Definitions for Social Impact Investing: Mission-Related; Program-Related; ESG Investing

Foundations, like many investors, are considering how to use their assets to both provide investment return and to promote their social and charitable causes. These approaches can be difficult to understand because of the terminology (which comes from both the worlds of investing and tax). The concept of social impact investing is broad and it can include a number of different approaches. Below is a chart to briefly describe program-related investments, mission-related investments, and “environmental, social, and governance” (“ESG”) investing (all of which may be considered “social impact investing”). Investments may start in one category but change over time, and may cross into separate categories.

These terms can be nebulous and, other than program-related investments, no definition is uniformly accepted. This is our attempt at giving some definition to these terms, but there are different interpretations (feel free to send along your own view, and we’ll update our chart).

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|  | Program-Related Investing | Mission-Related Investing | ESG Investing |
| Objective | An investment made for the primary purpose of charity as opposed to the generation of investment income. | An investment that aligns with and furthers an organization’s charitable mission, but for which the primary purpose is financial return. | An umbrella term that involves making investment decisions based on corporate behavior as it relates to environmental, social, or governance issues while maintaining a positive financial return on investment. |
| Use | Makes use of IRS exemption from the jeopardizing investment limitation (I.R.C. 4944) to make loans or capital investments which further the charitable purpose of an organization. | Uses positive and negative screening, shareholder engagement (such as proxy voting and shareholder resolutions), and high-impact investing strategies (such as allocating a portion of a portfolio to a specific cause). | Uses “screens” when selecting investments to create a portfolio made up of business models that incorporate positive environmental, social, and governance practices, or shareholder engagement to emphasize these factors (sometimes known as “collateral benefit” ESG) or employing ESG factors to assess expected investment risk and return (sometimes known as “risk-return” ESG). |
| Examples | | | |
|  | Program-Related Investing | Mission-Related Investing | ESG Investing |
|  | * High-risk investments in nonprofit low-income housing projects or in redevelopment projects in depressed neighborhoods * Low-interest or interest-free loans to students in need * The Gates Foundation program-related investments in biotechnology | * Impossible Foods (will likely IPO, but could also substantially reduce global warming) * Solar panel installation firm with good growth potential and credible business plan * The Ford Foundation’s $1 billion dollar commitment to MRIs in sectors like affordable housing in the United States and access to financial services by underserved communities | * Applying a “screen” to a basic diversified investment portfolio so that the portfolio does not include stock in companies that sell tobacco and alcohol products (“collateral benefit ESG”) * Avoiding investment in a fossil fuel company because a risk-return assessment indicates that the company’s litigation and regulatory risks are underestimated by the company’s share price (“risk-return ESG”) |

Program-related Investments

Program-related investments (PRIs) are a type of investment made primarily for a charitable purpose (that is recognized by the IRS) rather than for a profitable investment return. Private foundations are permitted to make these types of investments under a specific exception to the private foundation rules (the IRS exempts PRIs from the jeopardizing investment limitation, which normally prohibits a private foundation from engaging in risky investments). Other investors, including public charities and individuals, may invest in program-related investments, but they don’t necessarily need to pay attention to the requirements for program-related investments imposed on private foundations.

In order to qualify as a program-related investment, the investment must be made primarily to further the foundation’s tax-exempt purpose and the production of income or appreciation of property cannot be a significant purpose of the investment. This is a key issue—a program-related investment is treated similarly to a charitable grant for tax purposes, so to qualify, the PRI must be primarily for a charitable purpose—investment gains may only be a secondary consideration.

Typically, these are projects that may return principal with a limited return that does not outweigh the project’s risk (example: low-income housing projects for which the foundation provides a guarantee). However, private foundations are being more creative. For example, as of 2016, the Bill and Melinda Gates Foundation had allocated more than $1.5 billion to PRIs, with unique arrangements such as those with biotech startups in which the Foundation conditions its equity investments on agreements that the startup makes its products affordable in developing countries, and, in some instances, supplementing the investments with grants to fund product research and development.

Mission-related Investments

Mission-related investments (MRIs) are financial investments that align with and further an organization’s mission. An MRI is not defined by the Internal Revenue Code or Treasury Regulations, and these investments do not need to meet the same requirements as a program-related investment. Instead, the key issue for a mission-related investment is that its primary purpose is financial return, or in other words, that the investment has a good risk-return profile that may attract other investors. Oftentimes, these are start-up entities that have a possibility of success because of consumers’ desire to help impact society in their purchases or activities (examples: Impossible Foods, Toms Shoes, and Warby Parker, which are credible financial investments, but offer positive social returns).

These companies often describe themselves as having a “double bottom line” or “triple bottom line.” The company’s mission involves a social impact, but the company seeks to also have a good return on investments.

A private foundation can hold a mission-related investment, but it must be part of a well-rounded portfolio that will provide growth and income for the private foundation’s ultimate charitable purpose of making grants/supporting charities. The IRS has seemingly acknowledged these types of investments in Notice 2015-62, in which the Service stated that a foundation may consider its charitable mission when making investments without triggering the jeopardizing investment rule, as long as the primary purpose remains financial return, and the foundation manager exercises the requisite ordinary business care and prudence.

Like the term “social impact investing,” “mission-related investments” can encompass a proactive strategy where the investment manager actively looks for companies that will generate investment returns as well as a positive and social environmental impact or a more passive “screening approach.”

Environmental, Social, and Governance Investing

Environmental, social, and governance (ESG) investing focuses on making investment return while making investments in companies with track records and policies that contain certain criteria. This is usually accomplished by the foundation’s investment manager “screening” possible investments for companies that incorporate positive environmental, social, and governance practices, such as race and gender diversity, environmental responsibility, or fair labor practices. Or, an investment manager may seek to target companies who do well in these categories. The use of environmental, social and governance factors is growing in charitable trusts and endowment investments. In addition, individuals and trustees of non-charitable trusts may also employ ESG investing. It is still somewhat unclear how the requirements of fiduciary duty and the prudent investor rule apply in the case of charitable and non-charitable trusts. Trustees have fiduciary duties to make good investment decisions on behalf of the beneficiary or beneficiaries; and to the extent the trustees review and are satisfied that an ESG strategy can provide the same or better risk/return objective in the investment portfolio, ESG can be part of the investment strategy (future articles will review this issue).