

## An Overview of Impact Investing

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November 2010

*Impact investing is a proactive approach to investing that seeks to solve social and environmental challenges through direct investment in private companies, projects and funds, while also earning a relatively attractive financial return. It is this notion of making it financially attractive to solve social issues that is intriguing a growing number of institutional investors globally, starting with those whose raison d'être already has a social and/or environmental inclination. Developments in this area overall are farthest ahead in the U.S. and the U.K. and are being watched closely by Canadian investors. This paper is intended as an introduction to impact investing for institutional investors in Canada. In addition, we provide examples of various impact investment initiatives, as well as a bibliographical list for further reading.*

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## What is Impact Investing?

Impact investing aims to address deficiencies in the *status quo* in an attempt to solve some of the world's most pressing social and environmental issues, such as accessible education, clean water, health care and the supply of adequate food. It stems from the realization that existing systems for foreign aid, philanthropy, charity and government intervention are inadequate.

Impact investing is the evolution of socially responsible investing (SRI). It goes beyond screening investment portfolios for defined environmental, social and/or governance (ESG) criteria, or trying to influence corporate behaviour through shareholder engagement. It is an even more proactive and comprehensive approach that seeks to solve social and environmental challenges through direct investment in private companies, projects and funds, while also earning a relatively attractive financial return. It is this notion of making it financially attractive to solve social issues that is intriguing a growing number of institutional investors globally, particularly among those whose *raison d'être* includes a social and/or environmental bent.

This paper is intended as an introduction to impact investing for institutional investors. It outlines the evolution of impact investing and some recent developments in the field. In addition, we provide examples of various impact investment initiatives and a bibliographical list of further reading.

### Investing Outside of Public Markets

The term "impact investing" was coined by the Rockefeller Foundation and is defined as "...capital that is placed outside of public equities markets and generates social and environment value in addition to financial return."<sup>1</sup> For Antony Bugg-Levine, Managing Director of Impact Investing at the Foundation, the numbers make a non-traditional approach necessary, "The math is simple: the capital required to solve all of the world's problems is in the trillions. However, private giving is just a few hundred billion globally and foreign aid contribution is currently at \$150 billion. There is major gap, but also a \$50-\$100 trillion dollar opportunity by tapping into global (for-profit) capital markets."<sup>2</sup>

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<sup>1</sup> Rockefeller Foundation, as cited in "Frequently Asked Questions" section of the Impact Reporting and Investment Standards web page, accessed September 4, 2010 <<http://iris.thegiin.org/faq>>.

<sup>2</sup> Jagelewski, page 1.

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“It makes no sense to use 5 percent of your assets to try to promote something, while the other 95 percent might be doing something totally contrary ... We try to use 100 percent of our assets to promote our values.”

Victor De Luca, President, Jessie Smith Noyes Foundation, 2003

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The emergence of impact investing coincides with a desire among donors for greater accountability from the organizations they support and closer ties to the causes they fund. These donors-cum-investors are asking for metrics: information about specific goals and measurements of social impact.

Impact investing brings together philanthropists (who typically use grants as a way to fulfill their mission) and a growing group of social investors (who may have similar missions but also expect a financial return), all wanting to do more than simply disburse the financial returns from their assets portfolios. The thinking is that they can achieve considerably more impact by also directing their mainline investment activities (i.e., the investment activity within those portfolios), to pursue both financial AND social/environmental goals. This idea resonates with organizations that are dedicated to social or environmental change, as well as others like corporations with corporate social responsibility (CSR) programs.<sup>3</sup> As awareness builds about opportunities that combine economically reasonable returns with meaningful social/environmental change, demand could grow not only for products and solutions, but also for intermediary services that source opportunities as well as monitor, measure and correlate the full range of financial and non-financial outcomes.

Pioneers in this field who are located in the U.S. and the U.K. are credited with generating a momentum that is also gathering nascent strength within investment and philanthropic circles in smaller countries like Australia and Canada. Outside our borders, new investment opportunities are arising in many asset classes. In fact, as it evolves, impact investing seems to be enveloping many established types of social finance, including microfinance and community investing. The common element is that the investments seek to have an intentional and clearly articulated social/environmental impact. Thus, investments that unintentionally may achieve similar results are not considered to be impact investments.<sup>4</sup>

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<sup>3</sup> Impact investing, though, should not be confused with CSR programs, which operate on a budget allocated by a company and make grants or run programs.

