ACCELERATING IMPACT INVESTING INITIATIVE AI3

A Catalog of Economically Targeted Investments by Pension Funds:

Trends, Analysis, and Reflections

October 2016

A research brief by InSight at Pacific Community Ventures.

INSIGHT AT PACIFIC COMMUNITY VENTURES

Authors:
Tom Woelfel
Lauren F. Dixon

Contributors:
Kendra Berenson
Jane Ren
Noah Brod

Reader comments and ideas are welcome.
Please direct correspondence to:

Tom Woelfel
Director, PCV InSight
twoelfel@pvcmail.org

The authors would like to thank John Griffith from Enterprise Community Partners and Katie Grace and David Wood from the Initiative for Responsible Investment, who advised us on this research.

AI3 project supported by:

FORDFOUNDATION OMIDYAR NETWORK

Produced by the Accelerating Impact Investing Initiative (AI3)

The AI3 is a partnership between Enterprise Community Partners and InSight at Pacific Community Ventures, with research support from the Initiative for Responsible Investment.

INSIGHT AT PACIFIC COMMUNITY VENTURES

PCV InSight is the impact investing research and consulting practice at Pacific Community Ventures. PCV InSight provides information and analysis to investors and policymakers with the goal of driving capital to underserved markets. PCV InSight's work has provided the basis for national and international policy initiatives, including the U.S. National Advisory Board, White House Impact Economy Forum, and the Social Impact Investment Taskforce.

INTRODUCTION

On October 22, 2015, the Department of Labor (DOL) released guidance on Economically Targeted Investments (ETIs) made by retirement plans covered by the Employee Retirement Income Security Act (ERISA). The DOL's Interpretive Bulletin (IB) 2015-01 replaced the previous IB 2008-01 and reaffirmed pension funds ability to pursue ETIs—investments that generate collateral benefits apart from the investment return to the employee benefit plan investor.[1] On the one-year anniversary of the ERISA ETI guidance, we are pleased to release an extensively researched catalog of pension fund ETIs that is intended to be an informational resource to the pension fund community and its stakeholders, external investment managers, researchers, and the public.

While there is limited information available publicly on ETIs–through the process of aggregating, distilling, and examining information on ETIs – we have found there to be significant breadth in, and diversity of, these types of investments. Although few pension funds report having made impact investments, there is a rich history of pension fund ETIs dating back to the 1960s.[2,3] These investments, made with the purpose of pursuing appropriate risk-adjusted financial returns first and foremost, and collateral benefits second, share many of the same characteristics of impact investments. In the United States, pension funds currently have approximately $18.6 trillion dollars under management.[4] Through ETIs, managers of pension fund assets have the opportunity not only to provide a secure financial future for their members, but to invest in the sustainability and well-being of the communities they represent.

The goal of this research and the development of the ETI catalog is to compile and share information on both public and private pension funds pursuing investments that target, collateral social, environmental, or economic outcomes that is often only available in pension fund documentation, news reports, or other sources. The information contained in the catalog is the result of compiling information from several hundred sources, and documents; the how, why, and types of investments being made. It will better enable information sharing among the pension fund community and other interested parties by serving as a dedicated online resource and information center for ETIs.

When pursued prudently, ETIs have the potential to unleash a significant amount of new private investment that supports plan beneficiaries, their communities, and the environment. For example, if just two percent of the assets in the country's public pensions and one percent of the assets in private pensions were dedicated to ETIs, it would represent an additional $250-300 billion in capital that would support positive social, environmental, and economic outcomes across the U.S.[5]

ETI Catalog

The accompanying catalog is an extensively researched collection of 118 ETIs made from the 1960s through present day by public and private pension funds. The catalog is structured to focus on specific information for each individual ETI rather than each pension fund's overall participation in ETIs, as there can be multiple pension fund investors participating in an individual ETI. Our goal with the catalog is to provide pension funds, participants, intermediaries and other stakeholders with an up to date and readily accessible list of ETIs that includes information on pension fund investors, ETI objective, investment strategy, asset class, fund size/assets under management, location, and performance data (financial, social, environmental, and economic) whenever it is available. Data sources include published pension fund documentation on these investments, pension fund websites, news reports, academic literature and research, and interviews with pension fund investment officers or external investment managers—among other sources. The catalog exists in two forms—an online database with streamlined information for each ETI, and an extensive, searchable excel document for those interested in more in-depth information.

