



# Putting mission investing to work

Outcomes of the 2<sup>nd</sup> European Foundations Meeting  
on Mission Investing

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Ivo Knoepfel and David Imbert, onValues, November 2012

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## 1. Background and goals

For the second year running, 30 European foundations and foundation association representatives gathered to share their experience on “mission investing”, an umbrella term that refers to the conscious consideration of mission in endowment investment decisions. Mission investing can refer to practices ranging from a broad avoidance of investments that undermine a foundation’s goals (e.g. negative screening) to the use of investment tools to support specific projects directly linked to a foundation’s purpose (program-related investments), and everything in between. Put another way, mission investing expresses the conviction that a foundation should be more than just an investment company that donates some of its profits to charity and that a foundation should use all its resources, including endowment capital, to advance its mission.

The meeting was made possible by the Mistra Foundation and co-hosted by EFC, SwissFoundations and the investment strategy consultancy onValues. Nearly 30 participants from nine European countries gathered in Zurich to share practical experiences, discuss challenges and how they can be overcome. The day aimed to channel these candid exchanges into actionable recommendations for the European foundation sector to advance mission investing.

This report presents the main lessons learned during the meeting and lists a set of recommendations for “putting mission investing to work” tailored to various actors. The appendix contains further details of the day’s content.

## 2. Main findings from the event

### Framing mission investing

- Participants highlighted that the term mission investing can lead to misunderstandings (many understand mission-connected) and therefore for the sake of clarity we should always distinguish responsible investment<sup>1</sup> and impact investment<sup>2</sup>.
- There are two very different entry points for starting mission investing, and both are totally valid: some foundations find it easier to start with responsible investing (typically exclusions first), other find it easier to start with impact investing (typically disbursing loans instead of grants to mature beneficiaries). Several participants explained that in their foundations the mission investing process has started with a small impact investment first and has built from there.
- The current financial crisis and low market returns can be either an obstacle or a driver for more mission investing, depending on the board's attitude. Several participants pointed to the fact that when traditional asset classes do not yield the necessary returns anymore, boards are more open to look for alternatives, including mission investing. The financial crisis often is the catalyst for discussing investments in a depth not previously possible. This reflection is an opportunity for mission investing to get on the agenda.
- Mission investing needs to be understood for what it is: "Mission investing is a really good tool, but not to be used for everything. Foundations need to be honest with each other and avoid cheerleading", said one participant. Participants agreed on the need for more honesty on realistic return levels that can be attained through impact investing and the true risk levels of these investments. In this sense more information on observed returns and risks should be collected and shared. Foundation platforms and working groups should be used for an honest discussion of failures and pitfalls, as opposed to talking about successes only.

**"The financial crisis has motivated our board to take a step back and look at our investment approach with fresh eyes"**

### European developments in mission investing<sup>3</sup>

- Across Europe, discussions of mission investing are becoming more advanced and concrete. As one participant put it, "we are moving from the talking stage to the thinking stage".
- National working groups on mission investing have formed in the past two years in Switzerland and the UK, with further national working groups expected.
- Despite an increasing number of reports and events, there is a severe lack of data on foundations' use of mission investing (and of investment practices in general). Different solutions for this are: 1) national associations should regularly conduct surveys (by aggregating data and treating it

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<sup>1</sup> Responsible investment is an approach to investing that takes into account long-term economic, environmental and social trends, and aims at managing related risks and seizing opportunities with the goal of improving risk-adjusted returns. Sometimes, it also takes into account the ethical preferences of the investor. Responsible investing can take a variety of forms, from excluding investments in companies that violate basic international norms to integration of environmental, social and governance (ESG) factors in investment analysis and active ownership strategies such as proxy voting and company engagement. Responsible investment seeks competitive financial returns and can be applied easily in most asset classes.

<sup>2</sup> Impact investment evaluates the social impact of an investment as an integral part of investment decision making and provides capital to enterprises and funds that intentionally aim to contribute to defined social goals and whose contribution can be measured (or at least qualified). Impact investment often involves investing in illiquid assets via the private market. Program-related investments (PRI) that are directly related to the grantmaking activity of a foundation are part of the impact investment category.

<sup>3</sup> See Appendix 1 for a detailed overview of European mission investing developments

confidentially, the concern of foundations not wanting to go public can be overcome; EFC/EFFIO could propose a methodology to be used throughout Europe that would allow aggregation at the European level), 2) partnerships with academic institutions can help in gathering data, and several good examples have been set in Germany, Switzerland and Finland recently, 3) mainstream investment consultants could also help and resume some of the surveying that was done before the financial crisis (large foundations are important clients and their requests could trigger consultants to restart research in the field)

- In some countries (e.g. the UK) foundations are experiencing pressure from government to take on highly risky and still unproven impact investments. This shows how important it is for the foundation sector to engage pro-actively in a dialogue with government and stakeholders to explain its position in this area, what is doable and what is not, and what contributions the foundation sector uniquely brings to the field. It needs to drive the agenda, not be driven by policy agendas. Foundations should welcome government activity in the mission investing field (e.g. at the EU level the initiative to establish a European status for social enterprises and for social investment funds), while at the same time managing unrealistic expectations and excessive interference. It is important that there is clarity about the roles of government and the foundation sector in this domain.



