Leveraging Foundation's Assets for Impact

26 April 2022

PANELISTS

Julie Muraco, Moderator
Ksapa
New York, NY USA

Raphael Hara,
Managing Director & Co-Founder
Ksapa
Paris, France

David Miller
Partner, Tax Department
Proskauer Rose
New York, NY USA

Christine Looney
Deputy Director, Mission Investments
Ford Foundation
New York, NY

History of Socially Responsible Investment for Impact

1898
Quaker Friends Fiduciary corporation founded and adopts no weapons, alcohol or tobacco investment policy

1928
First public offering of a screened investment fund by a Boston ecclesiastical group

1960
Vietnam War and civil rights movement evolve Socially Responsible Investment

1973
Interfaith Center on Corporate Responsibility founded; files first shareholder resolution

1977
Congress passes CRA Act to reduce discriminatory credit practices against low-income neighborhoods. PAX World launched first socially responsible mutual fund

1980
Industrial accidents like Chernobyl & corporate activities activities negatively affect planet, climate change and ozone depletion

1984
Vietnam War and civil rights movement evolve Socially Responsible Investment

1990
Domini Social Index created evolving to MSCI KLD 400 Social Index

1993
$625 billion screened to exclude investment in South Africa in protest to Apartheid

2000s
Norway Govt Pension, Norway's largest pension, and CalPERS, USAs largest pension commit to 100% integration of sustainability over 15-year period

2006
Rockefeller Foundation launches major impact investing approach

2006
UN Principles for Responsible Investment launched with $4 trillion of AuM by signatories

2006
Dr. Muhammad Yunis and Grameen Bank awarded the Nobel Peace Prize

2009
Bloomberg adds significant sustainability news and ESG data coverage

2010
University of Harvard launch of Initiative for Responsible Investment (IRI)

2011
US White House convenes policy makers and other stakeholders for impact investing

2012
USSIF Issues first Trends publication reporting $3.74 trillion of sustainability managed assets

2016
TPG launches the Rise Fund raising USD2.1 billion sparking traditional PE capital to embrace impact investment

2020
Global Sustainable Investment Alliance (GSIA) issues Trends Report announcing USD35.3 trillion AuM dedicated to sustainable investments

2021
The UN Principles of Responsible Investing (PRI) has 3826 signatories with USD121 trillion AuM

2022
USD 11 trillion of global signatories have committed to fossil fuel divestiture

Source: Thompson Reuters, "History of Socially Responsible Investing in the U.S." August 2013 and Evestnet Research
Ksapa, www.ksapa.org

“US Foundations: Use of Endowment Assets for Social Good & Impact”

- In our society, forward-thinking organizations are working to evolve their businesses for the benefit of all stakeholder communities they serve.
- Current economic, social, and environmental realities compel fiduciaries to assess how their investment practices relate to the entity’s charitable mission and public benefit purposes.
- White Paper explores:
    - Elements of change in the use of endowment assets for social capital
    - History of using responsible investing & impact investing strategies
    - Implementation vehicles from which to position a portion, or the entirety of an endowment’s
    - Considerations of legal and tax

Key Takeaways

- A foundation has the ability to re-examine its fiduciary principles and expand upon those principles in order to maximize stakeholder outcomes and leverage positive impact in their communities.
- An organization and its fiduciaries must understand the context and perspective from which to deploy all forms of sustainable & impact capital.
- Fiduciaries must understand the legal and taxable considerations of impact investment vehicles before embarking on an impact strategy.
- Fiduciaries must understand the practical applications of such strategies

Advise
Invest
Advocate

Leveraging Foundation's Assets for Impact

Raphael Hara
Ksapa
rh@ksapa.org

ksapa

Introducing Ksapa

ADVISE

INVEST

ADVOCATE

Ksapa is an impact business

Our mission is to catalyze an economy-wide shift towards **economically, socially and environmentally-sound** operating and investment models.

