About InSight at Pacific Community Ventures

InSight is the thought leadership and advisory practice at Pacific Community Ventures, a US community development financial institution and non-profit organization. InSight has provided research on community development and impact investing to clients including The Rockefeller Foundation, Annie E. Casey Foundation, The California Endowment, and The Federal Reserve Bank of San Francisco, and evaluates the social performance of more than $1 billion of targeted private equity investments by pension funds including the $200 billion California Public Employees Retirement System, investment managers including Hamilton Lane, and foundations including the Northwest Area Foundation.

About the Initiative for Responsible Investment at Harvard University

The Initiative for Responsible Investment (IRI) at the Hauser Center for Nonprofit Organizations at Harvard University serves as a platform for dialogue on fundamental issues and theories underlying the ability of financial markets to promote wealth creation across asset classes, while creating a stronger society and a healthier environment. The IRI works across asset classes to build communities of practice around innovative responsible investment strategies and catalyze new opportunities and concepts in responsible investment, promoting the development of the theory and practice of responsible investment through research, dialogue, and action. The IRI is also the home of More for Mission, a resource for foundation endowments who seek opportunities to align their financial investments with their institutional mission.

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Preface

The Rockefeller Foundation launched its program initiative on impact investing with an important premise in mind: that the resources of government and philanthropy alone are insufficient to address the world’s biggest problems. We have been supporting the development of networks, infrastructure, intermediaries and research designed to accelerate the maturation of an impact investing industry that seeks to create social and environmental benefit in addition to profit. In so doing, our intent has been to unlock more capital for companies, funds and other vehicles that generate positive social and/or environmental outcomes—such as high-quality jobs, healthcare, education and affordable housing, cleaner and more efficient energy—in addition to financial return. We believe that government and philanthropy need impact investors to produce these outcomes at scale—and we also believe that impact investors need government (and philanthropy).

This publication represents a framework for thinking about the role government policy can play in creating an enabling environment for impact investing. This framework is based on, and illustrated by, 16 individual policies in 13 countries. The following document represents a significant contribution to our thinking about impact investing policy, but it is only the departure point for a conversation that must necessarily become more concrete as it finds application in specific impact objectives, sectors and geographies. We look forward to working with IRI, InSight and other partners to refine the framework and use it as a basis for additional research and policy proposals to unlock impact investment.

Margot Brandenburg, Associate Director, The Rockefeller Foundation
Justina Lai, Associate, The Rockefeller Foundation
Investments that effectively deliver social benefit invoke a strong case for government support.
Executive Summary

There is no market from which government is completely absent, whether as a direct participant providing and purchasing resources, or as an enforcer of standards and rules. Private investments always depend to some extent on the policy mechanisms that make economies viable.

This project focuses not on the general enabling role of public policy in markets—the provision of basic infrastructure and laying down of “the rules of the game”—but on specific efforts to catalyze investment opportunities that yield deliberate and substantial social or environmental benefit. These policies are often designed to correct market failures or spur new activity in underserved areas or innovative themes, and they may depend on interventions that directly subsidize, regulate, or otherwise activate private investment.

**WHAT IS IMPACT INVESTING?**

*Investments intended to create positive impact beyond financial return.*

Impact investors want to move beyond “socially responsible investment,” which focuses primarily on avoiding investments in harmful companies, and instead seek to actively deploy capital in businesses and projects that can provide solutions at scale.

For more information on the practice of impact investing, visit:

- The Global Impact Investing Network
  www.thegiin.org
- Investing for Social and Environmental Impact
  www.monitorinstitute.com/impactinvesting
- Impact Investments: An Emerging Asset Class
The Purpose of this Research

How can policymakers, investors, and civil society better develop and analyze impact investing policies? In this report, we draw on case studies to build a framework for addressing this key question.

The report presents three tools in order to lay the groundwork for future research:

- A model for locating the role of government in impact investing markets;
- A set of criteria providing a practical starting point for the design and evaluation of policy; and
- Sixteen case studies providing detailed insight into a range of policies from around the world.