### **Fiduciary duty and risk-return profile of mission investing**

This section draws on the results of the Sustainable Investment Research Platform (SIRP)<sup>4</sup> programme, the largest and longest-running academic research initiative on responsible investment. SIRP was launched by MISTRA in 2006 and connects 15 universities and research institutes from across Europe.

SIRP supported research in three main themes: sustainable investments and markets, sustainable companies and ratings, and fiduciary and incentive systems. The conclusions below highlight those SIRP findings that are most relevant for foundations considering mission investment and how it impacts risk/return and fiduciary duty:

- Responsible investing is a mature investment market with a large choice of providers and investment strategies. Academic research has shown that responsible investment returns and risk are comparable with traditional investments.
- Impact investments are often of the private equity type and are not well diversified. They therefore have a higher risk profile than responsible investing. Often (but not always!) their risk-adjusted returns are lower than those of comparable traditional investments.
- An excessive use of ethically motivated exclusions for investments comes with a financial opportunity cost and can conflict with fiduciary responsibility. Given that this is the most widely used responsible investing approach by foundations, particular care is warranted.
- Integration of sustainability considerations in financial analysis, active ownership and best-in-class approaches that do not substantially affect portfolio diversification and risk are in line with fiduciary duty considerations.

<sup>4</sup> See <http://www.sirp.se/>

- Impact investments that can be shown to increase the overall effectiveness of a foundation, used for only a small part of the portfolio (so as to not increase total portfolio risk considerably) are defensible from a fiduciary duty point of view.
- Foundation regulators usually accept the use of mission investing, as long as the board has a clear rationale, documents its decisions and pro-actively explains them to the regulator. A regulator that specifies mission investing as a recognized investment category may in fact encourage foundations to consider mission investing and provide a framework for discussions of mission investing where there is interest.
- Lack of diversification can be an issue that regulators raise, but such concerns should be balanced against the fact that regulators also accept that some foundations have large portfolio allocations to single buildings or to stock of the sponsoring company/family business (and therefore sub-optimal diversification).
- There are examples in the UK (Propoor), Netherlands (Cordaid) and Switzerland (elea) of foundations aiming to invest a large share of their assets in impact investments. If a foundation is of the expendable or spend-down type it is freer to invest a large portion of its assets in impact investing.

### **Implementation of mission investing**

- For the main asset classes (listed equities and fixed income) a wide choice of mature responsible investing strategies exists in the market and their use by foundations is relatively unproblematic. When using negative screening (the most common approach by foundations) it is important to avoid excessively restricting the investable universe because this could lead to higher risk/lower return levels.
- Real estate is a great resource for aligning to mission and contributing to social goals. Many foundations already use their buildings for social or cultural purposes, while still generating revenues, often unaware that this is actually a form of impact investing. The awareness for this should be raised and information on foundations' use of buildings for mission should be collected.
- The diversity of foundation missions in general makes finding appropriate positive mission investing options (e.g. positive screens or impact investments) a challenge. For certain types of foundations (those active in the environmental, development and certain research fields) it is easier to find appropriate impact investments. Nevertheless, foundations active in other fields can find opportunities for impact investments with some creative effort to generate new unconventional ideas (e.g. cultural foundations investing in the Blockbuster fund, which supports cultural events in the Netherlands with the potential to reach a large audience and achieve commercial success was mentioned at the meeting). Another approach is slightly adapting rating criteria used for responsible investing to better align the investment approach to mission (e.g. Dreilinden in Germany has created a simple custom sustainability screen focused on human rights and gender equality with research provider oekom).
- Some foundations have pursued unconventional ways of generating impact investment opportunities. For example, Cordaid uses a crowd sourcing platform of 10,000 participants proposing new investable social enterprises. Foundations concerned about the quality of impact investing opportunities should proactively work to create their own investment pipeline based on what they know, possibly in collaboration with other foundations. Spin-off companies from leading universities can be another interesting breeding ground for impact investments.
- In “building the infrastructure for mission investing” foundations that decide to specialise in the field and then offer co-investing opportunities and services to other foundations can also play an

**“On the border between grants and investments you have many opportunities to create interesting ideas for impact investments”**

important role. Examples are the shaerpa consultancy that was formed out of the Noaber foundation, the Swiss LGT Venture Philanthropy and elea foundations that are both developing co-investment opportunities for likeminded foundations, and Cordaid that plans to launch funds that can be used by other foundations. In the UK, many of the applicants to run funds for Big Society Capital have been foundations.

### External support

- Banks are reluctant to invest resources in providing mission investing advice and solutions before they see demand. Foundations are reluctant to pursue mission investing before they see an adequately rich field of options. The result is a “chicken and egg” situation. Foundations, however, are the perfect kind of organization to break such a cycle.
- The number of intermediaries and investment funds in the impact investing field is rapidly increasing. A participant mentioned that seven years ago only about 50 impact investing funds were available to foundations compared to the roughly 350 today. The fact that about 150 funds were added in the last 12 months shows the impressive exponential growth of the field.
- Nevertheless, the number of impact investment intermediaries is still small in absolute terms. Some of the large foundations (e.g. Cariplo) have therefore decided to help create such intermediaries and fiduciary platforms that are then available to the entire foundation world. In the UK, the government has set up Big Society Capital with the goal of catalysing the creation of more intermediaries.
- For investors in social enterprises it will be increasingly important to develop a market for exits from these investments. Luckily, many initiatives are working on this, including platforms such as NEXII, Mission Markets, the UK Social Stock Exchange etc. A number of cities and regions are also working on creating similar local exchanges.



