Values. Wealth. Sustainability.

IMPACT INVESTING PRIMER

I. What is Impact Investing?

Impact Investing utilizes capital markets to address global challenges.

Every investment has impact, whether intended or unintended. Impact investors, however, specifically seek out investments whose environmental and social outcomes are positive and definable. As Impact Investing becomes more mainstream, there are increasingly more opportunities to invest with impact. Impact investments are already available in both public and private markets and across all asset classes—including hard assets such as real estate, timber, and agriculture.

Impact investments provide capital to innovative private companies providing solutions to global sustainability issues such as climate change, accessible education, and energy and food security. They also support public and private companies with responsible and sustainable business practices. Additionally, impact investments promote community wealth building by creating jobs in low-income communities; helping in affordable housing initiatives and neighborhood revitalization; making loans to small businesses, and raising funds for vital community services. Impact Investing, whether private or public, stocks or bonds, requires professional management of social, environmental, and financial performance.

The Global Impact Investing Network (GIIN), a non-profit organization dedicated to increasing the scale and effectiveness of Impact Investing, defines it as "investments made into companies, organizations, and funds with the intention to generate measurable social and environmental impact alongside a financial return. Impact Investing includes investments that range from producing a return of principal capital to offering market-rate or even market-beating financial returns…Impact investors actively seek to place capital in businesses and funds that can harness the positive power of enterprise."[1]

[1] http://www.thegiin.org/cgi-bin/iowa/home/index.html

II. The Veris Perspective

Some believe that impact investments are only those with a direct connection between an investor's capital and impact creation—typically private, illiquid equity or debt investments. Veris, however, believes that it is possible to achieve positive impact across all asset classes, including publicly traded companies which can deliver solutions to global sustainability challenges at scale. When evaluating investment opportunities, impact analysis adds value through the identification of sustainability-related risks and opportunities missing from traditional financial analysis. Further value is added when investors diversify across the full range of asset classes in their portfolio, thereby increasing their potential for higher returns as well as the scope of their impact. In "Increasing Impact and Enhancing Returns" Jed Emerson and Steve Falci report: "Impact Investing is not an asset class per se, but rather a discipline of applying intent to achieve outcomes in the world with regard to a given thesis that can and should cross multiple asset classes including public stock and bond strategies."[2]

From a total portfolio management standpoint, Impact Investing is not a standalone asset class; each impact investment, rather, correlates to a specified asset class and/or sub-asset class. For example, a market-rate mezzanine debt fund targeting small to medium companies supporting job creation is classified as private debt; an investment in sustainable forestry is an investment in hard assets; and investment in a publicly traded US electric car company is classified as domestic equity. It is important to note that the performance of each investment is compared to the appropriate asset class benchmark and peer universe. *See table on page 7 with specific impact opportunities across all asset classes*.

A well-constructed impact portfolio is globally diversified with multiple asset class and sub-asset class allocations. The portfolio will invest in market-rate and/or below-market-rate investments, depending on the investor's risk-return profile and impact intent. The primary difference between an impact portfolio and a traditional portfolio involves the investment philosophy and process of the underlying managers and funds the portfolio invests with; asset managers that are integrating environmental, social and governance ("ESG") criteria into their investment process and are transparently monitoring the impact of their efforts are preferred when constructing an impact portfolio. Furthermore, although portfolio risks and returns are compared against traditional benchmarks, impact metrics are also tracked.

Veris believes that Impact Investing is a smarter way to invest because it provides additional material information with which to evaluate investments. Sustainable companies tend to have higher-quality management teams and increased risk mitigation practices. They also tend to identify opportunities by looking for solutions to sustainability issues; companies with sustainable products and practices will often outperform their peers.

III. Have We Reached a Tipping Point?

Though once a niche market, the Impact Investing industry is now accepted by many different types of investors—including institutional and retail investors, foundations and family offices. As the industry evolves and global challenges mount, many investors are either incorporating impact investments across all of their assets or carving out a portion of their portfolio to test the strategy. There is a growing number of institutional investors who are committed to impact and mission investing—including major banks and institutions such as Envestnet, UBS and Morgan Stanley—who have either launched or are planning to launch Impact Investing platforms and initiatives.