<sup>4</sup> Bridges Ventures and The Parthenon Group, page 3.

Impact investing aims to balance risk and return with the level of social and/or environmental impact, seeking to deliver community-based solutions of a scale that donations cannot. In this way, it aims to harness the power of investments in profitable business models for societal good and that is what attracts a myriad of investors from high-net-worth individuals and families to pension plans, corporations and foundations.

The actual definition of an impact investment is also evolving, making it difficult to pin down market size and potential. Many critical questions remain, including whether achieving greater scale will compromise either social/environmental impact or financial returns. Long term, there are questions as to whether the movement will be of sufficient scale and force to thrive and attract more mainstream investors, or whether it will draw only the committed few. Monitor Institute has succinctly outlined potential risks and challenges for impact investing in its study entitled, *Investing for Social & Environmental Impact*.<sup>5</sup>

## Evolution of Social Investing

Social finance has origins at least as far back as the mid-1700s (when the Quakers prohibited members from participating financially in the slave trade) and, over time, religious groups have actively continued to promote social values through investment. In the latter half of the 1900s, political, labour and then environmental concerns also became key drivers for socially-conscious investors. The rise of ethical investing in the 1980s added further momentum, as did a proliferation of CSR programs. These new approaches challenge the prevailing notion, articulated by Milton Friedman and others, that the sole responsibility of companies (and goal of investors) is to maximize financial returns.<sup>6</sup> Unlike Friedman, social investors and businesses increasingly believe they can contribute to the betterment of society and promote sustainable environmental practices, while also doing well financially.

Since the 1980s, SRI has focused on screening investments to avoid companies whose business practices do not align with the investor's criteria and favouring companies whose practices do; encouraging corporate responsibility through shareholder activism; and exercising proxy voting rights as a way to influence corporate practices and products. As SRI has evolved, a myriad of terms has developed among which readers may

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<sup>5</sup> Monitor Institute, 2010.

<sup>6</sup> See for example, Friedman, Milton. "The Social Responsibility of Business is to Increase its Profits." The New York Times Magazine, September 13, 1970. Accessed November 11, 2010 <<http://www.colorado.edu/studentgroups/libertarians/issues/friedman-soc-resp-business.html>>.

recognize “ethical investing”, “best-in-class screening”, and “values-based investing”. While screening and ESG criteria have played significant roles in social investment, initiatives that are more locally-focused also exist, such as, community investing, which usually involves economically-targeted investments (ETIs)<sup>7</sup> that channel money to community-focused entrepreneurs and enterprises through local institutions like community development banks, credit unions or venture capital funds or venture loans.<sup>8</sup> Another approach by social investors focuses on aligning investment activities with an area of personal interest as in “mission-based investing” (MBI) and “program-related investing” (PRI). Approaches like “double- and triple-bottom-line-investing” explicitly give comparable prominence to financial and social/environmental objectives.

Microfinance, mentioned earlier, gained momentum through the latter half of the 1900s and into the 2000s and aims to promote socio-economic development at the local level by providing loans to poor people. These loans are usually small and are accompanied by a repayment plan that is intended to deliver a modest return to the lender. As such, microfinance directs funds to social enterprises and fostering economic activity among the poorest elements of populations in an effort to empower them and help them be better able to handle crises and adversity.

Jed Emerson, former Managing Director of Integrated Performance at Uhuru Capital Management, believes that there is great opportunity in bridging the gap between traditional for-profit investment and ‘give-it-away’ philanthropy. He devised the term “blended value investing” in 2003 to describe the combination of investment and philanthropy.<sup>9</sup> As he sees it, blended-value investments offer a range of risk-reward profiles and different types of social and environmental value creation globally, while also seeking positive financial returns.

Increasingly, impact investing is understood to envelop this myriad of investment activities with social and environmental purpose that also delivers some element of financial reward.

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<sup>7</sup> Shareholder Association for Research & Education, page 11.

<sup>8</sup> Strandberg and Cameron, pages 6-7.

<sup>9</sup> Godeke and Pomares, page 9.

