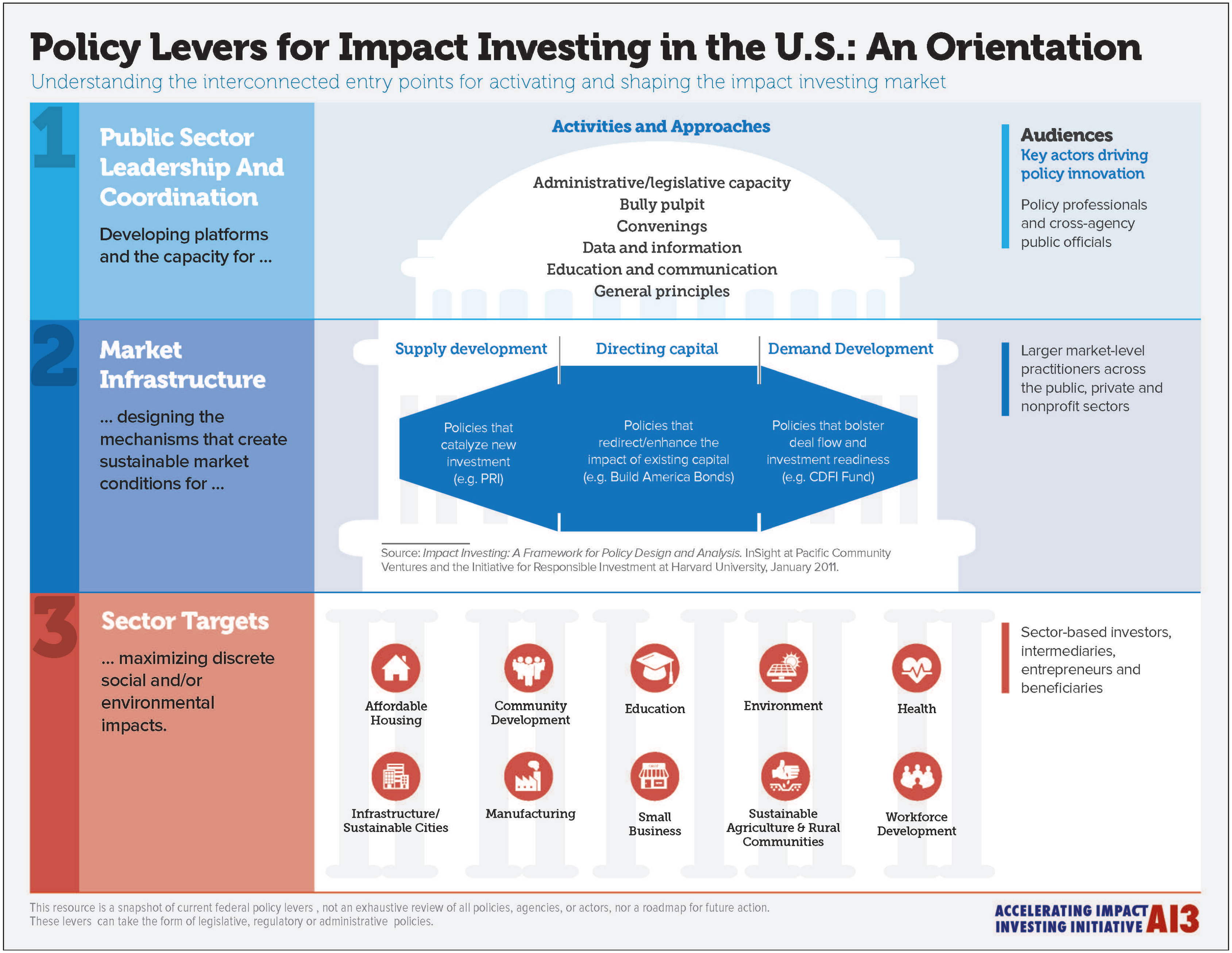
In this short paper, we discuss the need for a framework that enables a more robust understanding of the intersection of impact investing and public policy. The work builds on over 20 interviews with diverse actors engaged either directly or indirectly in the impact investing field, as well as experience of the three convening organizations of the AI3, as practitioners and researchers working at the cross-section of impact investing, community development and public policy.