- Independent consultants/advisors can play an important role in building the market and helping foundations identify and implement impact investment. Given the limited resources and know-how available to foundations, having somebody that can help the board define a strategy, identify potential investments, do due-diligence work etc. can be crucial. Advisors can be employed to conduct “horizon screening” in a targeted area of impact investing and then report back on a regular (e.g. bi-annual) basis.
- There are not yet many independent advisors in the impact investment field and foundations should share names and experience with them. Advice on responsible investing, on the other hand, is easier to get from mainstream consultants and banks, but it is not always very sophisticated and unbiased.

### Impact measurement

- Impact investments are often disadvantaged during board review by the fact that their financial return (private equity nature) and social return are not clear. Better (but simple) measurement systems for social return would help the review process and would provide a check against mission drift at impact investment firms. Excessive focus on measuring impact outputs, however, can also distract foundations from monitoring and managing the processes that generate those outputs. Given that social returns cannot be monetised, the trade-off (if there is one) between financial and social returns will still have to be decided by boards.
- More work is needed in measuring the social return of impact investments for boards to justify the often lower financial returns and/or higher risk of these investments. Initiatives such as the Social Return on Investment (SROI) Network and the work of the GIIN to develop IRIS (Impact Reporting & Investment Standards) are very valuable.

### **3. Recommended actions for accelerating mission investing uptake**

Based on the review of best-practices in different European countries and on the discussions that took place at the event, we summarise here recommended actions by different key stakeholders with the aim of accelerating the uptake of mission investing.

The impression is that we are at a tipping point for mission investing in Europe: our European landscape review (Appendix 1) has shown that the interest in this field has never been so high. We believe that a concerted effort by key stakeholders (informed by best-practices in more advanced countries) could lead to significant growth in the use of mission investing by European foundations.

#### **Recommended actions:**

##### **For national foundation associations**

- Establish a working group on mission investing where foundations of all experience levels can discuss the topic safely among peers
- Explicitly endorse the concept of “consideration for the mission when defining the investment strategy for the endowment” (e.g. through a mention in the national foundation code)
- Reach out to regulators to clarify the status of impact and program-related investments
- Regularly undertake surveys regarding members’ investment practice
- Partner with academic institutions/sustainable investment fora to produce research on mission investing in your country
- Explore ways in which foundations can pool resources when implementing mission investing (e.g. by jointly seeding new investment vehicles, establishing platforms to source deals and co-investing jointly etc.)

##### **For European foundation bodies**

- Create platforms through which best-practices from different European countries can be shared
- Aggregate and disseminate information on best-practices, notable examples, useful tools
- Aggregate results from national surveys on mission investing to the European level – in order for this to be possible, coordinate efforts to harmonise survey methodologies<sup>5</sup>
- Make the foundation sector voice heard when EU level initiatives are proposed (e.g. in the current debate on a European status for social enterprises and for social investment funds)

##### **For foundations**

- Ask your national association to consider the recommendations above
- Ask your banks/asset managers and investment consultants to propose investments suited to your foundation (can also be done jointly by national working groups)
- Ask investment consultants to provide background research and market surveys on foundation investment practices generally and mission investing specifically
- Find out how to otherwise access more information on mission investing
- Share your foundation’s experience with mission investing to motivate others (e.g. input to a working group, article, conference presentation, section in annual report)

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<sup>5</sup> An appropriate organisation to take the lead on this could be EFFIO, the European Foundations Financial and Investment Officers Group

**For investment advisors and other service providers**

- Educate yourself on mission investing and consider pro-actively raising the topic with your foundation clients
- Connect with your institution's responsible investment team to understand what is possible to recommend today
- Develop links to impact investment specialists to improve your market understanding and position your firm to draw on the best services if needed.