US SIF, the industry association for sustainable and responsible investing, has sized the US-domiciled market of investments that incorporate environmental, social and/or governance criteria and shareholder advocacy at $3.7 trillion, representing 11.3% of the $33.3 trillion in total assets under management domestically. The universe of

[2] Source: http://www.impactassets.org/files/Issue%20Brief%20%237.pdf

sustainable investments under professional management is growing at a rate that is faster than the broader universe of assets under management.[3] In addition to public equity, this includes assets in:

- Community Investing: 972 community development financial institutions (CDFIs) are operating in the U.S.; 601 of these are community development loan funds (CDLFs) managing approximately $10 billion in total assets.[4]
- Alternative Investments: $132 billion invested in 301 private equity and venture capital funds incorporating ESG criteria, reflecting a 250% growth in assets since 2010.[5]

Among foundations, there is mounting interest in and implementation of impact and mission-related investing ("MRI"). This involves employing the foundation's entire investment portfolio to make a positive impact alongside the 5% mission-aligned grants paid out by the foundation on an annual basis. The W.K. Kellogg Foundation's commitment of $100 million to socially responsible, program-aligned, mission-driven investing was hailed as "revolutionary" by *The New York Times.*[6]

Mission-related investing and program-related investing (PRI) give certain advantages to foundations:

- Program-related investments, which, unlike grants, provide foundations a return on investment, can be part of a foundation's formal approach to leveraging private dollars toward philanthropic goals. PRIs have been shown to have a high rate of repayment and, importantly, PRI payments can be "recycled" to provide assistance to subsequent organizations.
- Mission and program-related investing is an excellent means of leveraging additional private dollars toward a philanthropic project.

The attention to and growing acceptance of Impact Investing has been fueled by many factors, including the increasing realities of climate change, pandemics such as HIV/AIDS and obesity, and the increasing disparity in wealth. Institutions have made many positive contributions to the Impact Investing industry—new movements and corporate examples include:

- Fossil-fuel divestment campaigns on over 230 campuses kicked off 2013 with unprecedented energy and power.
- The California Public Employees' Retirement System, CalPERS, announced that they will employ ESG criteria in all their investment decisions.
- Bloomberg, one of the largest providers of investment analysis, provides ESG analysis on companies and is a major reporter on sustainability issues.
- FedEx set a new target of 30% improvement in fuel efficiency for its global vehicle fleet by 2020. By the end of its fiscal year 2013, FedEx Express will have increased the size of its advanced alternative-energy vehicle fleet to include a total of 360 hybrid-electric vehicles and 200 electric vehicles.
- Walmart's corporate sustainability goals include: running on 100% renewable energy, creating zero waste, and implementing carbon metrics.
- Unilever, the global consumer goods giant, has committed to sourcing 100% of its agricultural raw materials in a sustainable manner by 2020.

[3] 2012 Report on Sustainable and Responsible Investing Trends in the US: http://www.ussif.org/content.asp?contentid=82
[4] Source: http://altrushare.com/pdf/CDLF_Sept2012.pdf
[5] http://www.ussif.org/files/Publications/12_Trends_Exec_Summary.pdf
[6] http://dealbook.nytimes.com/2012/12/11/in-new-brand-of-philanthropy-nonprofits-invest-in-for-profits/

IV. How to Approach Impact in Public Equity and Fixed Income Investments

"Shareholders will be best served by companies who maximize their financial return by strategically managing their performance in this new economic, social, environmental and ethical context" – *Generation Investment Management*

An increasing number of individual and institutional investors seek to invest in public companies that take into consideration their environmental and social footprint. This impact is often collected and monitored through environmental, social and governance ("ESG") data. Impact investing in public equities includes two strategies that, together, create the greatest impact. The first consists of integrating ESG factors from the beginning of the investment process to identify high-quality public companies. The second strategy requires shareholder engagement, a leverage point in influencing the management of public companies to shift their behavior towards creating a positive impact.