Our objective in designing the framework is to initiate a discussion about how specific policies and policy opportunities can be integrated into a broad conversation on how government can, or should, enable private investments in support of the public good. In mapping and assessing the policy landscape as it exists today—e.g. particular tax policies, rules on how investors can structure portfolios, support for social entrepreneurs, new financial mechanisms, data on social returns—we aim to contribute to the development of a more targeted strategy for policy innovation moving forward.

The Landscape of Impact Investing Policy

Policies designed to mobilize private investment towards specific social purposes have a long history, predating the coining of the term "impact investing." The field of community investment in the U.S., as only one example, has grown in concert with policy support from the Community Reinvestment Act, the Low-Income Housing and later the New Markets Tax Credit, and the creation of the Treasury's CDFI Fund. These policies, and others across policy types and sectors, have fundamentally shaped what is a fast-growing sector.

Developing a more explicit focus on the intersection of public policy and impact investing requires first a formal mapping of the policy landscape. Such mapping enables us to better understand the range of tools available to support the impact investing ecosystem. The following image represents a broad overview of three different levels of policy interventions that enable impact investing:


Policy Levers for Impact Investing in the U.S.: An Orientation
Understanding the interconnected entry points for activating and shaping the impact investing market
1
Public Sector Leadership And Coordination
Developing platforms and the capacity for ...
Activities and Approaches
Administrative/legislative capacity
Bully pulpit
Convenings
Data and information
Education and communication
General principles
Audiences
Key actors driving policy innovation
Policy professionals and cross-agency public officials
2
Market Infrastructure
... designing the mechanisms that create sustainable market conditions for ...
Supply development
Directing capital
Demand Development
Policies that catalyze new investment (e.g. PRI)
Policies that redirect/enhance the impact of existing capital (e.g. Build America Bonds)
Policies that bolster deal flow and investment readiness (e.g. CDFI Fund)
Source: Impact Investing: A Framework for Policy Design and Analysis. InSight at Pacific Community Ventures and the Initiative for Responsible Investment at Harvard University, January 2011.
Larger market-level practitioners across the public, private and nonprofit sectors
3
Sector Targets
... maximizing discrete social and/or environmental impacts.
Affordable Housing
Community Development
Education
Environment
Health
Infrastructure/ Sustainable Cities
Manufacturing
Small Business
Sustainable Agriculture & Rural Communities
Workforce Development
Sector-based investors, intermediaries, entrepreneurs and beneficiaries
This resource is a snapshot of current federal policy levers , not an exhaustive review of all policies, agencies, or actors, nor a roadmap for future action.
These levers can take the form of legislative, regulatory or administrative policies.
ACCELERATING IMPACT INVESTING INITIATIVE AI3

The graphic enables the viewer to identify areas of the impact investing market that have received attention and others that remain underdeveloped. The three levels of policy represent broad areas of activity through which we can conceptualize and categorize current or prospective policies in impact investing.

The graphic is not an exhaustive review of all policies related to impact investing, but rather a tool for contextualizing existing and potential policies, and examining them in relation to each other. It accommodates legislative, regulatory, or administrative policies across its three levels. Interventions by the full suite of policymaking entities can be found across all three.

> ***Public Sector Leadership and Coordination***: The first level in the graphic points to activities that develop federal level capacity for impact investing policy development and implementation, and signal support for the field.
>
> It includes the ability of the government to convene; mobilize, collect, and disseminate data and information; create organizing principles to shape market and policy agendas; coordinate the work of different agencies to manage resources and align priorities; and educate and create market awareness and participation. These activities all help to provide a foundation, and navigable direction, for policy efforts throughout government.
>
> ***Market Infrastructure****:* The second level concerns the role of policy in supporting impact investing at the market level, addressing particular challenges and creating a more sustainable market.
>
> Policies here are broken up into three groups, based on the market outcome targeted– expanding or supporting the supply of capital for impact investing; creating or facilitating investable opportunities; and directing capital towards investments that catalyze social and environmental benefits. Examples of policies at this level include tax credits, procurement policies, R&D programs, investment rules and regulations, and co-investment opportunities.
>
> ***Sector Targets****:* Finally, the sector-oriented level fits impact investing policies into broad sectors of public interest. Policies at this level are organized by the social or environmental good they seek to create, helping the viewer to visualize where private investment fits in with existing sector-specific policies.