Our services range from **Sustainability Advisory** to **Innovative Solutions & Impact Investment Services**

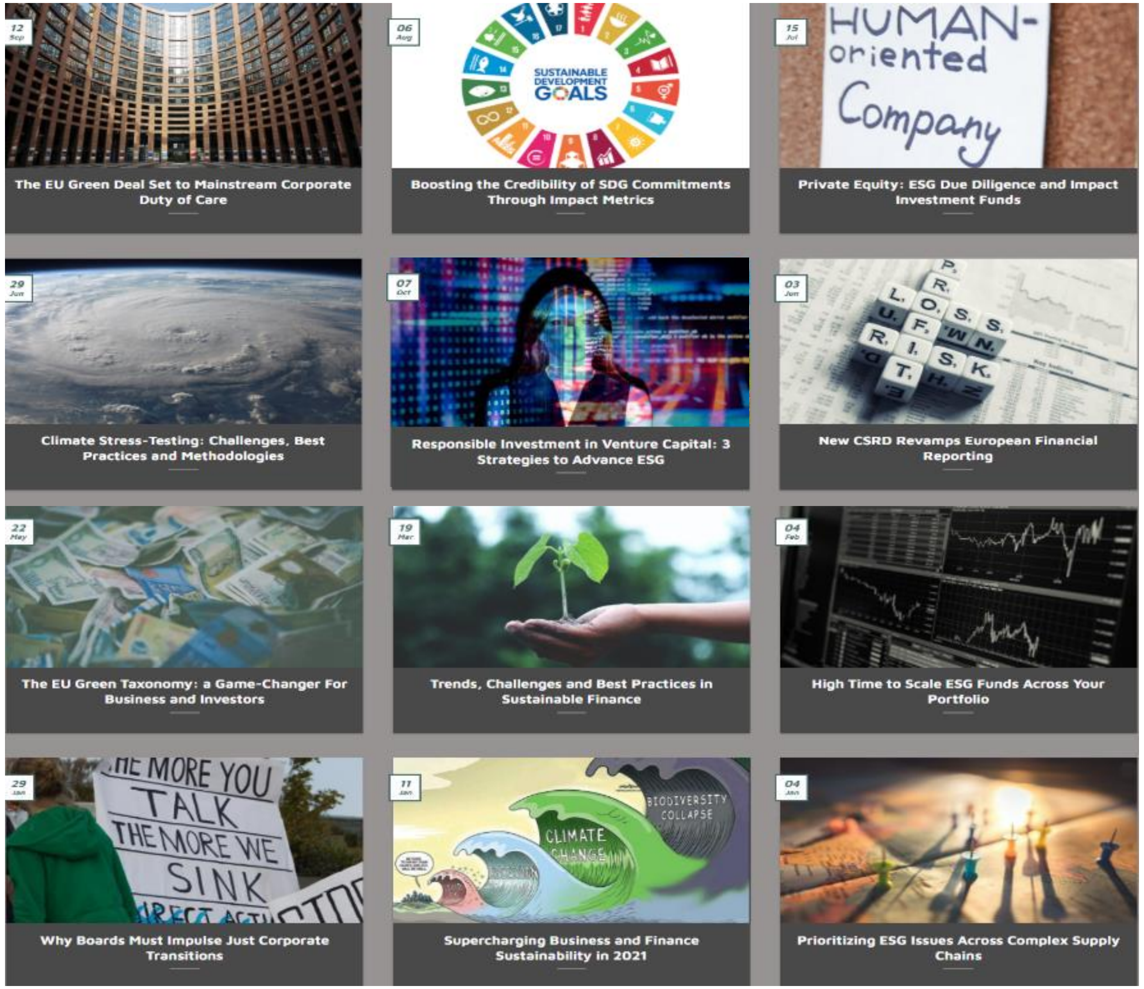
Sustainability, finance and investment, IT, agronomy, development and field expertise all **aggregated at core team level**

Thanks to **a network of partnering organizations** and **150^{+} experts worldwide,** we offer close contextual and operational support for effective impact on the ground

Ksapa's Inbuilt Commitment to Advocacy

REPORTS & BRIEFING PAPERS

ILLUSTRATIVE LIST OF POSTS ON SUSTAINABLE FINANCE



REGULAR WEBINARS

ESG & Impact - Two Complementary Approaches

ESG PERFORMANCE

IMPACT

GENERALISTS

Integration of ESG Criteria in Financial Risk Assessment and Asset management strategies

New frontier of value creation for mainstream investments based on common good - Towards positive contribution mainstreaming/valuation?

RESPONSIBLE INVESTMENT

SUSTAINABLE FINANCE

ESG-guided Investment Funds

SRI Funds

Sustainability Linked Bonds

Green, Social, Sustainable Bonds

Community-based Finance

Impact Investment

Impact Bonds

Contribution to SDGs: ESG vs Impact? ESG AND IMPACT!

SDG Financing Gap is tremendous: pre-COVID-19 figures between USD 2.5 & 4 trillion per year

ESG Risk Management

- Damage control
- Manage negative impacts

Limited positive contribution

≈0

≠

A company can positively contribute while not having sufficient ESG risk management & vice versa!