## Types of Impact Investors

Impact investors are a diverse group, albeit united in their desire to effect social or environmental change. Monitor Institute's Jessica Freireich and Katherine Fulton have segmented impact investors based on their investment objectives:<sup>10</sup>

### Impact First Investors

Impact First investors target social or environmental good as their primary objective, above achieving a financial return. This may mean accepting a lower-than-market rate return in order to reach tougher social/environmental goals that are seemingly not achievable through mainstream investment or even philanthropic activities. Because of their somewhat more altruistic vantage point, Impact First investors are also often willing/able to invest in more innovative products. Investors in this group include the Bill & Melinda Gates Foundation and F.B. Heron Foundation. Among the challenges for this group is how to measure the value derived from their social investment relative to the discount they may have to accept on their financial returns. In response to the notion of the foregone opportunity cost, several impact ratings systems are being developed to enable investors to assess the social/environmental impact of investment options.<sup>11</sup>

### Financial First Investors

Financial First investors, by comparison, prioritize the financial return objective over the nonetheless desirable social/environmental objective(s). This group tends to include commercial investors searching for investments that offer close-to-market-rate returns and also yield social or environmental good. Among the investors in this group is JP Morgan Urban Renaissance Property Fund, which pools investors' capital and directs it to the development or redevelopment of real estate projects in affordable and workforce housing, retail and other real estate sectors.<sup>12</sup> The challenge this group presents to the impact investment movement is that certain areas (like clean technology) are a better fit with traditional market mechanisms and may attract disproportionate amounts of socially-friendly capital, in effect diverting capital away from other areas of need, like poverty, health care and issues associated with disadvantaged people of various backgrounds. Furthermore, the focus on financial objectives may diminish the understanding of the social impact being achieved and may take away from the achievements of impact investing more generally.<sup>13</sup>

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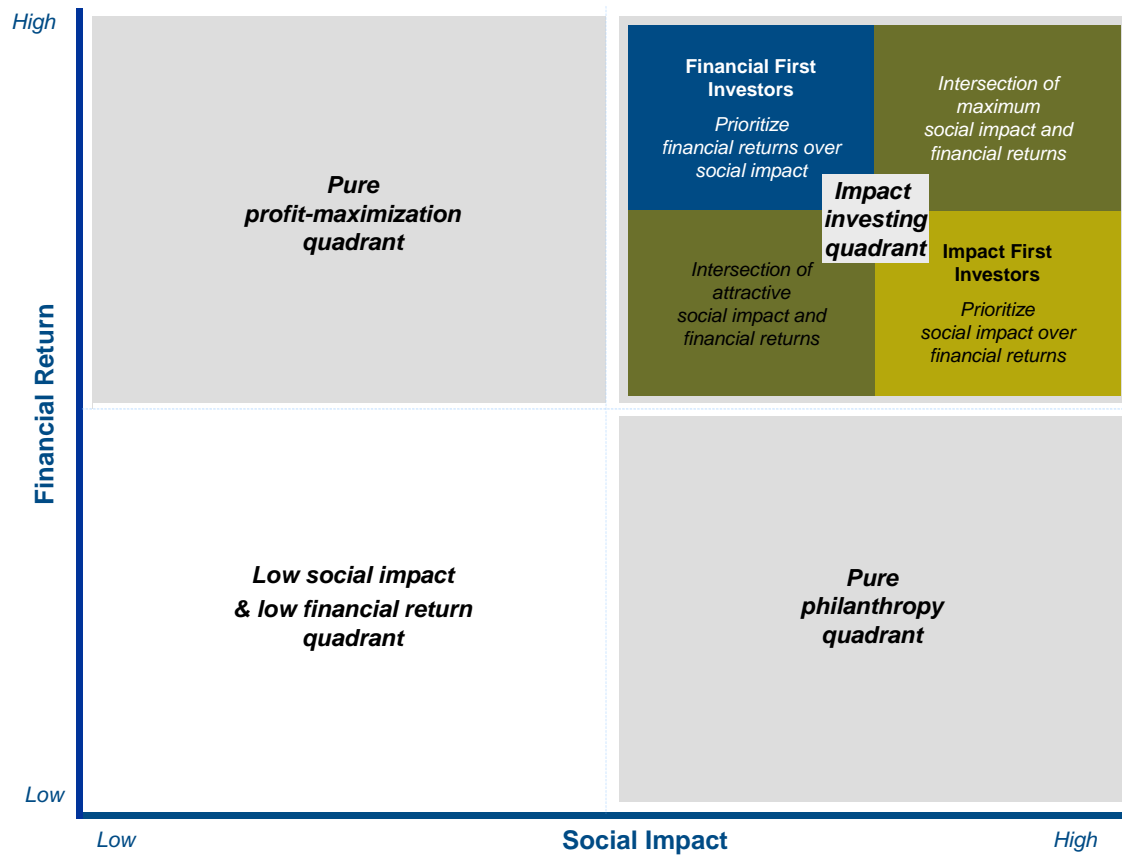
<sup>10</sup> Monitor Institute, -pages 31-32.

