The Impact Class Concept
Initial Findings from the Navigating Impact Investing Project

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Community Development (CD)

- The CD function within the Federal Reserve System—consisting of individual departments at each of the 12 Federal Reserve Banks and at the Board of Governors—promotes economic growth and financial stability for low- and moderate-income (LMI) communities and individuals through a range of activities, including:
  - **Convening stakeholders**, including practitioners, financial institutions, nonprofits, governmental agencies, and the philanthropic and private sectors
  - **Conducting and sharing research** to examine economic challenges facing LMI communities and attendant policy implications
  - **Identifying emerging issues**
Today’s Presenters and Agenda

• Cathy Clark, Director, CASE i3 Initiative on Impact Investing, Durham, North Carolina
• Ben Thornley, Managing Partner, Tideline, San Francisco, California
• Sasha Dichter, Chief Innovation Officer, Acumen, New York, New York
• The following will be discussed:
  – The impact capital market
  – The case for impact classes
  – Reaction to the impact class framework
The Impact Capital Market

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What is Impact Investing?
Addressing Barriers to Impact Investing

Could defining the segments under the tent help address critical impact investing field obstacles to create:

- Better market, program, product, and policy development?
- Aligned expectations of risk, return, and impact?
- Easier entry and efficiency for investors?
- Stakeholder-supported performance evaluation?
- More informed advocacy around what works?
- More effective engagement with investees?
Navigating Impact Investing Project

• Objective:
  – Help optimize the process of matching an investor’s unique risk, return, and impact preferences with the right investment opportunities

• Approach:
  – Literature review of 200+ sources from diverse fields, extensive market outreach (over 1,000 pages of transcripts from 45 interviews), and 2 advisory group meetings (including an in-person event hosted by BlackRock in New York City)

• Audience:
  – Primary: asset owners and their advisors
  – Secondary: investment managers
Impact Capital Market

Source: CASE Smart Impact Capital, © Duke University 2016
This is one of the more prominent, widely adopted frames for the market, which places impact investing within a broader spectrum ranging from traditional investment to philanthropy. This highlights an important evolution in thinking about the market: that the impact-first and finance-first distinction is not enough.

### Spectrum of Capital

<table>
<thead>
<tr>
<th>FOCUS</th>
<th>TRADITIONAL</th>
<th>RESPONSIBLE</th>
<th>SUSTAINABLE</th>
<th>THEOMATIC</th>
<th>IMPACT-FIRST</th>
<th>PHILANTHROPY</th>
</tr>
</thead>
<tbody>
<tr>
<td>COMPETITIVE RETURNS</td>
<td>Limited or no focus on ESG factors of underlying investments</td>
<td>Focus on ESG risks ranging from a wide consideration of ESG factors to negative screening of harmful products</td>
<td>Focus on ESG opportunities through investment selection, portfolio management, and shareholder advocacy</td>
<td>Focus on one or a cluster of issue areas in which social or environmental need created commercial growth opportunity for market rate or market beating returns</td>
<td>Focus on one or a cluster of issue areas in which social or environmental need requires some financial trade-off</td>
<td>Focus on one or a cluster of issue areas in which social or environmental need requires 100% financial trade-off</td>
</tr>
<tr>
<td>ESG OPPORTUNITIES</td>
<td>• Private equity firm integrating ESG risks into investment analysis</td>
<td>• Best-in-class socially responsible investment fund</td>
<td>• Clean energy mutual fund</td>
<td>• Fund providing debt or equity to social enterprises and/or trading charities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>HIGH IMPACT SOLUTIONS</td>
<td>• Ethically screened investment funds</td>
<td>• Long-only public equity fund focused on deep integration of ESG to create additional value</td>
<td>• Emerging markets health care fund</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Linking Asset Classes and Impact Themes

This chart is by far the most commonly cited by investors in describing their intentions, mapping investments by sector and asset class. The goal of impact classes is to be additive by providing an understanding of the approaches to impact investing that transcends sector and asset class.