Online Catalog

The online catalog can be accessed via the Accelerating Impact Investing (AI3) and Pacific Community Ventures websites.[6,7] The online catalog features a select subset of information on ETIs from the more extensive catalog that is sortable and includes fund name, pension fund investors, asset class, investment strategy, ETI objective, and fund size. Information on fund size has been included where it is publicly available and reflects the most recent available data.

Downloadable Catalog

The downloadable catalog includes all of the information available for each ETI. It is in excel format, and searchable by a multitude of categories. All of the information from the online catalog is included in the downloadable version, with the addition of performance data, fund description, fund size at multiple time periods, year of inception, location, type of pension fund investor, investment manager, and more.

Additional information sharing on ETIs by pension funds will help further document the practice of making ETIs and will support a more robust and comprehensive catalog of ETIs. We encourage pension funds, researchers, and others to engage with us to share updated data, new ETIs, and other publicly available data to help ensure that this resource stays current and reflects the practices of pension funds pursuing ETIs.

Key Findings

The ETI catalog that accompanies this research brief chronicles the history of ETIs in the United States. After conducting research and compiling the catalog, several findings stand out.

- **It is difficult to parse out the effects of ERISA guidance shifts from those of larger economic trends affecting the number of ETIs made by pension funds.** Data gathered for the catalog shows a decline in annual average ETIs after the 2008 DOL guidance, and although many believe the guidance had a chilling effect on ETIs, it is difficult to separate the effects of the guidance from those of the economic downturn.

- **The terminology used by pension funds to describe ETIs is varied, and can lead to confusion.** In researching the catalog, we encountered many different terms used to describe these investments – ancillary benefits, collateral benefits, impact, sustainable, socially responsible, and more. Variances in language can pose a challenge in identifying these investments, and for those seeking to learn more about ETIs. Explicit definitions and use of standard terms and language by pension funds to describe these investments will be important moving forward. This standardization will provide clarity around investment objectives and results, and support information sharing among pension funds interested in exploring the potential of these kinds of investments.

- **The majority of ETIs are made by public pension and Taft-Hartley funds.** Based on the publicly available data and interviews with pension fund managers and intermediaries, it is clear that private corporate pension funds have not engaged in making ETIs.

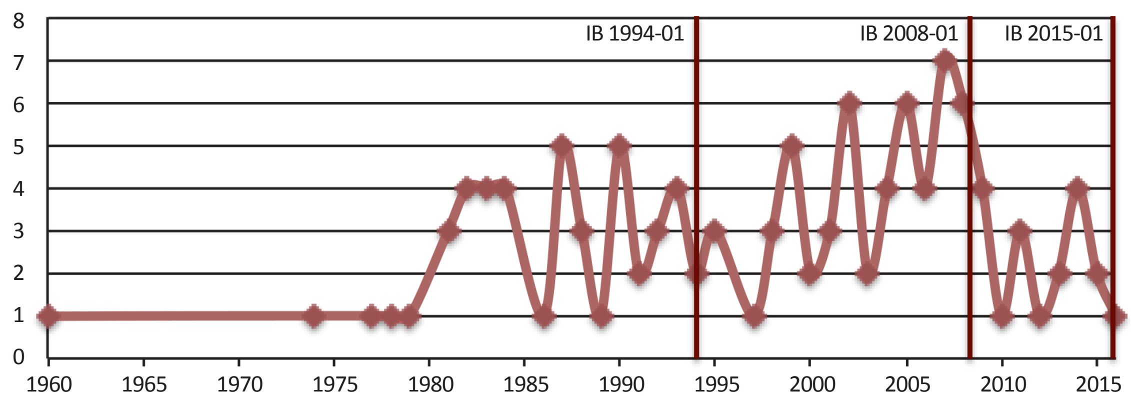
Analysis of ETIs (1960s to present)

It is difficult to parse out the effects of ERISA guidance shifts from those of larger economic trends affecting the number of ETIs made by pension funds. In 1994, Interpretive Bulletin, IB 1994-01 provided support for private pension fund managers to make ETIs. The 1994 guidance provided that "an ERISA plan fiduciary may invest plan assets in an ETI provided the fiduciary determines that such investment is appropriate for the plan in terms of the same factors that a prudent fiduciary would use in determining whether any other type of investment is appropriate for the plan."[8] In 2008 IB 2008-01 was issued by the US Department of Labor. This guidance placed a greater emphasis on the elements required to prove that these investments were on par with other non-ETI options available. Further the 2008 guidance stated that such investing should be "rare" and seemed to suggest a higher threshold of concern for these types of investments.[9]

While it is difficult to parse out the effect ERISA changes have had on pension fund ETIs in light of larger economic trends, the changes in ERISA guidance in 2008 did seem to lead to a change in belief and behavior around ETIs, as investors pulled back from these investments.

