AN ADVISOR'S NO-NONSENSE GUIDE TO IMPACT INVESTING

We've answered some of the most commonly asked questions to help you deliver impact investing solutions for your clients.

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The essentials

What is impact investing?

Impact investing is an investment made with the intent to generate measurable, beneficial social or environmental impact alongside financial return.

Return expectations are an important element that distinguishes impact investing from philanthropy. Impact funds and enterprises have a mechanism for generating revenue, with the goal of returning capital — and then some — to investors.

Why should an advisor care about impact investing?

Advisors that we work with tell us they are surprised at how quickly client demand for impact investing has grown. Indeed, 45% of all high net worth (HNW) investors say they own or are interested in making impact investments. Impact investing can be a notable differentiator or entry point in establishing a relationship with HNW prospective clients.

In addition, given the personal nature of impact investing, we also hear that it helps cultivate a more personal connection with existing clients and maintain stickier relationships.

One trend worth keeping an eye on is how younger investors are significantly outpacing their counterparts in impact investing interest and participation. Millennials are nearly three times more likely to be actively involved in impact investing than their Baby Boomer counterparts. And nearly all Millennials (92%) have a positive impression of impact investing (compared to just over half of Baby Boomers). As wealth transitions over the next decade, advisors will likely see a notable uptick in impact investing demand. 59% of Next Gen wealth inheritors say it's vital that their advisor understands their values and customizes a portfolio centered around their impact.

How do impact investments perform?

Recent market research shows that funds targeting risk-adjusted, market-rate returns have largely met expectations across asset classes.

Some impact investments may intentionally prioritize impact over risk-adjusted, market-rate returns. We categorize these opportunities as "impact-first" investments.

Both are prevalent in the impact investing landscape. About two-thirds of the opportunities featured in CapShift's Research Engine are comprised of market-rate investments; a third is "impact-first" investments. (As of January 2024).

What investment products are included in "impact investing", and what investment products are not?

Impact investments are available across asset classes, sectors, and geographies. These investments span funds from institutional managers to direct investments into young businesses.

In terms of what qualifies, you can think of "impact investing" as comprised of "impact" and "investing" (a no-brainer, we know).

When it comes to "impact," **intent** (i.e. a social or environmental mission) and **measurable outcomes** are the two boxes an impact investment must check. On the other hand, as investments, these opportunities should target the **repayment of capital** — at minimum — and **additional returns** to investors. This sets impact investments apart from charitable activity, which has no expectation of investment returns.

Is impact investing the same thing as ESG?

ESG (Environmental, Social, Governance) is a risk mitigation approach employed in public equities investing that considers the material risks related to "E," "S," and "G" factors in security selection and portfolio construction. Take, for example, a fund that omits fossil fuel exposure given the risks and market transformations presented by climate change.

Most ESG funds **do not**, in our opinion, qualify as impact investments, given the latter's criteria of established intent and measurable impact.

However — in an analysis of over 300+ funds — we found that a small group meets the bar for authentic impact in public markets. Generally, they incorporate at least one of these four strategies: shareholder advocacy and active engagement, investment in solutions-oriented companies, measurement and reporting of specific impact outcomes, and deep or unique ESG integration.

What it means for your advisory practice

How much demand is there for impact investing?

79% of all investors are interested in sustainable and impact investing, according to Morgan Stanley; yet, less than a third of investors have been approached by their advisor on impact investing. Particularly worth noting, 45% of all high net-worth (HNW) investors say they own or are interested in making impact investments.

Doubling in size between 2019 and 2022, the impact investing market is estimated to be about $1.2 trillion as of 2022, according to a report published by the Global Impact Investing Network.

Also worth keeping an eye on is how younger investors are significantly outpacing their counterparts in impact investing interest and participation. Millennials are nearly three times more likely to be active in impact investing than their Baby Boomer counterparts. And nearly all Millennials (92%) have a positive impression of impact investing (compared to just over half of Baby Boomers).

