

## The 100% Club

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When it comes to managing money, the rich are increasingly pursuing more than just financial rewards and going full tilt on the idea of using investments as a tool for social and environmental change.

A growing number of high-net-worth individuals, family offices and private foundations are placing their entire portfolios into impact investments that attempt to drive positive and measurable social or environmental outcomes with various levels of financial returns.

These investors are practicing “total portfolio management” or, as it is sometimes called, “100% impact” investment strategies, according to Jed Emerson, chief impact strategist at ImpactAssets, a nonprofit financial services firm based in Bethesda, Md.

More wealthy families are rethinking the meaning and purpose of their capital and their family legacies, he says. “When you have or receive a significant amount of wealth, it raises questions about what to do with it,” says Emerson, who serves as an advisor to four family offices that are executing 100% impact investing strategies.

Major life experiences, such as liquidity events and inheritances, can cause families to start reflecting deeply about what they’re doing with their money and how to deploy or redeploy portions of their capital in ways that truly support their values, he says. That can cause a re-examination of what they’re doing with the rest of their assets and lead to the decision to start transitioning their entire portfolios to impact investments. “Once you ask the questions, ‘What is the purpose of capital?’ ‘Why are you alive?’ and ‘What is it that you’re trying to do?’ you come to a conclusion—a halfway response is not adequate,” says Emerson.

Full-tilt impact investing may be the latest evolution of a concept that dates back to the 1950s, when faith-based organizations applied socially responsible investing (SRI) screens to their public equity investments to avoid businesses that were selling tobacco, alcohol, munitions and other products that were contrary to their beliefs—so-called “negative screening.”

The 1990s saw the addition of “positive screening,” where investors searched for businesses that engaged in best practices on environmental, social and governance (ESG) issues and corporate social responsibility (CSR).

In 2007, the Rockefeller Foundation hosted a meeting of leaders in the field, who coined the phrase “impact investing” to represent the next stage of the journey. Impact investors seek out companies they believe will provide measurable societal improvements, such as organic food producers and renewable energy generators,

as well as financial returns. These investors expect public benefit and financial performance to be aligned.

The latest step appears to be going “all in” across every asset class.

“This is not a conversation around trade-offs between ‘doing well’ and ‘doing good.’ It’s a conversation around maximizing total performance of assets across asset classes,” says Emerson.

### **Spotting Trends**

Worldwide, family offices allocate an average of 17% of their assets under management to impact investing, according to a Financial Times survey of 125 respondents. The report, *Investing for Global Impact 2014*, found a wide spread of exposure, from 1% to 80% for some multifamily offices in the U.S., U.K. and Switzerland, and 100% for some single-family offices in these locations.

As the survey indicates, most family offices have only a portion of their assets in impact investments. What’s driving the rest to go completely in and why now?

“The question should be turned around. Why would you not want to align 100% of your assets with your values and what you believe? You don’t check your values at the door. You live your values,” says Raúl Pomares, founder of Sonen Capital, a San Francisco-based firm that has over \$300 million in assets dedicated to impact investing.

Pomares says Sonen Capital’s clients want to channel their capital to address the increasing number of economic, demographic and environmental challenges they’re concerned about, including poverty, population growth and climate change.

“The momentum of those pursuing impact is not just in one place. It’s a global movement of asset owners that are pursuing this across asset classes and strategies,” says Pomares.

Sonen Capital helped the KL Felicitas Foundation transition its \$10 million in assets. The foundation is run by Charly Kleissner, a technology-executive-turned-impact-investor, and his wife, Lisa. In 2006, only 2% of the portfolio was allocated to impact. By the end of 2012, 85% was deployed. Pomares says the foundation is now just shy of 100%.

Organizations such as the 100% Impact Network are also assisting the wealthy in shifting assets.

The group’s 40 or so members, including high-net-worth individuals, family offices and foundations, have deployed about \$1 billion and committed about \$3.5 billion to impact investing. Launched by Kleissner, the network is part of Toniic, a global network of impact investors that he co-founded.

Another pioneer is Carol Newell. She coined the term “whole portfolio activation to mission” after spending 20 years moving her entire \$60 million portfolio to investments in the green economy of British Columbia. Newell’s work led to the founding of Renewal Partners, an organization in Vancouver, Canada, that uses business to promote social and environmental goals. Renewal Partners is a sponsor of “Play BIG,” an annual conference for those with discretionary capital of \$15 million or more who want to learn how to channel all their assets toward impact investments.

Other investors have joined The ImPact, co-founded by Justin Rockefeller. These investors pledge to make impact investments, track their social impact and financial performance and share their data with other group members.