<sup>11</sup> See *Development of Infrastructure, Tools and Standards* section of this paper.

<sup>12</sup> Bridges Ventures and The Parthenon Group, page 23.

<sup>13</sup> Monitor Institute, page 38.

**Chart 1: Impact Investing in the Context of Desired Outcomes<sup>14</sup>**



<sup>14</sup> Chart concept borrows from the Monitor Institute's segmentation, as illustrated in Monitor Institute, page 33.

## Types of Impact Investments

Opportunities in impact investing span a range of asset classes and geographies, as well as risk-adjusted financial return possibilities. A few examples are included below, with a more detailed list provided in Appendix One.

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“The majority of Impact Investment is no longer composed of microfinance loans or equity investments in cleantech start-ups. It is moving far beyond the quoted asset class in which Socially Responsible Investment (SRI) has its roots. Whether through sustainable forestry or cash lending to community development banks, investors have more choice than ever to diversify their portfolios ... across all asset classes that provide investors with numerous options to trade off among risk, return and level of impact.”

Bridges Ventures and The Parthenon Group, March 2010

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### Deposits

*Money in a cash account with a bank or similar institution, that pays a rate of interest (typically relatively low) and from which withdrawals can usually be made on demand.*

**In Canada,** VanCity’s Shared Growth Term Deposit earns a guaranteed, competitive interest rate, just like any other term deposit but the deposited funds are used specifically to provide loans to projects aimed at improving the social and environmental well-being of local communities. The Deposits-funded projects currently include a women’s resource centre, some social service groups, a co-operative auto network and a co-operative organic farm. In fact, VanCity’s business model aims to promote community investment by all divisions.

**Outside of Canada,** ShoreBank Pacific in Washington State offers services that include full-service banking for residents, businesses and non-profit organizations in low- and moderate-income communities. The Certificate of Deposit Account Registry Service (CDARS) is a Federal Deposit Insurance Corporation-insured market rate deposit account that leverages account-holders’ deposits for mission-related investment activities.<sup>15</sup>

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<sup>15</sup> “Certificate of Deposit Account Registry Service” <<http://www.sbk.com/foundations/cash/cdars>>.

## Fixed Income

*Fixed income generally refers to a loan by an investor to a recipient who pays a pre-determined rate of interest at intervals during the life of the loan and, at the end of the loan's life, repays the principal to the investor. Fixed income products (bonds) are usually rated for quality. Lending for social purposes may be perceived as risky (i.e., of lower quality) because it may not fit the financial criteria of status quo lending metrics.*

**In Canada**, the BeaLight Foundation, a private foundation in Ontario dedicated to promoting social entrepreneurship, has made approximately fifteen 5-year loans to owners in a for-profit car service franchise network that hires people who face employment barriers. Interest rates are tied to the number of social hires, starting at 9% and reduced incrementally to 5% as agreed upon targets of social hires are met.<sup>16</sup>

Edmonton Community Foundation has made several interest-paying loans to registered charities for specific social purposes, including a \$289,000 (CAD) loan at 6% for one year (now repaid) to purchase real estate for a charity's social enterprise. The Foundation also made a \$500,000 (CAD) loan at 5% for one year to an affordable housing agency.<sup>17</sup>

**Outside of Canada**, the Mississippi Development Bank issued an insured AAA-rated Taxable Special Obligation Bond in 2007 to finance the acquisition and development of a property by Toyota to build a new plant thus creating 10,000 jobs in an underinvested region. In return, Toyota set aside 15% of the construction budget to work with local minority-owned firms and donate \$50 million (USD) to the local school district. The bonds attracted impact investors because of both their market rate and social return.<sup>18</sup>

## Real Estate

*Real estate investing means purchasing physical properties with the intention of earning a financial return through rental income and property value appreciation and/or, for social investors, achieving other social/environmental or socio-economic objectives.*

**In Canada**, Alterna Community Alliance Housing Fund is a partnership with Alterna Savings, the Public Service Alliance of Canada (PSAC) and The Ottawa Community Loan Fund. These three organizations recently partnered to address Ottawa's affordable housing shortage. The funds are to be used to build, maintain or expand affordable housing projects in the National Capital Region.<sup>19</sup> While the actual amount of money invested is relatively small (\$2 million (CAD)), it demonstrates that impact investing is within reach of smaller institutional investors.