When investors urge their asset managers to include ESG criteria in equity selection, asset managers then draw companies into dialogue on ESG issues. As a significant number of asset owners take this approach, more companies become aware that these issues matter and companies, who are concerned about headline and reputational risk associated with ESG criteria, will attempt to mitigate this risk by changing their behavior. As an increasing number of investors seek to understand the social and environmental impact of their public equity portfolios, ESG metrics become increasingly sophisticated and encompass a global footprint.

Investors can also impact company behavior through shareholder engagement, which includes voting proxies. By dialoguing about how their managers voted on ESG-related matters, shareholder engagement and voting proxies can lead to corporate behavior change, an important step in employing an investor's public equity portfolio to create positive social and environmental impact. One example is the shareholder campaign with Bristol-Myers Squibb, which sought expanded disclosure of the company's lobbying activities, both direct and indirect. After a constructive dialogue, the company agreed to change its disclosure of lobbying oversight and expenditures. This sort of work is mounting, and is being led by institutional investors, third-party asset managers and shareholder advocacy organizations.

Indeed, public companies providing solutions to global sustainability challenges are creating meaningful impact in the world. Furthermore, there are a growing number of asset managers that incorporate ESG criteria into their investment process, have significant track records, and have positive performance relative to their peer group. Thus, these investments should be considered for inclusion in a globally diversified portfolio.

It is also possible in the fixed income asset class to purchase bonds that have a defined social and/or environmental purpose. An example of one type of bond is the Community Reinvestment Act mortgage bonds, made up of packaged mortgages that banks then provide to low-income communities in support of community wealth building. Although fewer opportunities exist than with public equity, there is a growing number of fixed income managers incorporating ESG criteria into their investment philosophy and process. Fixed income allocations can be created with very high impact in the areas of education, the environment, community wealth building, and health.

V. How to Measure Impact

Historically, efforts to measure social and environmental performance have been fragmented, as many investors have implemented proprietary measurement systems or have relied on anecdotes alone. This fragmentation creates inefficiencies that have not only made impact investment evaluation difficult, but have also resulted in overly burdensome data collection and reporting for mission-driven organizations.

The Impact Reporting and Investment Standards (IRIS), an initiative of the Global Impact Investing Network (GIIN), was developed to address this issue. The IRIS taxonomy provides a universal language for social, environmental, and financial performance. This approach to impact measurement enables funds and managers to prioritize impact on their own terms, transparently and through unified language.

Through the widespread use of commonly defined metrics, it will become possible to aggregate and compare performance data from across the Impact Investing industry. Additionally, the IRIS initiative works with data collection partners to aggregate anonymous data to produce market trend reports. Importantly, analyses of aggregated IRIS data can help to set social, environmental, and financial performance expectations across portfolios and to inform due diligence on impact investments. Available aggregated data currently measures the impact of private equity, private debt, and some publicly-traded fixed income portfolios.

Additionally, as mentioned above, public equity and debt investors have access to sophisticated Environmental, Social and Governance ("ESG") assessment through organizations such as Sustainalytics, MSCI and EIRES. ESG analysis has become increasingly comprehensive, covering both developed and emerging global markets. As the quality of data continues to improve, the ability of asset managers to incorporate ESG data into their investment selection process evolves. From our perspective, the highest quality approach is for asset managers to employ analysts trained in both ESG and financial analysis, or to establish, from the beginning of the investment process, a strong line of communication between the two analyst teams. We expect that at some point we will start seeing common notions of impact regardless of a company's status as public, private, large or small.

VI. Impact Financial Performance across Asset Classes

While the field is still relatively young, there is evidence that market-rate impact investments can perform as well as traditional investments.

Anecdotally, we know that there are top-performing, impact private equity funds and—as evidenced by low default rate and consistent returns—high-performing community development finance institutions (CDFIs). That said, no known academic research has been done to empirically evaluate the performance of impact funds in the high-risk/high-return private equity and venture capital space versus traditional alternative investments.