The following chart chronicles the number of ETIs made over time, marking inflection points at each successive guidance change (in 1994, 2008 and 2015). As can be seen, the average number of ETIs per year is highest between 1994 and 2008, with a significant decrease between 2009 and 2015. Now, one-year after the latest guidance, it remains to be seen what effects the change will have on the number of ETIs made.

Number of ETIs per Year



Time Period	Total Number of ETIs	Average Number of ETIs per Year
1960-1994	46	1.35
1995-2008	52	3.71
2009-2015	17	2.83

The terminology used by pension funds to describe ETIs is varied, and can lead to confusion. Pension funds use different terms in describing ETIs. This reflects the evolving nature of ETIs and overarching trends in the investment industry. The term ETI dates back to the 1990s and is still used by many pension funds due to its prominence in the ERISA guidance. These investments have also been referred to by pension funds and external investment managers as targeted investments, socially responsible investments, responsible investments, sustainable investments, and impact investments. The benefits the investments generate are also referred to using different terminology including, ancillary benefits, collateral benefits, social impact, social return, etc. The myriad of terms can present real challenges in identifying and examining these investments, as well as sharing information on these investments.

It is important to note that while the recent ERISA ETI guidance references investments that incorporate environmental, social, and governance (ESG) factors the catalog does not include these types of investments. Investments that take ESG factors into consideration do not typically have explicit environmental or social goals and instead utilize ESG factors as an additional information source to inform investment decisions and mitigate potential financial risk. For more on the distinction between ETIs and ESG factors see the following box below.

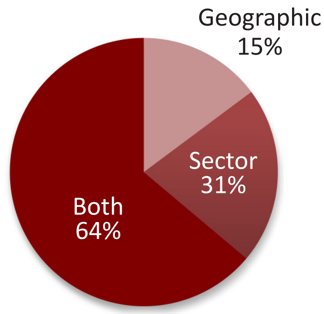
Economically Targeted Investments (ETIs)	Environmental Social Governance (ESG) factors
Investments that generate collateral social, environmental, or economic benefits apart from the investment return to the employee benefit plan investor. These investments can target a particular place (e.g. in-state investments) or sector (e.g. renewable energy). The non-financial benefits are often described as ancillary benefits as they are subordinate to the financial returns generated by the investment.	**ESG factors are examined as part of investment analysis and decision making** and provide additional information on non-financial areas that can materially affect financial performance. These can include: • Environmental – resource scarcity, energy efficiency, climate change • Social – human rights, labor standards, community impacts • Governance – company operations and accountability to shareholders

Explicit definitions and use of standard terms and language by pension funds to describe these investments will be important moving forward. This standardization will provide clarity around investment objectives and results, and support information sharing among pension funds interested in exploring the potential of these kinds of investments.

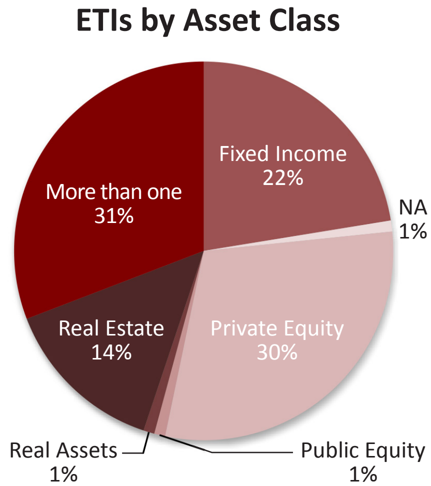
For the purpose of the catalog and larger research effort, we have standardized the data and information to improve readability and facilitate comparison of ETIs. Investments have been categorized according to a list of strategies, asset class, and funder type – among other categories.

By definition, ETIs are selected for the social, environmental, or economic benefits they create apart from their investment return. Investments can focus either on geographically or sector targeted investments. Many ETIs focus on both geography and sector, for example, a fund that supports the growth of small businesses in the state where the public pension fund and its beneficiaries reside.