If a client hasn't made a request, why does impact investing matter?

We notice that impact investing overlaps with three broader market trends relevant to advisors, particularly as they relate to high net-worth individuals.

1) **Client interest in private markets** has increased dramatically, nearly tripling to $12 trillion over the past decade. A key driver is the increase in HNW investors and family offices investing in alternative assets. It might not be a surprise, then, that 45% of high net-worth (HNW) investors say they own or are interested in making impact investments.
2) We're also observing a groundswell of interest and capital allocation in the **climate sector**. In fact, climate technology companies — alongside AI — took the majority of top venture deals in Q4 2023.
3) **Younger investors** are significantly outpacing their counterparts in impact investing interest and participation. Millennials are nearly three times more likely to be actively involved in impact investing than their Baby Boomer counterparts, with 92% expressing a positive impression of impact investing, compared to just over half of Baby Boomers. As wealth transitions over the next decade, advisors will likely see a notable uptick in impact investing demand.

How are impact investing capabilities and conversations driving client retention?

96.5% of high net-worth heirs fire their parent's financial advisors, with a fifth of them saying those advisors were "out of touch." Over the next two decades a total $72 trillion is expected to transfer to the next generation, with more than half ($35 trillion) expected from ultra-high and high net-worth households.

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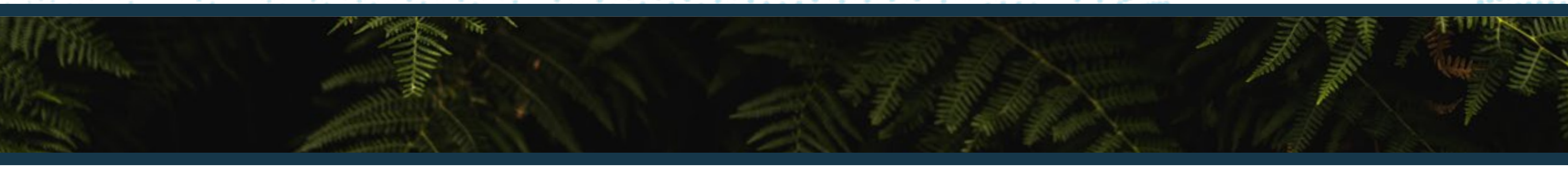

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What clients might be interested in impact investments?

Below are three types of clients that may be most suitable for introducing impact investments — and characteristics to look for.

Community and philanthropically oriented clients

- Have a donor advised fund (DAF) or family foundation
- Are active in their local or faith-based community
- Speak to you about year-end giving
- Skeptical of or disillusioned with traditional philanthropic vehicles
- Care about the world they are leaving behind for the next generation
- Serve as a board member of a local nonprofit

Clients with thematic interests

- Concerned about the effects of the climate crisis
- Have ties to or is passionate about the education system
- Invested in providing opportunities to historically marginalized groups
- Interested in technology/AI/innovation for global challenges
- Have a family member suffering from a specific medical condition
- Eager to support humanitarian crises

Lifestyle

- Conscious about products that align with their values
- Prioritize a healthy, sustainable diet or lifestyle
- Enjoy outdoor recreation and spending time in nature
- Appreciate different cultures or enjoys travel
- Have ties to or deep roots in a certain community, city, or geographic region

How might impact investing grow your practice?

Impact investing helps advisors **attract new clients** and **retain existing relationships** — particularly high net-worth and Next Gen ones.

45% of all high net-worth (HNW) investors say they own or are interested in making impact investments. Impact investing can be a notable differentiator or entry point in establishing a relationship with HNW prospective clients. Younger investors are also significantly more involved and interested in impact investing; for example, nearly all Millennials (92%) have a positive impression of impact investing.

Impact investing also allows advisors to support clients in areas that are deeply personal to them, maintaining stickier relationships. Indeed, 98% of current impact investors plan to maintain or increase the amount allocated; and nearly two thirds (62%) are very satisfied with their participation.