<table>
<thead>
<tr>
<th>LIQUIDITY</th>
<th>INCOME AND WEALTH PRESERVATION</th>
<th>CAPITAL APPRECIATION AND WEALTH GROWTH</th>
<th>INFLATION PROTECTION</th>
<th>Commodities and Other Real Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash/Cash Alternatives</td>
<td>Notes/Other Debt Obligations</td>
<td>Bonds</td>
<td>Absolute Returns/Low Equity Correlations</td>
<td>Public Equity</td>
</tr>
<tr>
<td>CLIMATE CHANGE</td>
<td>Green Deposit Bank</td>
<td>Tax-Exempt Green Bonds</td>
<td>Carbon Trading</td>
<td>Positive and Negative Screening</td>
</tr>
<tr>
<td>WATER</td>
<td>Corporate Infrastructure Bonds</td>
<td>Water Treatment Project Finance</td>
<td>Unit Investment Trust, Closed End Funds</td>
<td>Water Funds</td>
</tr>
<tr>
<td>COMMUNITY DEVELOPMENT</td>
<td>Community Bank Certificates of Deposit</td>
<td>Foreclosure Repair</td>
<td>Microfinance Institutions Debt</td>
<td>Shareholder Proxy Voting</td>
</tr>
<tr>
<td>SOCIAL ENTERPRISES</td>
<td>Social Enterprise Credit</td>
<td>Bridge Financing</td>
<td>Structured Public Note</td>
<td>Micro-Cap Listed Social Companies</td>
</tr>
<tr>
<td>HEALTH AND WELLNESS</td>
<td>Trade Finance Guarantee/Deposit</td>
<td>Smart Growth Municipal Boards</td>
<td>Blended Debt Equity Hybrid Structures</td>
<td>Thematic Screening</td>
</tr>
<tr>
<td>SUSTAINABLE DEVELOPMENT</td>
<td>Linked Deposit/Guarantee</td>
<td>Charter School Bonds</td>
<td></td>
<td></td>
</tr>
<tr>
<td>EDUCATION</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The Case for Impact Classes

Ben Thornley
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Role in the Investment Process

Impact classes provide an additional layer of information, supplementing other factors related to impact.

Sources:
***Variables drawn from Bridges Ventures’ Impact Radar framework
Designing Impact Classes

Impact classes are a clustering of investments with similar impact characteristics.

<table>
<thead>
<tr>
<th>DESIGN OBJECTIVES</th>
<th>CHALLENGES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Limited set of high-level classes</td>
<td>How to characterize impact without getting into the cornucopia of impact goals and objectives</td>
</tr>
<tr>
<td>Simple and compelling construct</td>
<td>How to best articulate or layer information and resist the urge to over-complicate</td>
</tr>
<tr>
<td>Meaningful and objective</td>
<td>How to incentivize managers to self-categorize, while leaving open the possibility of third-party verification</td>
</tr>
<tr>
<td>Neutral on the degree or quality of impact</td>
<td>How to ensure the framework has value without making value judgments</td>
</tr>
<tr>
<td>Categorical and exhaustive</td>
<td>How to create classes that include all impact investments, without precluding new innovations</td>
</tr>
</tbody>
</table>
## Impact Class Concept

### Prospective Elements

<table>
<thead>
<tr>
<th>Type of impact evidence</th>
<th>Inputs, outputs, outcomes, impacts</th>
</tr>
</thead>
<tbody>
<tr>
<td>Role of impact investing capital</td>
<td>Pioneering, scaling, influencing</td>
</tr>
<tr>
<td>Market and beneficiary characteristics</td>
<td>Level of market development, nature of beneficiary, capital need</td>
</tr>
</tbody>
</table>

### Model Framework #1

**Impact Evidence**

### Model Framework #2

- **Beneficiary**
- **Market**
- **Capital need**
Framework #1: Landscape

This preliminary example of an impact class framework combines two variables: role of impact capital and type of impact evidence. This approach allows clustering based on why impact investing is needed (role of impact capital) and how the resulting impact is demonstrated (type of impact evidence). The impact classes in this case may be each individual cell in the matrix or could be groups of cells with overarching characteristics in common.