On the public fixed income and equity side, a number of studies have shown that public companies exhibiting higher environmental, social and governance ratings will perform better than their lower-scoring counterparts. This is the type of data that helps to promote the rightful understanding that public equity has an important role in both achieving one's financial goals and in creating positive impact in our world. See below for some of the studies conducted:

Academic Research Meta-Study: Fulton, Mark, et al., "Sustainable Investing: Establishing Long Term Value and Performance," Deutsche Bank Climate Change Advisors, June 2012.

This Deutsche Bank report looks at over 300 studies that were conducted on performance of indices and funds that incorporate environmental, social and governance factors into equity portfolio construction. The studies show:

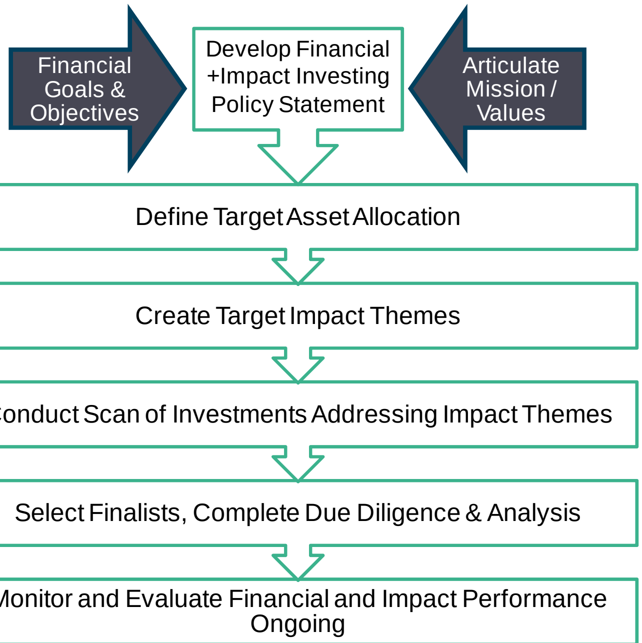
- 100% of academic studies agree that companies with high ratings for CSR and ESG factors have a lower cost of capital in terms of debt (loans and bonds) and equity. In effect, the market recognizes that these companies are lower risk than other companies and rewards them accordingly.
- 89% of the studies show that companies with higher ratings for ESG factors exhibit market-based outperformance. Here again the market is showing a correlation between financial performance of companies and what it perceives to be advantageous ESG strategies, at least over the medium (3-5 years) and long term (5-10 years).

Outperformance Found in *High Sustainability* Companies: Eccles, Robert, et al., "The Impact of Corporate Culture of Sustainability on Corporate Behavior and Performance," HBS Working Paper Series 12-035, November 2011.

- "Using a matched sample of 180 companies, we find that corporations that voluntarily adopted environmental and social policies many years ago – termed as High Sustainability companies – exhibit fundamentally different characteristics from a matched sample of firms that adopted almost none of these policies – termed as Low Sustainability companies…Overall, we find evidence that firms in the High Sustainability group are able to significantly outperform their counterparts in the Low Sustainability group."

VII. How to Conceptualize Impact Investing in Your Portfolio

As stated above, impact investors look to create long-term value in their portfolios while providing solutions to some of the biggest global sustainability challenges. This type of impact can be achieved across all asset classes and in both public and private markets. The road map below is to help investors—both individual and institutional—conceptualize a plan for integrating Impact Investing into an investment portfolio. The key elements include articulating the investor's mission and/or values, developing an investment policy statement ("IPS") related to the portfolio's objectives, integrating the impact component and, finally, identifying investment opportunities that are aligned with the IPS. Veris' process helps to identify managers and approaches that can fit the priorities of an individual, a foundation, or a family office.