Positive Impact

- Go beyond “do no harm” stance
- Positive contribution by design

Direct positive contribution

>0

Dashboard

Comparability through SDG matrix

How Is Impact Characterized?

The following conditions help distinguish Impact from other concepts such as ESG excellence for instance.

INTENTIONALITY

Upfront objective of having a specific positive social or environment outcome

MATERIALITY

The positive outcome is of material significance to the beneficiaries and company.

ADDITIONALITY

Ability to resolve unmet environmental and social needs

MEASURABILITY

A concrete evaluation of the positive environmental, social and contribution

What are the main stakes for Impact?

ACCEPTABILITY

Positive contribution will become essential to companies' legitimacy and contribution to SDGs agenda 2030 is a major source of economic value creation also driving an increase of acceptability

SCALABILITY

Impact-oriented strategies are on track to grow rapidly in private equity. However, to significantly scale-up impact strategies, it is critical that impact take over the listed companies' and institutional investment universe

COMPARABILITY

For impact strategies to take over the listed equity universe, impact measurement needs to converge on international standards to build comparability and credibility of impact approaches

Advise
Invest
Advocate

Leveraging Foundation's Assets for Impact

David Miller
Proskauer Rose
dmiller@proskauer.com

Proskauer

Program-Related Investments

David S. Miller

April 26, 2022

Proskauer

The Private Foundation 5% Distribution Requirement

- **Private foundations are required to "distribute" (i.e., spend for direct charitable purposes) at least 5% of the value of their assets each year (the "minimum investment return").**

- **"Program-related investments" are:**
  - treated as "qualifying distributions" for this purpose (and therefore can be used to satisfy the 5% distribution requirement), and
  - excluded from the assets taken into account in determining minimum investment return.

Treasury regulations sections 53.4942(a)-3(a)(2)(i) and 53.4942(a)-2(c)(3)(ii)(d).

Program-Related Investments - Definition

- **A program-related investment is an investment:**
  - The **<u>primary purpose</u>** of which is to accomplish one or more charitable purposes;
  - **<u>No significant purpose</u>** of which is the production of income or the appreciation of property; and
  - **<u>No purpose</u>** of which is to attempt to influence legislation or participate or intervene in any political campaign on behalf of (or in opposition to) any candidate for public office.

Other Benefits of Program-Related Investments

- Gain on the sale of a program-related investment is not subject to the 1.39% excise tax on net investment income. Treasury regulation section 53.4940-1(f)(1).

- Program-related investments are not treated as jeopardizing investments, which can subject a private foundation to excise taxes. Treasury regulation section 53.4944-3(a)(1).

- Program-related investments are not treated as "business enterprises" and so a private foundation that makes an equity program-related investment can hold an unlimited amount of the underlying company. Treasury regulation section 53.4943-10(b).

Other Benefits of Program-Related Investments (continued)

- **Program-related investments are not "taxable expenditures" (but expenditure responsibility may be required). Treasury regulation section 53.4945-6(c)(1)(i).**

- **Lobbying expenses paid by the recipient of a program-related investment are not treated as paid by the private foundation so long as the private foundation doesn't earmark funds for that purpose and the recipient of the program-related investment can claim an ordinary business deduction for the payments. Treasury regulation~~s~~ section 53.4945-2(a)(4).**

Unrelated Business Taxable Income (UBTI)

- Income and gain from program-related investments are treated the same as income and gain from non-program-related investments. So, program-related investments can give rise to UBTI if they are not related to the tax-exempt purpose of the organization.

- An equity program-related investment in a flow-through entity that is engaged in a trade or business can give rise to UBTI.

- Interest received on a loan to an unrelated entity, and capital gain are generally excluded from UBTI. Therefore, most loans do not give rise to UBTI.

- Equity in a C-corporation does not give rise to UBTI.

Program-Related Investment v. Mission Related Investment

- **A program-related investment is an investment:**
  - The **<u>primary purpose</u>** of which is to accomplish one or more charitable purposes;
  - **<u>No significant purpose</u>** of which is the production of income or the appreciation of property; and
  - **<u>No purpose</u>** of which is to attempt to influence legislation or participate or intervene in any political campaign on behalf of (or in opposition to) any candidate for public office.
- **A "mission related investment" ("MRI") is generally defined as an "investment that seeks to generate a reasonable rate of return on capital, while also furthering a social purpose."**
- **MRI's do not qualify as program related investments.**

Program-Related Investment – Primary Purpose Test

- **The primary purpose of a program-related investment must be to accomplish one or more charitable purposes.**

  - Two parts to the test: The investment must "**significantly further**" the accomplishment of the foundation's exempt purpose, and the investment would not have been made "**but for**" its relationship to the foundation's exempt purpose.