<table>
<thead>
<tr>
<th>ROLE OF IMPACT CAPITAL</th>
<th>THESIS-ALIGNED</th>
<th>STRATEGIC OUTPUTS</th>
<th>OUTCOME DATA</th>
<th>IMPACT DATA</th>
</tr>
</thead>
<tbody>
<tr>
<td>INFLUENCING</td>
<td>A</td>
<td>A</td>
<td>B</td>
<td>-</td>
</tr>
<tr>
<td>PROMPTING the</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>impactful actions of</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>mature businesses</td>
<td>A</td>
<td>A</td>
<td>B</td>
<td>-</td>
</tr>
<tr>
<td>SCALING</td>
<td>A</td>
<td>B</td>
<td>B</td>
<td>C</td>
</tr>
<tr>
<td>GROWING proven,</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>impactful business</td>
<td>B</td>
<td>B</td>
<td>C</td>
<td></td>
</tr>
<tr>
<td>models or sectors</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>PIONEERING</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SEEDING new or early</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>stage impactful</td>
<td>B</td>
<td>B</td>
<td>C</td>
<td>C</td>
</tr>
<tr>
<td>business models and</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>financial innovations</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Please note that these frameworks are preliminary and are still undergoing testing and development.
Framework #2: Elemental

Below is another preliminary example framework defined by three variables—the nature of beneficiaries, nature of the market, and degree of capital need—that in combination describe the approach to impact. For the purpose of arriving at high-level impact classes, each of the three variables has two discrete settings (defined below), which is indicated according to light or dark shading of the triangles in the graphic.

Please note that these frameworks are preliminary and are still undergoing testing and development.

**Beneficiary**

<table>
<thead>
<tr>
<th>Vulnerable</th>
<th>Undefined</th>
</tr>
</thead>
<tbody>
<tr>
<td>Benefits are targeted primarily to people, places, or systems that are disadvantaged, under threat, and/or lack access to resources and opportunity.</td>
<td>Benefits are primarily broad-based and are not targeted toward people, places, or systems that are demonstrably vulnerable.</td>
</tr>
</tbody>
</table>

**Market**

<table>
<thead>
<tr>
<th>Underdeveloped</th>
<th>Established</th>
</tr>
</thead>
<tbody>
<tr>
<td>The investment’s market is relatively new, emerging, or subject to systemic challenges.</td>
<td>The investment’s market is relatively proven, efficient, and well-functioning.</td>
</tr>
</tbody>
</table>

**Capital Need**

<table>
<thead>
<tr>
<th>Critical</th>
<th>Supplemental</th>
</tr>
</thead>
<tbody>
<tr>
<td>Limited opportunities are available for the investee to access capital, implying that capital provided plays a key role in making the impact possible.</td>
<td>Access to capital is generally available in the investee’s market. Additional capital provided is of a supplemental nature.</td>
</tr>
</tbody>
</table>
Most Recent Framework

ACCOUNTABILITY

Practices | Indicators | Evidence
---|---|---
Influencing | ALIGNED | THEMATIC
Scaling | THEMATIC | TARGETED
Pioneering | TARGETED |
A government enters into a pay-for-success contract that encourages private investors to provide the initial funding for an intervention aimed at reducing recidivism.

A foundation makes a program-related investment into a fund that provides financing for community clinics.

A high-net-worth investor invests in a mutual fund that invests in public equities and files shareholder resolutions or engages with public companies on environmental issues.

Impact classes in practice: Categorizing hypothetical investments

The following example illustrates how impact classes could help diverse investors match their specific preferences to suitable investments.