## 4. Useful resources

### Reports

|  |  |
|--|--|
| Cummings and Hehenberger, " <a href="#">Strategies for Foundations: When, Why and How to Use Venture Philanthropy</a> ", European Venture Philanthropy Association, 2010.  | Detailed introduction for foundations interested in implementing venture philanthropy approaches, with multiple strategies tailored to specific foundation situations. Includes 4 large case studies of foundations focused on venture philanthropy. |
| EIRIS Foundation, " <a href="#">Socially Responsible Investment: A practical introduction for charity trustees</a> " Charity SRI, 2010.  | Chapter 5 presents a step by step process for implementing responsible investments at a foundation.  |
| Gootjes, Verstappen and Hummels, " <a href="#">VBDO Benchmark Responsible Investment: Fundraising charities and foundations in the Netherlands 2011</a> ", VBDO, 2011.   | Annual review of foundations' and charities' mission investing practices in the Netherlands, with details on how each foundation implements their policy.  |
| Hand, K. ed., " <a href="#">Unlocking Socially Responsible Investment</a> ", Charity Finance Directors Group, 2010.  | Chapter 6 provides a step by step guide to generating and implementing a responsible investment policy. This detailed section ranges from getting mission investing on the agenda to selecting and monitoring asset managers.                        |
| Imbert and Knoepfel, onValues Ltd. " <a href="#">Report on 1<sup>st</sup> European foundations meeting on mission investing</a> ", Mistra, 2011.   | Summary report from 1 <sup>st</sup> European foundations mission investing meeting.  |
| Jenkins, R. " <a href="#">The Governance &amp; Financial Management of Endowed Charitable Foundations</a> ", Association of Charitable Foundations, 2012.  | Major report on best practice investment governance at foundations with a dedicated section on connecting mission and investment.  |
| Knoepfel and Imbert, onValues Ltd., " <a href="#">360-degrees for Mission: How leading European foundations use their investments to support their mission and the greater good</a> ", Mistra, 2011.                             | Introduces the concept of mission investing and 8 leading European foundations in detailed case studies.   |
| Knoepfel, I., " <a href="#">Nachhaltige und zweckgerichtete Investitionen für Stiftungen</a> " SwissFoundations, 2012.   | 13 frequently asked questions and answers on mission investing, and clarification of terms.  |
| Knoepfel, I., " <a href="#">Impact Investments für Stiftungen</a> ", in "Schweizer Stiftungsreport 2012" (Eckhardt, Jakob and Schurbein) Swiss Foundations, CEPS and Universität Zürich, 2012. (also in <a href="#">French</a> ) | Short article highlighting how mission investing is of strategic interest to foundations and presenting various alternatives of responsible and impact investment.   |
| Schneeweiss and Weber, " <a href="#">Mission Investing im deutschen Stiftungssektor</a> ", Bundesverband Deutscher Stiftungen, 2012.   | Excellent overview of the whole mission investing space from a German foundations perspective. Includes a comprehensive definition of terms and approaches and a number of detailed case-studies of German foundations.                              |
| Then et al., " <a href="#">Anlageverhalten der kapitalstärksten deutschen Stiftungen</a> ", Centre for Social Investment, Universität Heidelberg, 2012.  | Major study on how foundations have invested after the financial crisis, including chapter on mission investing. Produced in cooperation with German national association of foundations.  |

### Websites

|   |   |
|---|---|
| <a href="#">Principles for Responsible Investment (PRI)</a> | For responsible investing across asset classes      |
| <a href="#">Global Impact Investing Network (GIIN)</a>      | For impact investing                                |
| <a href="#">Charity SRI</a>                                 | Information for foundations on resp. investing      |
| <a href="#">Mission Investors Exchange</a>                  | North American foundation mission investing network |

## **Appendix 1. The European Landscape of Mission Investing**

*(this section is based on onValues research)*

The 2nd European Foundations Meeting on Mission Investing is indicative of a growing trend among European foundations to take mission investing seriously, or, as one participant put it, “to move from the talking stage to the thinking stage”. As an input to this meeting, onValues researched the landscape of mission investing activity around Europe and presented it to participants.

From our research, we identified the following developments in European mission investing:

1. National-level working groups
2. Academic-national association collaborations
3. Increasing number of events and reports
4. Minimal activity by mainstream consultants and banks; innovation by specialised intermediaries

In the following paragraphs we briefly describe these developments. Overall we observe that the ongoing financial crisis has if anything increased European foundations’ interest in mission investing. Indeed, foundations appear to take a more critical view of traditional capital management and show interest in new investment approaches.

### **National working groups**

National working groups provide a simple yet critical support system for foundations to understand and implement mission investing. In October 2010, foundations in the UK informally began exchanging information on social impact investments. This began as an email list between a core group of active foundations and evolved by January 2011 into regular in-person meetings. Today, the Social Impact Investors Group comprises 20 organizations with secretarial support provided by the UK national association, the Association of Charitable Foundations. Meetings cover specific topics proposed by members, for example impact measurement, an introduction to institutions such as Big Society Capital or the Global Impact Investing Network, or organized ‘pitch days’ where impact investment managers explain their offer and receive feedback from the foundations.

In March 2012, the national association of Switzerland, SwissFoundations launched the Sustainable and Impact Investor Group. The group focuses on developing resources for stimulating and supporting trustee discussion of mission investing and has recently issued a SwissFoundations position paper on the topic. The Swiss working group has also begun exploring options for foundations to pool resources for common use of services such as proxy voting.

We expect that other European national associations will organize working groups on mission investing in the coming years.

### **Academic-national association collaborations**

The past year has also seen several productive collaborations between universities and national associations. In October 2012, the German national association, Bundesverband Deutscher Stiftungen and the Centre for Social Investment at the University of Heidelberg produced a major report on the post-crisis investment behaviour of German foundations<sup>6</sup>, which included a chapter on mission investing. In February 2012, SwissFoundations and the Center for Philanthropy Studies at the University of Basel worked together to produce a study on mission investing in the Swiss foundation sector<sup>7</sup>. This fall, the Council of Finnish

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<sup>6</sup> Then et al., “Anlageverhalten der kapitalstärksten deutschen Stiftungen”, Centre for Social Investment, Universität Heidelberg, 2012.