The graphic is intended to serve two key purposes. First, it is meant to give the reader a sense of the wide landscape of impact investing policy, helping to orient any particular policy under discussion within the broader scope. To our thinking, this step is crucial both in underscoring the value of individual policies, and in recognizing their importance within the field as a whole.

Second, we hope the graphic helps stakeholders across sectors position themselves in relationship to each other, thereby laying the groundwork for a more coherent narrative for the field. Such cross-sector alignment will allow stakeholders to view specific policy priorities within the context of the broader goals of the impact investing community. We believe that a broad-based network will contribute to more effective private investment for social benefit.

For this first iteration of the map, we have chosen to focus on federal policy. However, we recognize that state and local policy also plays a critical role, often in concert with federal support. Additionally, we see much of the above framework as relevant and applicable to state and local policy.

Identifying Good Impact Investing Policy

In addition to gaining a sense of the landscape of impact investing policies, policymakers, investors, and advocates also need a method for assessing the value of any particular policy in question. Through our work with these stakeholders, we have provisionally identified a set of indicators for evaluating the strength of impact investing policy, as well as a set of criteria for prioritizing policy opportunities.

The following criteria describe an ideal type of impact investing policy. These criteria, when applied to a particular policy or set of policy opportunities as a "first cut" can help ensure that any ensuing legislation uses government resources optimally while generating substantive outcomes. They build on the principles for policy design and assessment identified in IRI & PCV's 2010 report *Impact Investing: A Framework for Policy Design and Analysis* and the 2013 Impact Investing Policy Collaborative *London Principles.*

Based on our analysis, impact investment policy should be:

1. **Efficient**. The policy maximizes the use of government resources.
2. **Effective**. The policy leads to the expected scale of investment and/or leads to more durable private investment in the public good.
3. **Targeted**. The focus of the policy matches objectives, which target a defined public good.
4. **Transparent**. The design of the policy and its operational mechanisms are understandable to all stakeholders.
5. **Coordinated**. The policy is aligned with, and builds on, supplements, or fills gaps in, existing policies and markets.
6. **Vetted**. Targeted investors and relevant stakeholders have been engaged in the policy development or implementation process.
7. **Appropriate**. The length, enforcement, and scale of the policy matches the needs and challenges that are being addressed.
8. **Implementable**. The policy can effectively put into practice and monitored.

Using these criteria, we can identify policies that meet the needs of investors, ensure public benefits are integrated into investment outcomes, and minimize unnecessary or unwieldy strategies for addressing social problems.

Evaluating Impact Investing Policy Opportunities

The criteria offer an effective way to define what makes for good policy theoretically, but they can only get us so far. Any attempt at reforming or developing new policy necessitates an examination of the larger political context in order to determine those policy opportunities on which impact investors might best focus in a given moment. In other words, we must use an additional set of criteria that allows us to prioritize policy opportunities by their potential impact and feasibility.

Our work with impact investment stakeholders has pointed to distinctive factors that help identify policies that are high-leverage, appropriate, and opportune. It is important to note that differing individual/institutional values and strategic considerations mean that top policy opportunities may vary significantly—for instance, some people may place policies that have a higher chance of succeeding politically ahead of those that have greater impact potential, but are longer-term propositions. In applying this set of "criteria" to our policy evaluation process, we seek to surface these issues, and provide a useful starting point for the impact investing community's conversation on policy.

We propose using the following four criteria to evaluate high-quality impact investing policy opportunities:

1. **Impact**. What are the societal goals this policy is targeting? What is the market challenge being addressed? Who are the prospective investors? What is the scale of capital in question—both public commitments required and private investment expected?
2. **Fit**. Where does this policy fit within existing policy structures—impact-specific or otherwise? Does it require complementary policies, and if so, do they exist?
3. **Capacity**. Is the government capable of engaging the market in the way described? Can it effectively design, implement, and monitor the policy proposed?
4. **Opportunity**. What type of policy is this? What is its political outlook, based on its policy type? What is the timeline for the policy proposal, implementation, and lifespan? What are the budget implications? Is there stakeholder support, and where is it likely to come from?