  - To satisfy the "significantly further" test, the foundation must determine that the investment significantly furthers with one or more section 501(c)(3) purposes and, if the foundation's purposes are more narrow, significantly furthers the foundation's purposes.

  - To satisfy the "but for" test, the foundation must also conclude that it would not have made the investment but for the investment's contribution to the accomplishment of the foundation's exempt purposes.

Program-Related Investment – No Significant Purpose Test

- **<u>No significant purpose</u>** of the investment can be the production of income or the appreciation of property.

- Relevant whether investors solely engaged in the investment for profit would be likely to make the investment on the same terms as the private foundation.

- However, the fact that an investment produces significant income or capital appreciation is not, in the absence of other factors, conclusive evidence of a significant purpose involving the production of income or the appreciation of property.

Treasury regulation section 53.4944-3(a)(2)(iii).

Program-Related Investment – Examples

- **A foundation can invest in for-profit businesses if the purpose of the investment is charitable.**

- **A below-market loan to a small business in a deteriorated urban area and owned by an economically disadvantaged minority group may be a PRI if:**
  - the foundation's primary purpose for making the loan is to encourage the economic development of minority groups,
  - no significant purpose involves the production of income or the appreciation of property,
  - making the loan advances the foundation's charitable purposes, and
  - the loan would not have been made except that it advances the foundation's charitable purposes.

Treasury regulation section 53.4944-3(b), Example (1).

Program-Related Investment – Examples

- **A private foundation can purchase stock in a for-profit pharmaceutical company to finance the development of a vaccine to prevent a disease that will affect poor individuals in developing countries if the company would not likely have the resources to develop the vaccine.**
  - The company is required to distribute the vaccine to the poor individuals at an affordable price.
  - The company is free to sell the vaccine at market prices to other individuals.
  - The company is required to publish the research results and disclose substantially all information that would be useful to the interested public as promptly as possible without jeopardizing the company's right to secure patents to protect its ownership or control of the results of the research.
  - The return is less than a market return.
  - The primary purpose is to fund scientific research.
  - No significant purpose is the production of income or appreciation.
  - The investment significantly furthers the accomplishment of the foundation's tax-exempt purpose, and would not have been made but for the relationship between the investment and the foundation's exempt purposes.

  Treasury regulation section 53.4944-3(b), Example (11).

Program-Related Investment – Hypothetical

- **A private foundation is a "disease foundation", dedicated to the cure and relief of a deadly disease.**
- **The foundation regularly makes grants to research institutions to fund promising research.**
- **The foundation recently learned about a different "disease foundation" that had made a grant to a university in exchange for a royalty if the research was successful. The other foundation sold the royalty for several hundred million dollars.**
- **The private foundation will ask for similar terms for its next grant.**
- **Program-related investment?**

Program-Related Investments and UPMIFA

- **The Uniform Prudent Management of Institutional Funds Act is a uniform act that is the law in 49 states. It provides guidance for investment decision-making by charitable institutions.**

- **Section 2(5)(A) of UPMIFA excludes "program-related assets."**

- **A "program-related asset" means an asset held by an institution primarily to accomplish a charitable purpose of the institution and not primarily for investment.**

- **The drafting committee's comments to UPMIFA make clear that program-related "assets" include "investments" that primarily accomplish a charitable purpose.**

Program-Related Investments and UPMIFA (continued)

- **The comments provide that while UPMIFA does not apply to program-related investments, if program-related assets serve, in part, as investments for an institution, then the institution should identify categories for reporting those investments and should establish investment criteria for the investments that are reasonably related to achieving the institution’s charitable purposes.**

- **For example, a program providing below-market loans to inner-city businesses may be “primarily to accomplish a charitable purpose of the institution” but also can be considered, in part, an investment. The institution should create reasonable credit standards and other guidelines for the program to increase the likelihood that the loans will be repaid.**

Program-Related Investments

David S. Miller

April 26, 2022

Proskauer

Advise
Invest
Advocate

Leveraging Foundation’s Assets for Impact

Christine Looney
Ford Foundation
c.looney@fordfoundation.org

FORD FOUNDATION

ksapa

QUESTIONS & ANSWERS

ksapa.org – contact@ksapa.org

Advise
Invest
Advocate

Leveraging Foundation’s Assets for Impact

Raphael Hara
Ksapa
rh@ksapa.org

David Miller
Proskauer Rose
DMiller@proskauer.com

Christine Looney
Ford Foundation
c.looney@fordfoundation.org