“All In For Impact” is even the theme of the annual SRI (Sustainable, Responsible, Impact Investing) conference in November in Colorado Springs, Colo., the largest and longest running conference of its kind in the world, according to its organizers.

## **Demanding Clients**

In the latest biennial Report on U.S. Sustainable, Responsible and Impact Investing Trends, 119 asset managers offering various ESG products said the top reason they do so—cited by 80% of them—is client demand. Over 70% said they considered ESG criteria to fulfill their or their clients’ mission to increase returns and reduce risk.

U.S.-managed assets invested in SRI strategies rose 76%—from \$3.74 trillion to \$6.57 trillion—from 2012 to 2014, according to US SIF, the Forum for Sustainable and Responsible Investment. The 2014 figure represents 18% of all U.S. assets under professional management, versus 12% for 2012.

Globally, 92% of high-net-worth individuals believe that driving social impact is important and 60% say it’s “very” or “extremely” important, according to a survey of 4,500 individuals in 23 countries conducted for the World Wealth Report 2014 by Capgemini and RBC Wealth Management. It’s even more important to younger investors, with 75% of affluent individuals under 40 saying that fostering social impact is “very” or “extremely” important. Those in emerging markets, such as China, India and Indonesia, are even more likely to agree (89%, 91% and 89%, respectively).

## **Debunking Myths**

The notion that there are not enough quality products to build a diversified portfolio entirely from impact investments is quickly fading.

“One of the misconceptions in the marketplace is that there aren’t that many funds out there,” says Pomares. Using the firm’s proprietary process of categorizing funds, he says Sonen Capital has a database of more than 2,000 public and private impact funds globally, including ESG- and SRI-screened funds, as well as ETFs, including solar- and water-oriented funds.

In addition to more and better product offerings, more qualitative and quantitative tools exist that measure social and environmental outcomes, such as the B Impact Assessment platform for measuring and benchmarking impact, which includes the Global Impact Investing Ratings System (GIIRS) survey. GIIRS assesses the impact of companies and funds using a ratings and analytics approach similar to Morningstar’s investment rankings.

The idea that investors must choose between impact and financial performance has also been challenged. A May 2014 study by the Global Impact Investing Network and JPMorgan, *Spotlight on the Market: The Impact Investor Survey*, collected data from 125 impact investors, mostly fund managers and foundations managing at least \$10 million of impact investment capital. Survey participants said their portfolios are performing largely in accordance with both their impact expectations (79%) and financial expectations (75%). Twenty percent reported outperformance against their impact expectations, while 16% noted outperformance against their financial expectations. Just 1% reported impact underperformance and only 9% noted financial underperformance.

A June 2012 analysis by Deutsche Bank researchers of over 100 academic studies of sustainable investing around the world found that CSR and ESG factors are “correlated with superior risk-adjusted returns at a securities level.” In *Sustainable Investing: Establishing Long-Term Value and Performance*, the authors said they “were surprised by the clarity of the results [they] uncovered: 100% of the 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.”

“Performance appears to be better in bear markets,” says Casey Verbeck, a director at San Francisco-based Veris Wealth Partners, a registered investment advisory and certified B corp that builds impact portfolios for clients. “It seems consistent that way for a long time. Businesses with CSR and ESG best practices are simply more efficient,” says Verbeck.

During the recent financial crisis, sustainability-focused companies outperformed their peers, according to a 2009 study by management consulting firm A.T. Kearney. This “performance differential” translated to an average of \$650 million in market capitalization per company. The researchers concluded that investors might have rewarded companies that focus on long-term health rather than short-term gains; demonstrate strong corporate governance; implement prudent risk management practices; and invest in “green” innovations.

But Emerson says the best performance data may be hard to come by, as most impact funds operate in private markets and have no disclosure obligations. “Those analytics are often inside firms that are using that information to drive their strategies. There is very good, practical data. But firms are not going to publish it,” says Emerson, who recently co-authored a book, *The Impact Investor: Lessons in Leadership and Strategy for Collaborative Capitalism*, that profiles 12 of the top-performing private funds around the world.

Despite the progress the industry has made, the World Economic Forum warned in a December 2014 report that “there is a shortage of expertise, tools and frameworks to enable engagement.” Ironically, the report contains a comprehensive list of resources, including recommended readings, networks and membership associations, forums and conferences, investment opportunities, impact measurement tools and family office networks and forums.

Another frequently raised objection to impact investing involves advisors’ concerns about violating their fiduciary duties.

Some say the failure to consider impact, SRI and ESG criteria should be a bigger concern for advisors and asset managers. “Being a good fiduciary is about more than making money,” says Emerson. “If you’re managing assets for a long-term horizon, and you’re not thinking about how off-balance-sheet risks affect performance, that’s just not good investing. You can set aside any conversation about ‘responsibility’ or ‘impact.’ It’s just fundamentally bad investing to put money into business strategies that are at risk on terms that you’re not considering.”