Nuts and bolts

What asset classes make up impact investing? What does impact look like in each asset class?

You can find impact investments across every asset class, from public equities to venture capital to private debt. Here are some examples:

- *Venture Capital:* A venture capital fund invests in companies that have the potential for gigaton-scale climate impact.
- *Private Equity:* Growth equity and buyout fund focuses on scaling education and workforce development companies targeting underserved communities.
- *Private Credit:* A debt fund extends low-interest loans to newly arrived refugee and asylee families to help them build credit in the U.S.
- *Public Equity:* Diversified strategy focuses on engaging with holding companies on sustainability, workplace development, and diversity and inclusion.
- *Real Assets:* A timberland fund that implements sustainable harvesting strategies and monetizes conservation easements.
- *Direct Investment:* A startup develops technology to produce lithium more efficiently, a key ingredient to batteries critical to supporting a transition to a lower carbon economy.

Is there a minimum amount of capital required to begin impact investing?

Impact investing in cash and public markets can be done at very low minimums, just like traditional depository accounts and public equity funds.

Some private fixed-income products have minimums that start at as low as $20. And Community Development Financial Institutions (CDFIs) — a way to invest in local communities — offer notes that can be accessed at a thousand dollars or less.

Other private-market impact investments, such as venture capital or private equity funds, tend to have investment minimums starting at two hundred and fifty thousand dollars or higher.

What's an example of a successful impact investment?

The first Elevar Equity Fund is a good example of a successful and fully matured impact investment fund.

Elevar Equity invests growth capital specifically in entrepreneurs that tackle the intersection of inclusivity, affordability, and scalability. Its first fund, vintage 2006, invested in seven budding institutions targeting financial access for historically marginalized communities — helping them grow into high-capacity, regulated finance companies.

The fund returned 44% IRR to investors; Elevar supported companies have reached more than 20+ million end-customers to date through its portfolio focused on financial access, affordable housing, education, and more.

What is impact measurement, management, and reporting? How do I use this in practice?

In one sentence — impact measurement and reporting measure and communicate the social and environmental outcomes of an investment.

This exercise of measurement and reporting builds trust by offering evidence that the intended benefits are being realized. Importantly, it can deepen satisfaction and interest in a clients' purpose-driven investment.

For example, a green infrastructure fund might measure its portfolio companies' total emissions averted, energy produced renewably, and jobs created. Its impact report might share its approach, framework for measurement, and metrics collected.

In fact, over three-fourths of investors who make impact investments report that their investment's impact (88%) and financial (79%) expectations are being met or exceeded. Impact reporting is often used as an engagement tool to spotlight the successes of the investment.

What's an easy way to understand the landscape of impact themes?

The impact landscape can seem overwhelming — with opportunities stretching from sustainable aquaculture to education technologies.

However, there's a simple, broadly recognized framework for identifying categories of impact investments: the United Nations Sustainable Development Goals. The 17 goals, adopted by all UN member states in 2015, is a shared blueprint for progress towards a more sustainable and prosperous global future.

Impact investments often self-identify which goal(s) they contribute to; thus, this framework is a great starting point to identify your client's impact goals.

What's the difference between ESG, SRI, and CSR?

ESG (Environmental, Social, Governance) is a **risk management framework** employed in public equities investing that considers the material risks related to "E," "S," and "G" factors in security selection and portfolio construction.

SRI (Socially Responsible Investing) is an **investment philosophy** that takes into account ethical considerations. Many SRI strategies incorporate screens to filter out holdings commonly associated with addictive substances, weapons production, environmental harms, etc.

CSR (Corporate Social Responsibility) is a **business approach** whereby companies see their role as contributing to the well-being of planet and people, in tandem with their economic interests.

Client interest themes

What are the most popular themes in impact investing?