The next critical step is to identify when impact investing policy might be justified in specific markets and how to apply the framework in those instances.

**GOVERNMENT AS INVESTMENT CATALYST**

Impact investing, broadly defined as investment made with the intent to create social or environmental benefit in addition to financial return, is important to government to the extent that private capital can leverage finite government resources to bring substantially larger sums of funding to bear on social and environmental problems. If impact investments deliver social benefit effectively and efficiently, they invoke a strong case for more nuanced and explicit government intervention.

Examples of impact investing markets, and the policies that have created and sustained them, include:

- The $24 billion market for equity and debt investments in low-income communities in the United States driven by Community Development Financial Institutions registered and supported by the U.S. CDFI Fund and other related policies including the New Markets Tax Credit and Community Reinvestment Act;
- The construction of 40,000 new subsidized residences for low- and middle-income families in Australia as a result of the recently implemented National Rental Affordability Scheme;
- More than $27 billion in capital directed in 2009 to Indian borrowers in underserved or target sectors by banks under the country’s Priority Sector Lending regulations;
- Investments of more than €6.8 billion ($9.6 billion) in 5,000 environmental projects in the Netherlands through “Green Funds” created by government tax credits and exemptions;
- $1.5 billion of direct investments in carbon emissions mitigation in Brazil, where the government has developed national infrastructure and capacity to support the implementation of the Kyoto Protocol’s Clean Development Mechanism.
Locating Policy in Impact Investing Markets

We can view impact investing as a subset of financial markets generally. There is a supply side: the providers of capital, including governments, individuals, foundations, banks, investment funds and retirement systems. There is a demand side: the companies, cooperatives, projects, and other vehicles in need of capital. And there is a market in which exchange occurs, where rules govern the terms of trade and buyers and sellers set prices.

Policy in impact investing may be understood as intervening at one or more points in this cycle:

→ Increasing the amount of capital for investment (supply development);
→ Increasing the availability or strengthening the capacity of capital recipients (demand development); or
→ Adjusting terms of trade, market norms, or prices (directing capital).

In each of these—supply, demand, and direction—government can participate directly in the market or influence impact investing through policy or regulation, as the model below demonstrates.

The model can be used either to situate a given policy within the broader ecosystem of enabling infrastructure for impact investing, or as a departure point for exploring new or different policies and regulations designed to accelerate and effectively direct inflows of capital. Once we understand how and to what purpose policy intervenes, we can begin to consider its actual or likely effectiveness.
Evaluating Policy in Impact Investing

It may be useful to break down elements of a policy’s effectiveness into core characteristics that address how a particular intervention may activate the desired private market activity. Here we provide a general set of six criteria to assess and develop potential policy.

The six criteria are key findings drawn from the case studies in this report and provide rules of thumb for considering the performance of impact investing policies. The criteria are also consistent with the needs of investors uncovered during our outreach to practitioners and described in the literature.

The criteria are an important lens through which to consider impact investing policy. Although we do not intend the criteria to be determinative, they do provide a set of general principals to guide readers:

**SIX CRITERIA TO DESIGN AND ASSESS POTENTIAL POLICY**

**Targeting:** The focus of a policy must be carefully matched to its objectives. The more narrowly a policy is targeted, the more likely it is to catalyze a discrete social or environmental outcome. A broadly targeted policy may create an environment in which impact investing more readily occurs, on a larger scale, but will likely lead to some “mission drift” as investors search out the most profitable opportunities from a greater universe of options.

**Transparency:** Transparency in the substance and mechanism of policy is important for investors, and is likely to be an important factor in determining market participation. In particular cases where information disclosure is the mechanism of policy, the closeness of fit between disclosed information and investment decision also has a direct bearing on investor behavior.

**Coordination:** A policy is likely to be more effective if it works in coordination with existing policies and markets to leverage their effectiveness. Although government has a role to play in rapidly advancing the field, small steps forward that build on established infrastructure may be more suitable than bold but isolated innovations.