## **Getting Started**

Blueprints abound for advisors who want to help clients transition to impact investments. A good place to start is ImpactAsset’s first (of 13, so far) issue brief, *Invest with Meaning: An Introduction to a Unified Investment Strategy for Impact*. Sonen Capital’s report, *Evolution Of An Impact Portfolio: From Implementation To Results*, discusses how the KL Felicitas Foundation repositioned its assets. *Total Portfolio Activation: A Framework for Creating Social and Environmental Impact Across Asset Classes* by nonprofit organization Tides and Trillium Asset Management is another resource.

Emerson says the first step usually involves assembling a team to help guide the transition. For those with substantial wealth, he says it can take a year or more of working with their financial advisors to identify asset managers who can help the clients achieve their strategic vision. Advisors and clients can accelerate the learning curve by joining networks of like-minded investors, such as The ImPact, Toniic and Investors’ Circle.

Moving cash is a good first step. Emerson says clients can get similar financial returns, with impact, by redirecting money to local or regional banks and credit unions. As long as banks are FDIC-insured and credit unions are NCUA-insured, there shouldn't be any additional risk in moving cash from entities that may be financing activities of which clients disapprove.

"Municipal bonds are also fairly impactful vehicles. They help build infrastructure and schools," says Emerson.

After cash and municipal bonds, he suggests that advisors move one or two of the "worst" legacy investments to impact-oriented funds, then help clients develop a longer-term strategy to transition the rest of the portfolio.

Verbeck says that Veris Wealth Partners takes care to transform traditional portfolios in a methodical way and to work with clients' accountants, estate planning attorneys, philanthropic advisors and other professionals to time asset liquidation to minimize taxes and manage capital gains. He cautions that some legacy investments, such as hedge funds and private equity vehicles, can take several years to unwind, especially if there's a lockup period. Sometimes new infrastructure needs to be created before assets can be moved. For example, clients may want to set up a new trust to house the impact assets.

Emerson says many first-generation family members are using the topic of transitioning to 100% impact portfolios as a way to re-engage with the second and third generation about the meaning and purpose of capital and their family values. And advisors should pay close attention.

He's aware of families with hundreds of millions in assets who've abandoned decades-long relationships with advisors because the families concluded that those advisors were unable to deliver the types and scales of impact the families wanted.

"The greatest threat to traditional wealth managers and advisors is that some have a huge, ideological blind spot around the possibility of managing capital for financial performance with impact," says Emerson. "By not being aware of that blind spot, they're open to significant risk."

"People can talk about this as 'hype' and 'new' and 'risky,' but money will—especially when you put millennials into the conversation—continue to flow out of traditional strategies that are managed with no consideration for impact," says Emerson.

Indeed, almost one of every six dollars under professional management in the U.S. is now invested in vehicles and strategies that consider impact, according to the latest US SIF report.

"This is not a fad. It's a trend," says Emerson. "Advisors need to position themselves to be part of the trend and to benefit from it going forward."

## **Clients Who Went 'All In'**

### **Client "A"**

*One of Veris Wealth Partners' newest clients is a woman in her early 70s who's passionate about addressing climate change and protecting endangered species. She carved out an initial 25% (about \$3 million) of her family foundation's assets to invest for impact and plans to transition all the foundation's assets to impact investments in*

*the near future.*

*Most of the equity funds selected for the client are fossil fuel-free and several engage in high-profile shareholder advocacy focused on the sustainable sourcing of palm oil to protect original rain forest habitat. The client also holds a promissory note that helps female coffee and cocoa farmers in Africa and Latin America grow their crops sustainably with stable prices.*

### **Clients "B" and "C"**

*A mother-daughter duo came to Veris Wealth after the daughter heard the firm's chief investment officer speak at a philanthropy conference. While the daughter initiated the conversation about impact investing, the mother entered into the conversation after the firm back-tested its proposals and demonstrated competitive financial results.*

*These clients are transitioning assets to the firm that will eventually be fully invested for impact. The 30-something daughter has already transferred all her personal and trust assets to the firm (about \$5 million). The mother transitioned her \$20 million family foundation at the end of December and plans to move her personal assets this year.*

*In leaving a decades-long private banking relationship at a top-tier U.S. bank, the mother said a key motivator was the opportunity to increase the impact of the family's philanthropy with investments consistent with their foundation's mission of environmental conservation. To further the clients' impact goals, the firm selected fund managers that invest in low-carbon and fossil fuel-free businesses, as well as in the promissory notes of a community development financial institution that stabilizes urban neighborhoods.*

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