Some of the most common areas of interest our clients cite include:

- *Climate:* Pioneer new technologies to mitigate carbon emissions and help communities adapt to the effects of the climate crisis.
- *Equity & Inclusion:* Promote fair systems and equal opportunities, particularly for overlooked groups.
- *Healthcare:* Enhance health outcomes through breakthrough innovations and ensure equitable access to services for everyone.
- *Local Investing:* Build up small businesses and local economies that serve as the foundation of thriving communities.
- *Sustainable Agriculture:* Support farmers and agricultural innovations advancing soil health, regenerative systems, and food security.

How could a client get started if they're interested in investing locally?

Many clients interested in supporting their community start with an allocation to a community development financial institution (CDFI).

CDFIs can be banks, loan funds, or private equity funds that support local small businesses, development of affordable housing, and other community facilities and services. Most are anchored in place, knowing the communities they serve intimately. These organizations have a long track record of adding value to the communities they serve.

CDFIs tend to be a popular choice for first-time impact investors because of their accessibility, with investment minimums of $1,000–$10,000, easy-to-understand products like notes and FDIC-backed depository accounts, and variety in focus areas.

What are the ways I can help a client passionate about racial equity and justice integrate this goal into their portfolio?

CapShift's Racial Justice Framework — developed with the help of TheCaseMade — identifies three categories of equity-focused investments:

- *Diversity and Inclusion:* Investment opportunity intentionally seeking or supporting diversity and inclusion in employees, ownership, customers, and beneficiaries.

  Example: A private equity firm focused on addressing training gaps in healthcare and technology, with an initiative focusing on employees of traditionally overlooked backgrounds.

- *Racial Equity:* Opportunities creating pathways for BIPOC (Black, Indigenous, and People of Color) communities to thrive. They support longer-term outcomes that level the playing field.

  Example: A loan fund providing BIPOC-owned small businesses in the South with flexible, low-cost funding.

- *Racial Justice:* Investments driving systemic change — a necessary precondition for true racial justice —, reshaping the pattern of historical underinvestment in BIPOC communities.

  Example: A cooperative that gives historically marginalized communities control over how to invest non-extractive funding.

What is the common climate investing approaches a client might adopt?

Based on feedback from dozens of families, we found that three commonly pursued goals for climate investing are mitigation, resiliency, and alpha:

- *Mitigation:* Reduce, prevent, or remove heat-trapping greenhouse gas emissions in the atmosphere, addressing the root cause of warming. Examples include renewable energy, electric vehicles, and biofuels.
- *Resiliency:* Help vulnerable communities and economic systems adapt to the impacts of climate change, reducing potential risks and damage. Examples include sustainable small-scale agriculture, smart electric grids, and flood-resistant water infrastructure.
- *Alpha:* Boost investment returns and reduce volatility by mitigating climate-related risks and investing in climate opportunities. Examples include fossil-fuel-free private portfolios, electric vehicle infrastructure, and carbon credit generation.

For more information, consult our primer on climate investing.

Trending topics

What should I make of the recent ESG critiques?

Over the last two years, use of ESG (Environmental, Social, Governance) data by fund managers has become a hot-button issue in the US political sphere, with stances largely split across party lines. While it has become a politicized lightning rod, we view ESG as a relevant risk management framework employed in a market environment increasingly influenced by the climate crisis and public scrutiny towards corporations.

But we also agree that not all ESG products are cut from the same cloth; the ESG landscape is broad, and we see many asset managers charge higher fees for minimal ESG integration. Investors have grown weary of these types of disingenuous products, as evidenced by the $2.1 billion in outflows in the third quarter from iShares ESG Aware MSCI USA ETF, which only uses basic ESG screening to build its portfolio.

We think this is a good thing — investor scrutiny, as well as increased regulatory oversight deepens the rigor of ESG frameworks.