<sup>7</sup> Fritz, Tizian, “Mission Related Investing bei Schweizer Förderstiftungen”, Center for Philanthropy Studies, Universität Basel, 2012.

Foundations will begin a study in cooperation with the Handelshögskolan Helsinki on the role of foundation investors in the Finnish national economy.

Academic-national association collaborations are a win-win for all parties. For foundations, they bring resources and analysis to an under-examined topic of critical importance. For universities, collaborations provide survey contacts and data in a field that has been under-researched by academia, and which has growing practical relevance to society.

### **Events and reports**

Across Europe, mission investing events and reports have popped up in the past two years. The 1<sup>st</sup> and 2<sup>nd</sup> European meetings on mission investing that we organized in 2011 and 2012 and the “360-degrees for Mission” report<sup>8</sup> we authored in May 2012 on behalf of Mistra have been key pan-European developments, but there have also been a number of national developments of equal importance. In April 2012 in the UK—perhaps the most-advanced European country on foundation investment generally and mission investment specifically—the Association of Charitable Foundations issued a major report on the investment governance of foundations with a dedicated section on connecting mission and investments<sup>9</sup>. The author, Richard Jenkins, will continue in the same vein with a follow-on report in early 2013. In the Netherlands, another of the most advanced countries, the national sustainable investment forum, VBDO, has published a benchmark study of responsible investment by foundations every year since 2010<sup>10,11</sup>, and will complement this work in 2012 with a new report on asset manager attention to mission investing. In Germany, the national association published a significant report on mission investing activity in July 2012, launching this topic formally and seriously on the German foundation sector agenda<sup>12</sup>. 2012 events in France, Liechtenstein, Germany, the UK and Netherlands specifically focused on mission investing have provided a physical embodiment of the increasing interest in this topic.

### **Minimal activity at traditional advisers while specialists innovate**

The academic studies and independent reports mentioned above are in part a reaction to the withdrawal of mainstream investment advisers from providing research on foundation investment practices. For institutional asset owners like pension funds, regular market surveys provide important data for benchmarking performance and comparing outlooks with peers. Unfortunately for foundations in Europe, the leading mainstream providers of foundation investment research, Towers Watson and JPMorgan Asset Management (in the UK), discontinued their foundation market surveys after the financial crisis. The absence of good data currently inhibits the assessment and development of mission investing by the foundation sector.

With less focus on foundations in general, mainstream investment consultants have been unable to develop expertise on the emerging topic of mission investing. This, of course, is a two-sided coin. Our research shows that only a quarter of European foundations use external investment consultants, compared to 80 per cent in the US.

European foundations tend to rely on their banks for investment advice. While we have not yet seen banks systematically engaging their foundation clients on mission investing, we do observe that banks can offer solutions if prompted. Banks have the ability in-house to provide or advise on ethical exclusions, SRI products and (sometimes) proxy voting services. When it comes to impact investments, however, banks often

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<sup>8</sup> Knoepfel and Imbert, on Values Ltd., “360-degrees for Mission: How leading European foundations use their investments to support their mission and the greater good”, Mistra, 2011.

<sup>9</sup> Jenkins, R. “The Governance & Financial Management of Endowed Charitable Foundations”, ACF, 2012.

<sup>10</sup> Gootjes, Hummels and Wiley, “VBDO Benchmark Responsible Investment: Fundraising charities and foundations in the Netherlands 2010”, VBDO, 2010.

<sup>11</sup> Gootjes, Verstappen and Hummels, “VBDO Benchmark Responsible Investment: Fundraising charities and foundations in the Netherlands 2011”, VBDO, 2011.

<sup>12</sup> Schneeweiss and Weber, “Mission Investing im deutschen Stiftungssektor”, Bundesverband Deutscher Stiftungen, 2012.

lack the expertise to provide such investments or help their clients to navigate the increasingly vast range of impact investment opportunities on the market.

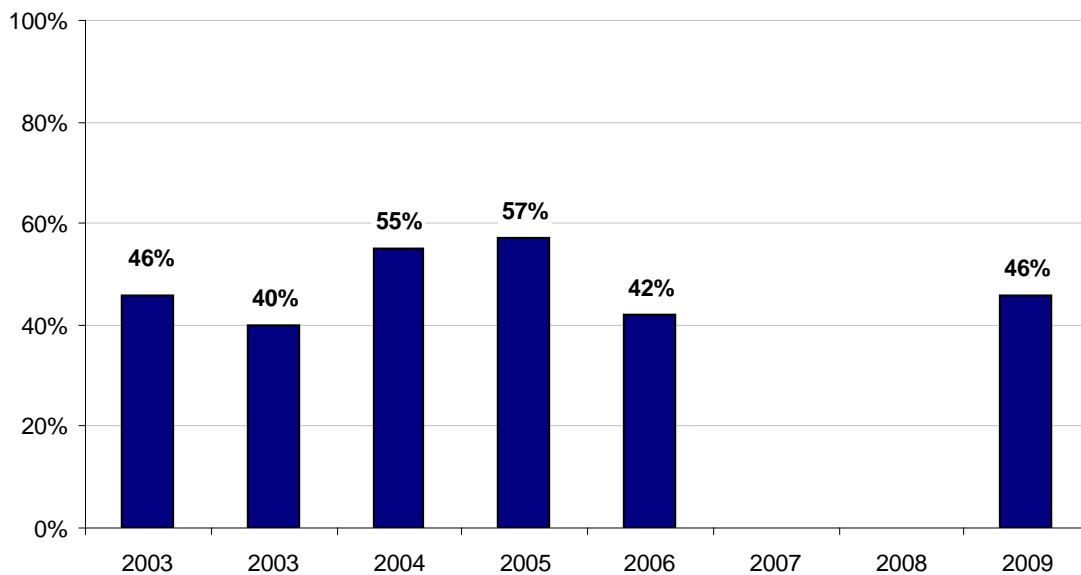
Our research indicates that the number of intermediaries and investment funds has grown by almost 50 per cent in the past year. Roughly 350 funds now offer investment strategies in fields ranging from health to education, rural development and the environment. As innovative boutiques develop more impact investing options, the need for better support from traditional investment advisers will increase.