ETI Area of Focus



The asset classes for ETIs are varied, and investments are generally opportunistic in nature rather than an explicit component of an overarching allocation to a particular asset class. The majority of ETIs fall into the private equity and fixed income asset classes. For funds where ETIs utilize multiple asset classes, fixed income and private equity are often represented.



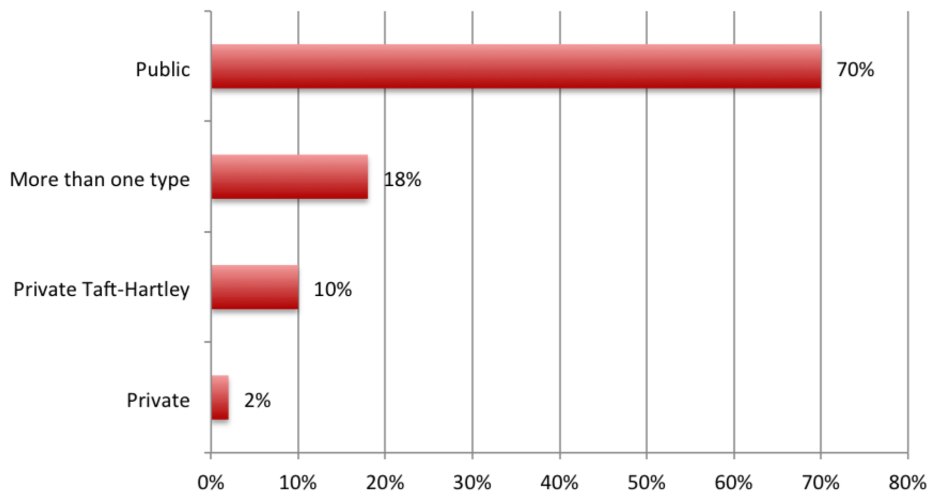
ETIs employ a wide variety of investment strategies. The catalog includes ten overarching categories that capture and help describe broadly the investment strategies of ETIs and supports interested parties in identifying relevant examples of ETIs within the particular strategies.

The investment strategy most often cited by pension funds is investment in community development. Investments in community development often seek to identify place-based investment opportunities and can provide not only financial returns, but benefits to the community as well. For many of the ETIs in the catalog, an emphasis on community development is usually paired with another strategy such as affordable housing or business financing.

**Note: Categories are not mutually exclusive. Some ETIs utilize multiple strategies.*

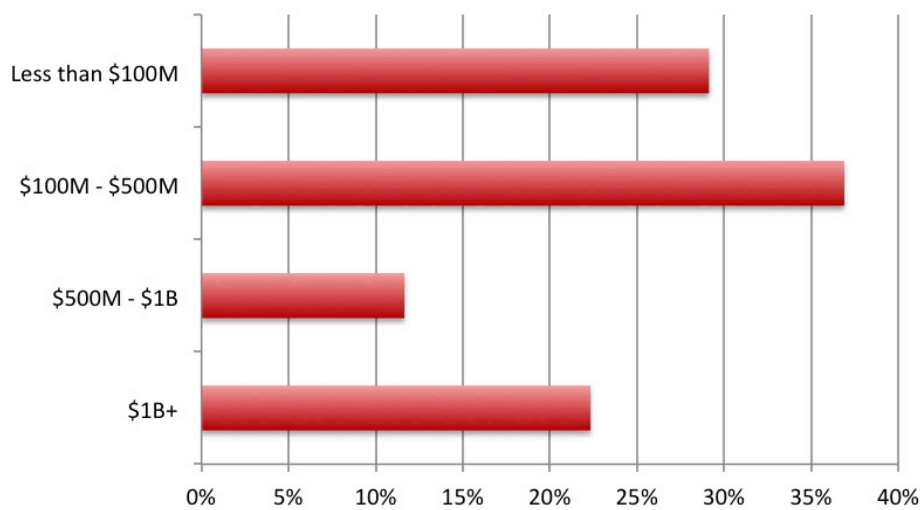
The majority of ETIs are made by public pension and Taft-Hartley funds. While ERISA only governs private pension funds, the guidance provides an important reference point for public funds and other asset owners and contributes to the overarching body of law on fiduciary duty. In fact, most ETIs have been created by and for public pension funds and private Taft-Hartley funds, with minimal information available on private corporate pension fund ETIs.