Of course, the quality of the strategy and its integration makes all the difference. In our analysis at CapShift, we evaluate the authenticity of the strategy — including its thesis, voting, shareholder advocacy, and more — as well as fees and fund performance indicators.

Our outlook is that — despite loud anti-ESG campaigns — sustainable funds will continue to be attractive to investors because they capture important macroeconomic trends like decarbonization, energy transition, workforce transformation, and proper governance.

What is impact- and green-washing? Should I be worried about it?

Impact-washing and green-washing are when organizations or funds overstate or falsely claim an investment's positive impact on the environment or society. It can be done **intentionally** to attract investor capital or may occur **unintentionally** due to inadequate resources and expertise.

Impact- and green-washing can erode client confidence, underscoring the importance of thoughtful sourcing and diligence, as well as measurement and reporting.

As an advisor, you can combat impact- and greenwashing in the following ways:

1) **Assess impact strategy and transparency in sourcing and diligence.** Before the investment is made, advisors can evaluate the depth and rigor of impact integration by reviewing the theory of change, specific investment policies or strategies, and previous or expected reporting.
2) **Identify the organization's metrics and reporting.** Advisors can also explore the metrics the organization plans to report on (or already has). Do they make sense in relation to the strategy? Are there common industry frameworks — like the IRIS+ framework — integrated or third-party verification services used?
3) **Evaluate outcomes by comparing them against promises.** Continued monitoring after the investment is also important. Advisors can review progress against key milestones, as well as examine changes in key impact metrics.

Is impact investing more relevant for clients with philanthropic capital?

There are over a trillion dollars of charitable assets in the U.S., much of which is allocated to investments before being granted out.

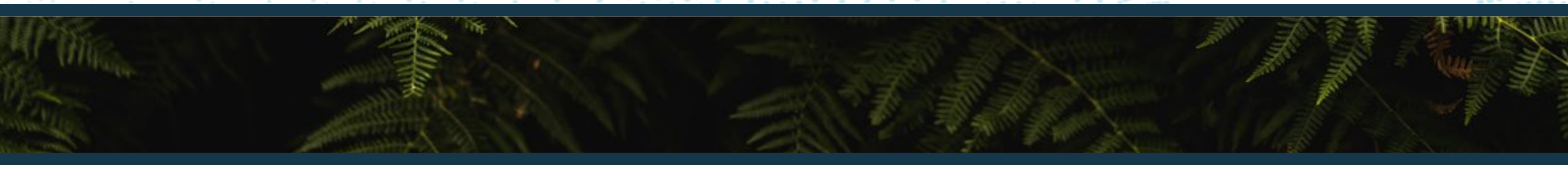
Only a small fraction of those assets is invested in impact. This means that at best, they are impact-neutral; in some cases, they may fund companies that directly conflict with the mission of the charitable capital. One example is a client interested in climate causes who may be unknowingly exposed to fossil fuel companies fighting against their climate efforts.

Impact investing allows clients to affect change over the lifetime of the capital, not just when it's granted out.

Many high net-worth individuals choose to align their investments to their philanthropic goals with their foundation or donor advised fund (DAF) assets. DAFs are giving accounts sponsored by community foundations, financial institutions, or specialized charitable organizations.

How might my client's political opinions impact their reception to impact investing?

You might be surprised to learn that political lean does not significantly affect interest in impact investing. Morgan Stanley's report surveying 1,000 investors found that 82% of very conservative investors, 84% of moderate investors, and 94% of very liberal investors reported being very or somewhat interested in impact investing.



CapShift empowers advisors who work with us to deliver impact investing to their clients — every step from navigating client conversations to investment diligence.

Get started with us.

ABOUT CAPSHIFT

Designed to scale, CapShift is the backbone of impact investing solutions across many of the world's largest financial, charitable, and corporate institutions. Our comprehensive platform ssupports our partners at every step - from client interest to allocation. Rely on our expertise and technology to find opportunities, engage clients, and invest easily.

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