We hope that foundations will increasingly start the conversation on mission investing with their advisers and banks. Simply asking, ‘what do you suggest?’ will prompt a deeper consideration of the issue.

### **From thought to action**

Our impression is that the increasing interest in mission investing has not yet translated to increased investment activity. Evidence collected from a variety of sources shows that the percentage of European foundations that take additional action related to their mission in any part of their endowment capital has remained stable at around 30% for the past ten years. In some countries, such as the UK or Netherlands, the absolute level may be higher but the growth trend is still flat (see below).

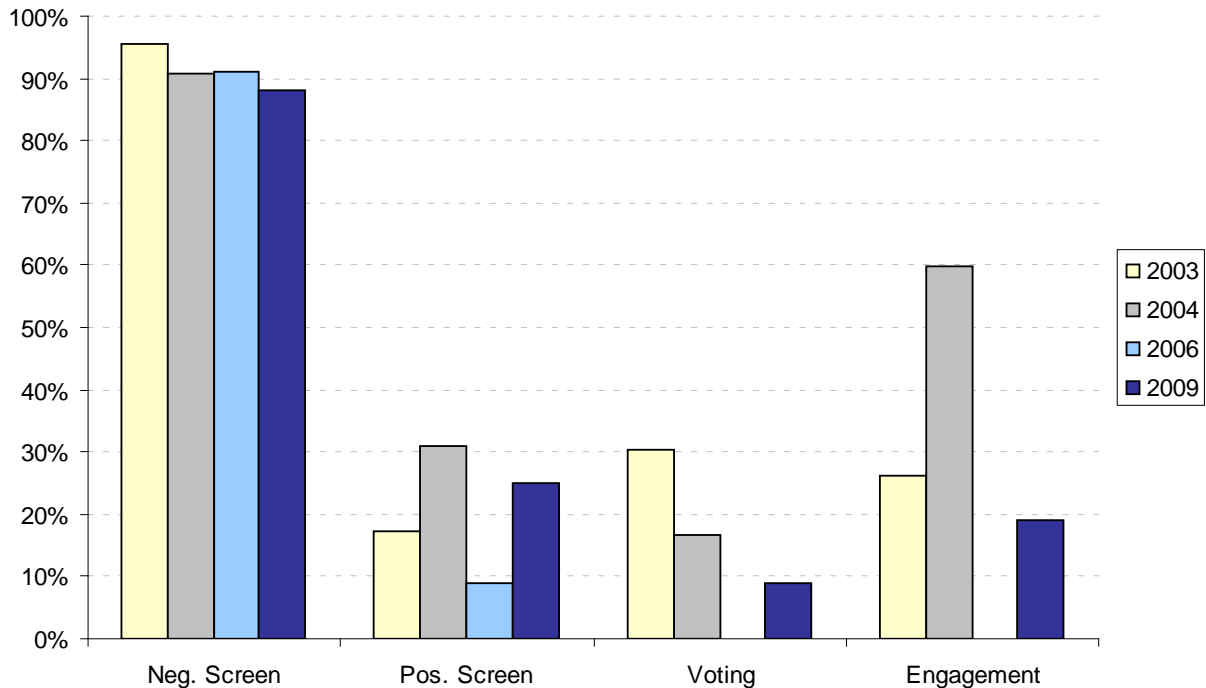
**Data from the UK: Does your foundation practice mission investing?**



Source: JP Morgan 2003 & 2006, Watson Wyatt 2005, Green 2003, Kreander 2009, CFDG & EIRIS 2009, onValues research

Furthermore, research shows that those foundations that do practice mission investing overwhelmingly do so through negative screening (see below). The more modern techniques of ESG integration and impact investing are rare. The poor quality of data on European foundation investment practices, however, hinders a definitive current assessment of mission investing uptake.

**Data from the UK: When used, what kind of mission investing is practiced?**



Source: Green 2003, JP Morgan 2006, Kreander 2009, CFDG & EIRIS 2009, onValues research

The coming years and better monitoring will reveal whether mission investing enters the mainstream among European foundations or remains a niche topic for a handful of leading actors. We are convinced that embracing and developing the concept of mission investing will strategically position the foundation sector to extract maximum value from its philanthropic resources and maintain its license to operate in the post-crisis world.