ETI Funder Type



Information on fund size is limited, and most ETIs have information available for only one point in time, but where it is available, we have reported it as part of the catalog. In general, ETIs tend to be less than $500 million in size–with 37 percent reporting between $100 and $500 million in assets under management (AUM) and 29 percent reporting less than $100 million in AUM. The data in this section is reported in three different ways: AUM at inception, at any interim date (with date cited), and current AUM. For the chart below, we report the most recent data available.

ETI Fund Size (AUM)



Conclusion

Pension funds have a longstanding history of pursuing ETIs or investments that generate appropriate risk-adjusted returns and collateral benefits. While ETIs share many commonalities with impact investments, pension funds describe these investments differently than impact investors–including by emphasizing financial returns above any social, environmental, or economic benefits. However, these investments carry the potential to significantly benefit the communities of plan beneficiaries, disadvantaged populations, and the environment. While there are many examples of pension funds pursuing ETIs, there is limited information available on these investments publicly, and the information that is available is captured in difficult to access sources. We hope that this catalog can serve as an informational resource to the pension fund community and its stakeholders, external investment managers, researchers and the public, and support interested parties in understanding how pension funds pursue ETIs. We encourage pension funds, researchers, and others to engage with us to share new or updated data on ETIs for inclusion in the catalog.

Since IB 2015-01 was released one year ago, there remains uncertainty as to how this new guidance will affect investment practices of pension funds. In early 2017 we will be releasing further research on ETIs to accompany this catalog. This research will provide additional information and clarity on the state of pension fund ETIs and will explore the history of ETIs; including how these investments are structured, overarching trends affecting pension funds' consideration of ETIs, and how ETIs have evolved over time. The research will include case studies as concrete examples of pension fund ETIs, and profiles of intermediaries working with pension funds to invest assets prudently and in accordance with their fiduciary duty.

The Department of Labor's 2015 ETI ERISA guidance reaffirms that pension funds can make ETIs so long as they are prudent investments. It is our hope, that following this new guidance and with more information and research available on ETIs, pension funds will be better equipped to consider making ETIs that further the long-term interests of their plan participants and beneficiaries.

About the AI3

The Accelerating Impact Investing Initiative (AI3) was launched in 2013 to spark a national conversation about the federal government's role in improving and expanding the market for impact investments in the United States.

AI3 is a cross-sector coalition of investors, researchers, philanthropic organizations, practitioners and policy experts with three main objectives:

- Research & Thought Leadership: Through original research and timely analysis, identify the policy changes necessary to meaningfully grow the market for domestic impact investing.
- Coalition Building: Convene a diverse array of stakeholders to identify high-priority policy opportunities, then collectively engage policymakers to encourage real policy changes.
- Policy Implementation: Work with investors, practitioners and other stakeholders in the field to build the market infrastructure necessary to put policy changes into action.

To learn more about AI3 and see our work, visit www.AcceleratingImpactInvesting.org.

REFERENCES

1. https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/fact-sheets/fsetis.pdf
2. World Economic Forum, From the Margins to the Mainstream: Assessment of the Impact Investment Sector and Opportunities to Engage Mainstream. Investors (September 2013): http://www3.weforum.org/docs/WEF_II_FromMarginsMainstream_Report_2013.pdf.
3. https://thegiin.org/impact-investing/. "Impact investments are investments made into companies, organizations, and funds with the intention to generate social and environmental impact alongside a financial return."
4. Board of Governors of the Federal Reserve System, Financial Accounts of the United States, "Chart L.117 Private and Public Pension Funds" (Q2 2016): http://www.federalreserve.gov/releases/z1/current/accessible/l117.htm.
5. John Griffith, Tom Woelfel, Keith Fairey. Unleashing the Power of Pensions: Expanding Economically Targeted Investments by U.S. Pension Funds. December 2015. https://s3.amazonaws.com/KSPProd/ERC_Upload/0100934.PDF
6. https://www.pacificcommunityventures.org/
7. https://acceleratingimpactinvesting.org/
8. U.S. Department of Labor ERISA Investment Bulletin 1994-01. https://www.gpo.gov/fdsys/pkg/FR-1994-06-23/html/94-15162.htm
9. U.S. Department of Labor ERISA Investment Bulletin 2008-01. http://webapps.dol.gov/FederalRegister/HtmlDisplay.aspx?DocId=21631&AgencyId=8&DocumentType=2