<table>
<thead>
<tr>
<th>Sector/impact theme</th>
<th>Prisoner rehabilitation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asset class</td>
<td>Pay-for success contract</td>
</tr>
<tr>
<td>Geography</td>
<td>United Kingdom</td>
</tr>
<tr>
<td>Impact class</td>
<td>TARGETED</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Sector/impact theme</th>
<th>Health care delivery</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asset class</td>
<td>Fixed income</td>
</tr>
<tr>
<td>Geography</td>
<td>United States</td>
</tr>
<tr>
<td>Impact class</td>
<td>THEMATIC</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Sector/impact theme</th>
<th>Environment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asset class</td>
<td>Public equity</td>
</tr>
<tr>
<td>Geography</td>
<td>International</td>
</tr>
<tr>
<td>Impact class</td>
<td>ALIGNED</td>
</tr>
</tbody>
</table>
Sasha Dichter
Chief Innovation Officer, Acumen
New York, New York
sdichter@acumen.org
CATALYZING ENTREPRENEURSHIP TO CREATE A WORLD WITHOUT POVERTY
GLOBAL PRESENCE

INVESTMENTS BY REGION

- 27% EAST AFRICA
- 27% INDIA
- 15% PAKISTAN
- 7% WEST AFRICA
- 3% LATIN AMERICA
- 3% UNITED STATES
- 19% MULTI-GEOGRAPHY
OUR IMPACT TO DATE

$103M  96  189M  322  16  430K

CUMULATIVE INVESTED*  COMPANIES*  LIVES IMPACTED  LEADERS DEVELOPED  +ACUMEN CHAPTERS  COURSE SIGN-UPS

*SINCE 2001
Acumen invests pioneer and early growth capital where there is the biggest financing gap.

Risk capital is scarce for early-stage social enterprises. Acumen fills this critical "pioneer" funding gap.

Where most grants are given → Blueprint → Validate → Prepare → Scale

Where most impact funds invest
This is Sam and Ned. In 2007 they set out to eradicate kerosene.
INVESTING TO SCALE: D.LIGHT DESIGN
INVESTING TO SCALE: D.LIGHT DESIGN

200K

2008

$1M equity

= 250,000 LIVES
INVESTING TO SCALE: D.LIGHT DESIGN

2008
200K
$1M equity

2010
1.3M
$575k equity

= 250,000 LIVES
INVESTING TO SCALE: D.LIGHT DESIGN

- 2008: 200K, $1M equity
- 2010: 1.3M, $575k equity
- 2012: 6.5M, $528k equity

1 lantern = 250,000 lives
INVESTING TO SCALE: D.LIGHT DESIGN

- **2008**: 200K
  - $1M equity

- **2010**: 1.3M
  - $575k equity

- **2012**: 6.5M
  - $528k equity

- **2014**: 26M
  - $1.8M equity / debt

Each light kit represents 250,000 lives.
INVESTING TO SCALE: D.I.G H T D E S I G N

$3.9 M INVESTED

22 M TONS OF CO2 OFFSET

Source: d.light
INVESTING TO SCALE:
D.LIGHT DESIGN

$3.9M
INVESTED

$5 Billion
IN FUEL SAVINGS
FOR THE POOR

Source: d.light
100 million
Questions?

You have two options to ask questions today:

1. Email us at: communities@stls.frb.org
2. Type your question into the chat box of the webinar
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• Investing in Digital Inclusion Under CRA:
  - Thursday, December 08, 2016
  - 2-3 pm CT/ 3-4 pm ET

• Presenters:
  - Joanne Hovis, CTC Technology & Energy
  - Jordana Barton, Federal Reserve Bank of Dallas
  - Cathy Gates, Board of Governors of the Federal Reserve System
Thank you to today’s presenters and to all participants for joining this session.

Next steps:

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It provides an array of practical resources to help you in your role as a CD professional, whether your work involves supporting people, places, the practice of CD, or small business development.