## Appendix 2. Risk-return and fiduciary duty

Dr. Lars Hassel, Professor of Accounting and Auditing, Umeå School of Business and Program Leader of the Sustainable Investment Research Platform (SIRP) presented key lessons from academic research on two critical topics for foundations considering mission investing:

- the risk-return characteristics of responsible investments
- the fiduciary duty implications of mission investing

### Risk and Return

Considering first the common strategy of ethical exclusions, the SIRP research in fact concluded that investors may suffer impaired risk-adjusted returns for excluding “sin” stocks active in businesses such as tobacco, alcohol, weapons and gambling. A variety of research results showed that because of reduced analyst coverage due to underweight institutional ownership, sin stocks were able to be acquired at lower valuation ratios and therefore generated abnormal returns. Conversely, universes which excluded these stocks did not capture this outperformance. This is an important point for foundations considering negative ethical exclusions.

## Performance of controversial stocks

**Controversial stocks continue to outperform their peers!  
An unintended consequence of RI**

| Study                       | Region and Period         | Tobac. | Alc. | Game | Weap. | Nuke | Biotech | Adult | Alpha                         |
|-----------------------------|---------------------------|--------|------|------|-------|------|---------|-------|-------------------------------|
| Hong and Kacperzyk (2009)   | U.S.<br>1926-2006         | X      | X    | X    | X     |      |         |       | Positive                      |
| Kempf and Osthoff (2007)    | U.S.<br>1991-2004         | X      | X    | X    | X     | X    |         |       | Positive<br>(non-significant) |
| Statman and Glushkov (2009) | U.S.<br>1992-2007         | X      | X    | X    | X     | X    |         |       | Positive<br>(non-significant) |
| Salaber (2007)              | Europe<br>1975-2006       | X      | X    | X    |       |      |         |       | Positive                      |
| Fabozzi et al. (2009)       | 21 countries<br>1970-2007 | X      | X    | X    | X     | X    | X       | X     | Positive                      |
| Derwall et al. (2011)       | U.S.<br>1992-2002         | X      | X    | X    | X     | X    |         |       | 2.86*                         |
|                             | 1992-2008                 |        |      |      |       |      |         |       | 2.64*                         |

Turning toward the more “advanced” responsible investment practice of integrating environmental, social and governance (ESG) information in investment decisions, that is, preferentially investing in those firms that show high ESG performance the SIRP research produced some interesting conclusions. At the company level, sustainable business practices indeed produce superior operating performance (Guenster et al. 2010, Semenova and Hassel 2011, Eichholtz et al. 2010, Hahn and Bauer 2010). However, at the investment level, these operating results were shown to be increasingly efficiently priced by the market. Therefore the outperformance from ESG investing was shown to diminish over time.

Foundations can take note that advanced responsible investment practices are likely not a magic formula for superior returns, but at the same time feel confident that ESG investing will produce risk-adjusted returns in line with the market. The breadth of manager choice and maturity of the responsible investment industry ensures that there are institutional-quality investment options available to foundations.

On the risk and return of impact investments, foundations should be aware that these often take the form of private transactions with low liquidity and a variety of risks. This can lead to lower risk-adjusted returns even as specific social objectives are met. Nevertheless, if a foundation is informed and clear about such tradeoffs, this is an acceptable investment as part of a diversified portfolio.

## Fiduciary duty


Fiduciary duty is an obligation that is monitored by regulators but that is defined through best practice and evolving legal opinion. The current best definition of fiduciary duty is, “the duty to pursue an investment strategy incorporating risk and return objectives suitable to the trust while exercising reasonable care, skill, and caution” (Freshfields 2005, Stalebrink, Kriz and Guo 2010).

This general definition requires further specificity. For example, in the US the Uniform Prudent Investor Act of 1992 incorporates the concepts of modern portfolio theory and total return into the definition of fiduciary duty by making the following key points:

- Investments are assessed not in isolation but by portfolio contribution
- No duty to “maximize” the return on each investment, but the portfolio must be well diversified
- The prudence of an investment is to be judged at the time the investment was made, not in hindsight

This guidance is similar in other jurisdictions.

When it comes to responsible and impact investing, however, there is conceptual confusion over whether fiduciary duty requires, permits or restricts consideration of ESG. Popular perception, which is not necessarily founded in jurisprudence or empirical data, seems to view fiduciary duty as an obstacle to ESG investing. On balance, however, a professionally implemented mission investing policy appears in fact to fall on the right side of fiduciary duty. The Freshfields, Bruckhaus, Deriger Report (2005) argues: “integrating ESG considerations into investment analysis so as to more reliably predict financial performance is clearly permissible and is arguably required in all jurisdictions”.