VIII. Impact Investing Across All Asset Classes

	CASH	FIXED INCOME	PUBLIC EQUITIES	ALTERNATIVES	MISSION ALIGNMENT ACTIVITIES
Market Rate	> FDIC and FCUA Insured CDs > Community Bank and Credit Union money market	> Corporate Bonds > Gov't Agency Bonds > Municipal Bonds > International Bonds > Community Loan Funds > Promissory Notes > Micro-finance > Small Business Loans	> Global > International > Emerging Markets > Domestic > Passive > Thematic Funds • e.g. Environmental Markets	> Private Equity Funds > Direct Private Equity > Venture Capital Funds > Private Debt Funds > Liquid Alternatives > Hedge Funds > Hard Assets • e.g. Sustainable Agriculture, Timberland, Real Estate	> Custom ESG Overlay Screening > Shareholder Engagement > Proxy Voting > Program-Related Investments Note: Impact investors target returns that range from below market rate to market rate. Below market rate is defined as a lower rate of return than is expected for the amount of risk taken.
Below Market Rate	> Community Bank CDs and money market	> Community Loan Funds > Promissory Notes > Loan Guarantees > Micro-finance		> Direct Private Equity	

<< LOWER RISK — HIGHER RISK >>

IX. Impact & Mission-Related Investing Terms

Impact Investing

- Create solutions to global problems by leveraging the private sector
- Direct capital to businesses that seek to generate significant social and/or environmental good
- Invest in companies positioned to respond to sustainability issues such as depletion of resources, climate change, higher corporate governance standards, and pandemics

Sustainable & Impact Investment Managers

- Focus on companies who are becoming market leaders by evolving their business models to address sustainability issues and create meaningful environmental and social outcomes
- Sustainability analysis provides greater insights into business models, practices, products and/or services
- Identify factors that may increase risk and diminish value, such as: greenhouse gas emissions, strip mining or water pollution
- Discover innovative and responsible companies
- Ascertain quality management teams with a focus on good corporate governance

Mission-Related Investing

- Investments that seek to achieve specific social and/or environmental goals while targeting market-rate financial returns; these are more commonly used by foundations

Program-Related Investing

- Foundation strategy that seeks investments to achieve specific charitable goals consistent with the foundation's mission, typically targeting below-market-rate returns

Blended Value, Impact First, and Financial First

- Blended Value: Investments that offer both positive impact and competitive financial return
- Impact First Investments: Potentially compromising returns or increasing risk in exchange for greater environmental or social impact
- Financial First Investments: Potentially compromising some impact in exchange for greater financial return

Patient Capital/Slow Money

- Investing in innovative solutions with significant positive impact and being willing to wait a longer period before achieving financial returns, primarily venture capital investments

X. Additional Impact Investing Research to Review

- Balandina-Jaquier, Julia. "Guide to Impact Investing: For Family Offices and High Net Worth Individuals." February, 2011. <http://www.guidetoimpactinvesting.net/index.php/the-book/>.
- Bugg-Levine, Antony and Jed Emerson. "Impact Investing: Transforming How We Make Money While Making a Difference." Jossey-Bass: September, 2011.
- Emerson, Jed and Steve Falci. "Increasing Impact and Enhancing Returns." Impact Assets and Kleinwort Benson Investors. <http://www.impactassets.org/files/Issue%20Brief%20%237.pdf >.
- Gladman, Kimberly. "Ten Things to Know about Responsible Investment & Performance." Governance Metrics International, Inc. March 2011.
- Godeke, Steven and Raul Pomares et al. "Solutions for Impact Investors: From Strategy to Implementation." Rockefeller Philanthropy Advisors. November, 2009.
- J.P. Morgan and Global Impact Investing Network. "Perspectives on Progress: The Impact Investor Survey." January, 2013. <http://www.thegiin.org/cgibin/iowa/download?row=489&field=gated_download_1;>.
- US SIF. "Trends Report on Sustainable Investing Trends in the United States." 2012. <http://www.ussif.org/trends>.

XI. Additional Resources

- www.ussif.org – The Forum for Sustainable and Responsible Investment, the U.S. Sustainable and Responsible Investing Industry Association
- www.thegiin.org – Global Impact Investing Network
- http://www.thegiin.org/binary-data/Data_Driven_IRIS_report_final.pdf – The first analysis of aggregated performance data collected using IRIS.
- www.sristudies.org – Access to research reports related to sustainable investing
- www.impactbase.org – ImpactBase, a project of GIIN, is a searchable database of over 250 impact investments, mostly private equity and debt.
- http://www.impactassets.org/impactassets-50 – ImpactAssets 50, an open-source database of private debt and equity impact investment opportunities