**Engagement:** Engagement with impact investors is important for clarifying needs. Investors are less likely to support a policy, and to therefore ensure its effectiveness, if it is conceived of and created absent dialogue with current or prospective sources of capital. This may be especially true where policies impose behavioral changes, or where an otherwise welcome concept might fail in practice because of poor design or implementation.

**Commitment:** Commitment to a policy should be consistent with the need. Different markets require different levels of real or presumed commitment to a policy from government, in duration, scale, and enforcement. Consistency of a commitment, when it is necessary, alleviates investor uncertainty. However, when government is no longer needed to sustain a market, continued intervention is likely to exacerbate inefficiencies.

**Implementation:** An institutional context and infrastructure that supports efficient implementation and modification is critical to success. When the specific provisions of a policy hamper its delivery, the capacity of government to respond quickly to a demonstrated need for adjustment is an important determinant of effectiveness.
Case Studies

There are many thousands of policies that influence impact investors in some manner globally. We present 16 case studies that reflect some of the field’s diversity of geography, issues, policy method, and intention. Around half of the policies more directly intervene in what we describe as impact investing markets, and half provide an ancillary support to impact investing markets as one component of a wider objective. Each case study provides insight into the critical details of government activity and tells the story of a concrete intervention in its own right. The case studies can be accessed in their entirety at: www.pacificcommunityventures.org/insight/impactinvesting.

1. **US**
   - **New Markets Tax Credit:** Tax credit for investing in qualified community development vehicles

2. **US**
   - **CDFI Fund Program:** Certifies and supports a discrete category of community-based financial institutions

3. **Brazil**
   - **Clean Development Mechanism (CDM):** Tradable credits for projects that reduce global emissions

4. **UK**
   - **Community Interest Companies:** New legal form facilitating investments in for-profit entities with a social purpose

5. **Netherlands**
   - **Green Funds Scheme:** Tax credit for investors in certified investment funds targeting environmental projects

6. **Germany**
   - **Feed-in Tariffs (StrEG and EEG):** Minimum, mandated prices for renewable energy

7. **EU**
   - **Joint European Support for Sustainable Investment in City Areas (JESSICA):** Capital and guarantees promoting collaborative sustainable development in Europe’s urban areas

8. **South Africa**
   - **Broad-Based Black Economic Empowerment:** Government procurement favoring black-owned businesses

9. **Kenya**
   - **Microfinance Act:** Applies capital requirements and regulatory oversight to depository MFIs in Kenya

10. **India**
    - **Priority Sector Lending:** Regulation requiring a fixed percentage of lending in underserved and target markets

11. **China**
    - **National High-Tech R&D (863) Program:** Government investment in high-priority economic sectors including for environmental protection and renewable energy

12. **Japan**
    - **Tokyo Cap and Trade Program:** Cap on CO2 emissions from offices and factories in Tokyo and a market for trading credits

13. **Malaysia**
    - **Corporate Social Responsibility Disclosure:** Regulation requiring disclosure of corporate social responsibility information by publicly listed companies

14. **Australia**
    - **National Rental Affordability Scheme:** Tax credit for investment in affordable housing
The Way Forward

Whether government provides direct financial or institutional support, or influences markets through laws and regulations, the effectiveness of impact investing policies is in creating viable private markets that support the creation of social goods efficiently, and potentially at greater scale. For example, in the case of the CDFI Fund in the United States, it is estimated that for every $1 of government aid, $20 is invested in low-income communities.

Where private capital seeks financial return in markets with intentional social or environmental benefits, there may be an opportunity for government to realize a policy objective by supporting impact investing.

This report makes no recommendations on when, specifically, impact investing policy might be justifiable, or on how to apply the framework. That question must be answered in the context of the country environment, issue area needs and challenges, and investment infrastructure of a particular market. Rather, the report will help policymakers and advocates consider options for intervention, and design and implement policies more likely to create viable markets for impact investing.

Impact investing has the potential to provide government with a powerful delivery mechanism for social goods. This report clears the path for the next critical steps in policy innovation and development.