This process—evaluating the universe of policy opportunities to determine which ones are of highest interest for the impact investing community—allows us to determine where various stakeholders are situated, and from where supporters for particular initiatives are likely to come.

Looking Forward

The AI3's goals thus far have been twofold: to develop a process for building broad stakeholder support for sound impact investing policy; and to provide a method for identifying near-term policy opportunities. We see the development of an impact investing policy platform as a way to unite a network of investors and other stakeholders who can be readily engaged when policy opportunities are relevant and timely.

As we worked to develop this platform and evaluation methodology, our conversations with diverse stakeholders unearthed a series of themes and specific opportunities for policy interventions. These include:

1. **Mobilizing investment at scale**. Removing perceived barriers limiting private, large-scale investments with socially beneficial attributes is often seen as a way to mobilize significant capital for the field. This might include risk mitigation for impact investing projects and funds; or inclusion of impact investing opportunities within allowable guidelines for investment such as those found in ERISA.
2. **Stable subsidies and their importance in market-building**. Much of the community development space is underpinned by major tax credits and grant

programs like the New Markets Tax Credit, Low Income Housing Tax Credit, and Community Development Block Grant. These programs are crucial to the community development market, and the risk of losing private funding if they disappeared or were modified is substantial. A broad-based narrative around the value of impact investing should help identify and support high leverage subsidies that promote investment with outsized social benefit.

3. **Cross-sector platforms and investability**. There are a multitude of initiatives within (and outside) government focused on cross-sector investment and collaboration, often with at least implicit roles for private sector investment. Existing federal programs such as the Sustainable Communities Initiative or the E3 Initiative offer opportunities for private sector engagement with impact investing that could be substantially expanded.
4. **Innovation and new tools**. Policies like Pay for Success, the Rental Assistance Demonstration, or crowd-funding point to innovation in the field and reinforce the idea that measurable social benefit can be integrated in private sector investment platforms.
5. **Education and communication**. Overcoming informational barriers and elevating understanding of the field, including through the National Advisory Board and the White House Office of Social Innovation and Civic Participation, are immediate opportunities to normalize the discourse on public policy and impact investing. Better access to information will also ensure that financial intermediaries and institutions fully capitalize on the policies *already* supporting their work at scale, including the SBA's Small Business Investment Companies program, and Program Related Investment tax laws.
6. **Data and Transparency**. The market needs better and more comprehensive sharing of investment results, as well as the standardization of data that often accompanies disclosure. Greater disclosure will help build the investment track records needed to reduce perceived risk and create scalable products.

In sum, the AI3 is designed to help spur conversation on all these issues. These preliminary ideas and observations are intended to help advance the shared objectives of the impact investing community, and to respond to increased interest in the field. We look forward to hearing your thoughts as we seek to build a road map to engage with the broader coalition, identify a suite of specific objectives and contribute to ongoing policy discussions.

About the AI3

The Accelerating Impact Investing Initiative (AI3) is a partnership between PCV InSight, Enterprise Community Partners, and the Initiative for Responsible Investment at the Hauser Institute for Civil Society at Harvard University. The convening partners seek to build a multi-stakeholder coalition to steward a policy platform for growing impact investing in the United States from conception to implementation. The policy platform will facilitate more effective policy design and a broader capital base for impact investing, fostering social innovation and economic development in the country's most underserved areas. It will also function as a coordinated hub for addressing the historic and structural fragmentation in the U.S. impact investing market.

Impact investing has the potential to spur much needed economic development in underserved markets in the U.S., including by:

1. Growing enterprises and creating quality jobs
2. Building sustainable community infrastructure (i.e. schools, housing, transportation, and health care assets)
3. Supporting businesses that create beneficial social and environmental impacts through products, services, or operational performance

With the support of the Ford Foundation and the Surdna Foundation, the AI3 has initiated a series of activities aimed at strengthening the policy infrastructure for impact investing in the U.S. The AI3 will undertake a multi-year process of coalition building, mapping existing policy, providing ongoing research, and developing recommendations for increasing government support of impact investing.

We invite you to engage in this effort and join the conversation. Please send feedback to ai3@pcvmail.org

See more at: http://www.pacificcommunityventures.org/blog-and-news/the-ai3-a-policy-platform-for-impact-investing-in-the-us/