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<sup>16</sup> Strandberg (2010), page 4.

<sup>17</sup> Strandberg (2010), page 5.

<sup>18</sup> F.B. Heron Foundation, page 18.

<sup>19</sup> SHARE, page 12.

**Outside of Canada**, Preqin alternative asset research firm reports that nine environmentally/socially responsible private equity real estate funds have closed after raising \$1.5 billion (USD); and that another nine funds are seeking commitments of \$2.2 billion (USD) for social investment purposes.<sup>20</sup>

## Hybrid Investments

*Hybrid investments generally refer to investments that do not exactly fit the true definition of classic investment vehicle. Quasi bonds would be such an example, an investment vehicle that has many of the characteristics of bonds but not all.*

**Outside of Canada**, social impact bonds (SIBs) are being touted as a new investment vehicle. The term ‘bond’ is something of a misnomer in this context as there is no guarantee to repay the principle, although repayment may be linked to attendant impact-related hurdles. In March 2010, the British government announced a 6-year pilot scheme to direct monies from private investors to help reduce reoffending by minor offenders. Investors provide the money needed to engage experienced third-party social service providers to deliver intensive support services both in prison and after when offenders resettle in the community. If reoffending is reduced by at least 7.5% over the bond's life, the investors will share in the government's long-term savings.<sup>21</sup> One of the service providers in the pilot project says, "The creation of Social Impact Bonds to fund preventative work like ours is a ‘win, win, win’ situation. Society wins as there are fewer victims of crime, the tax payer wins as less money is spent on prisons and clients win because they are given the chance to turn their lives around."<sup>22</sup> Moreover, investors win by achieving a social good while pursuing a financial return.

## Note about Guarantees

*Guarantees (or backstops) may be provided by governments, corporations or philanthropic organizations and may help boost the credibility and therefore credit-worthiness of a social initiative. Third-party guarantees help illustrate the important role partnering can play in making impact investments attractive to mainstream investors.*

**Inside and outside Canada**, third-party guarantees are an important tool that can mitigate the credit risk of the borrowers. WaterHealth International in India, for example, was able to negotiate a loan guarantee in 2004 with India's second largest commercial bank, ICICI, using equity investments from supporting organizations like Acumen Fund.<sup>23</sup>

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<sup>20</sup> Preqin blog posting, October 30, 2009. Accessed November 12, 2010  
<<http://www.preqin.com/blog/101/1773/responsible-private-equity-real-estate-funds>>.

<sup>21</sup> As described on the Social Finance web site, accessed September 4, 2010  
<[http://www.socialfinance.org.uk/services/index.php?page\\_ID=15](http://www.socialfinance.org.uk/services/index.php?page_ID=15)>.

<sup>22</sup> Rob Owen, Chief Executive of the St. Giles Trust, as quoted in Social Finance's press release of March 18, 2010 announcing the Peterborough Prison SIB pilot project.

<sup>23</sup> Bugg-Levine and Goldstein, page 37.

**Chart 2: Investor Initiatives by Asset Class**

<b>CANADA</b>		<b>Financial First</b>	<b>Impact First</b>	
<b>Asset Classes</b>	Cash		Vancity deposit products	
	Debt	Ottawa Community Loan Fund Insurance Corporation of BC	Central One Credit Union of BC Jubilee Fund	
	Mezzanine/Quasi Equity	Société de capital de risque autochtone du Québec (SOCARIAQ) Sarona Frontiers Markets Fund 1 LP		
	<b>Alternative Instruments</b>	Venture Capital	Vancity Capital Corporation	
		Private/Growth Equity	CAPE Fund	
		Real Estate	Alterna Community Alliance Housing Fund	Jubilee Fund
		Absolute Return (Hedge Funds)		
	<b>INTERNATIONAL</b>		<b>Financial First</b>	<b>Impact First</b>
<b>Asset Classes</b>	Cash	ShoreBank Pacific	Charity Bank	
	Debt	The Dexia Micro-Credit Fund IFFIm	Root Capital Calvert Community Investment Notes	
	Mezzanine/Quasi Equity	Triodos Climate Change Bonds	Bridges Ventures Social Entrepreneurs Fund KL Felicitas Foundation	
	<b>Alternative Instruments</b>	Venture Capital	Bridges Ventures CDV Funds	Aavishkaar
		Private/Growth Equity	Equilibrium Capital Group	Acumen
		Real Estate	JP Morgan Urban Renaissance Property Fund	
		Absolute Return (Hedge Funds)	BelAir Sustainable Alternatives SRI Fund	