**Answer: '[...] integrating ESG considerations into an investment analysis so as to more reliably predict financial performance is clearly permissible and is arguably required in all jurisdictions\*.' (Freshfields Bruckhaus Deringer, 2005:13)**

**Main question:**  
**Is ESG integration permitted, required or hampered by law and regulation?**

**But, a disclaimer from the report:** “[...] those seeking a greater regard for ESG issues in investment decision-making often encounter resistance on the basis of a belief that institutional principals and their agents are legally prevented from taking account of such issues” (Freshfields Bruckhaus Deringer, 2005:6)

A legal Framework for the integration of environmental, social and governance issues into institutional investment  
Prepared by the Joint International Working Group of the Green Finance Institute  
October 2005

Further development by practitioners and academics will clarify these issues to an even greater degree, but for now foundations should consider the following recommendations:

**Do:**

- Focus responsible investment policies on the risk and return contributions of ESG considerations
- Be transparent in the use of ESG criteria. If risk and return is not the whole motivation specify what social motivations generate the investment decision or policy.
- Be clear about the use of impact investments to achieve defined social objectives, even if the risk-return profile of these investments cannot compare with traditional investments.
- When excluding certain sectors, consider diversification impacts above all
- Consider active ownership and voting as an acceptable way of expressing ESG concerns

**Don't**

- Adopt the language of a “social crusader” in investment policy documents
- Implement strict negative screens that eliminate entire asset classes or regions

**In summary**

- Responsible investing is a mature investment market with a large choice of providers and investment strategies. Academic research has shown that responsible investment returns and risk are comparable with traditional investments.
- Impact investments are often of the private equity type and are not well diversified. They therefore have a higher risk profile than responsible investing. Often (but not always!) their risk-adjusted returns are lower than those of comparable traditional investments.
- An excessive use of ethically motivated exclusions for investments comes with a financial opportunity cost and can conflict with fiduciary responsibility. Given that this is the most widely used responsible investing approach by foundations, particular care is warranted.
- Integration of sustainability considerations in financial analysis, active ownership and best-in-class approaches that do not substantially affect portfolio diversification and risk are aligned with fiduciary duty considerations
- Impact investments that can be shown to increase the overall effectiveness of a foundation, used for only a small part of the portfolio (so as not to considerably increase total portfolio risk) are defensible from a fiduciary duty point of view.



## Appendix 3. Participant list

### 2nd European Foundations Meeting on Mission Investing, Zurich, 7 November 2012

| Organisation                   | Title    | First Name | Last Name       | Country       | Position                                 |
|--------------------------------|----------|------------|-----------------|---------------|--|
| Animato Stiftung               | Mr       | Peter      | Spinnler        | Switzerland   | Stiftungspräsident                       |
| Aventis Foundation             | Mr       | Thomas     | Ebermann        | Germany       | Program Officer                          |
| Canopus Foundation             | Dr       | Peter W.   | Heller          | Germany       | Executive Director                       |
| Cordaid                        | Mr       | Henri      | van Eeghen      | Netherlands   | COO                                      |
| Council of Finnish Foundations | Prof. Dr | Paavo      | Hohti           | Finland       | Managing Director                        |
| Dreilinden gGmbH               | Ms       | Antje      | Schneeweiss     | Germany       | Trustee                                  |
| Finnish Cultural Foundation    | Mr       | Juhana     | Lassila         | Finland       | Director of Cultural Affairs             |
| Fondation Leenaards            | Mr       | Peter      | Brey            | Switzerland   | Directeur                                |
| Fondation Philanthropia        | Mr       | Bertrand   | Gacon           | Switzerland   | Head of Impact Investing                 |
| Fondazione Cariplo             | Mr       | Francesco  | Lorenzetti      | Italy         | Chief Financial and Fund Raising Officer |
| Fonds 1818                     | Mr       | Boudewijn  | de Blij         | Netherlands   | Executive Director                       |
| Friends Provident Foundation   | Ms       | Danielle   | Walker Palmour  | UK            | Foundation Director                      |
| Hilti Foundation               | Mr       | Bruno      | Walt            | Liechtenstein | Consultant                               |
| King Baudouin Foundation       | Mr       | Luc        | Tayart de Borms | Belgium       | Managing Director                        |
| Martin Hilti Family Trust      | Dr       | Stefan     | Klein           | Liechtenstein | Head of Asset Management                 |
| Mistra                         | Mr       | Fredrik    | Gunnarsson      | Sweden        | Chief Financial Officer                  |
| Noaber Foundation              | Mr       | Matthijs   | Blokhuis        | Netherlands   | Investment Manager                       |
| onValues Ltd.                  | Dr       | Ivo        | Knoepfel        | Switzerland   | Managing Director                        |
| onValues Ltd.                  | Mr       | David      | Imbert          | Switzerland   | Senior Consultant                        |
| Progressio Foundation          | Mr       | Marcello   | Palazzi         | Netherlands   | President                                |
| Saheee Foundation              | Mr       | Linus      | Jauslin         | Switzerland   | Trustee                                  |
| Stiftung Drittes Millennium    | Mr       | Hans-Ruedi | Zulliger        | Switzerland   | President                                |
| Stiftung Edith Maryon          | Dr       | Ulrich     | Kriese          | Switzerland   | Research and Project Development         |
| SwissFoundations               | Ms       | Beate      | Eckhardt        | Switzerland   | Geschäftsführerin                        |
| Umeå University                | Prof. Dr | Lars G     | Hassel          | Sweden        | Professor of Accounting                  |
| Velux Stiftung                 | Mr       | Lukas      | von Orelli      | Switzerland   | Geschäftsführer                          |
| VSBfonds                       | Ms       | Marina     | de Kanter       | Netherlands   | Manager Finance & Control                |