## The Growth of Impact Investing

Driven by the concern that governments and altruism cannot deliver sufficient resources, some opinion leaders and notable thinkers have reframed the challenge: it's not a shortage of money, but a need for innovation and intermediaries to redirect money that is already in circulation in the financial system to areas of need/concern by making it financially attractive to pursue social change and making it feasible to benchmark success. Karim Harji, of Social Capital Partners in Toronto, portrays the gap between the supply and demand for social capital as "...a misalignment between plentiful supply and plentiful demand."<sup>24</sup> And he asserts that before supply and demand can be matched effectively, intermediary functions must exist to promote projects, analyze and articulate the investment opportunities, provide operational support, and measure and monitor the outcomes, etc.

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"I think societies everywhere will come to the conclusion that an important part of the capitalist system is having a powerful social sector to address social issues, because government doesn't have the resources."

Sir Ronald Cohen, June 2010  
Chairman, Social Investment Taskforce  
and considered by many to be the father of British venture capital

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Some long-term investors are rearticulating their investment beliefs and philosophies to acknowledge their desire to address environmental and social issues. In recent years, Philanthropic Foundations Canada (PFC) and Community Foundations Canada (CFC) have joined forces to educate their respective members about community or mission-based investing. They have also made it a priority to understand which foundations in Canada already embrace impact investing and CFC has declared that impact investing will be a focus of their 2011 biennial conference.<sup>25</sup>

### Steps Taken by Governments

Generally speaking, a charity is only permitted to conduct business related to its expressed charitable purpose, thereby restricting the types of revenue-generating activities in which it may engage. Charitable status does not always suit social entrepreneurs who need to raise capital and fund their community-oriented initiatives.

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<sup>24</sup> Harji, page 5.

<sup>25</sup> Per Hilary Pearson, President & CEO, Philanthropic Foundations Canada.

In recent decades, thought leaders and philanthropists like the Clinton Foundation in the U.S. and Al Gore and David Blood's Generation Investment Management LP in the U.K., have sought to address a perceived gap between charitable entities and profit-maximizing entities. Their lobbying has helped convince politicians and regulators to provide vehicles and incentives to promote investment in social finance.

In the U.S., the Community Reinvestment Act (CRA) became law in 1977, requiring banks to meet the credit needs of all borrowers in their communities, especially in low- to moderate-income communities. This act is partially credited with encouraging lending to lower-income communities, although a favourable returns experience has also likely played a role.<sup>26</sup>

In 2005, the U.K. legislated a new type of corporate entity known as a community interest company (CIC), designed to overcome some legal issues faced by social entrepreneurs. A CIC is a limited liability company that can be private or public and has the ability to issue shares to raise capital. What distinguishes a CIC from other legal entities is that it exists to benefit the community, rather than the shareholders. They differ from charities in that they may be formed for any lawful purpose, whereas a charity may only be formed for a charitable purpose and is, as a result, regulated more stringently.

In 2008, the British Ministry of Justice published a National Strategy on The Third Sector to engage more effectively with that segment of the British economy. The goal of this strategy is to lead to more specific business-related planning and discussions aimed at building effective partnerships and to achieve common goals between government and the third sector.<sup>27</sup>

The State of Vermont passed legislation in 2008 to create the Low-Profit Limited Liability Company, or L3C. The L3C is also a hybrid non-profit and for-profit enterprise and aims primarily to achieve social benefits with profit-making as a secondary goal. The structure unites investors of many types with various tolerances for risk and it allocates expenses and income among them such that taxation occurs in the hands of the investor. As businesses, L3Cs usually serve social purposes that have some economic viability but also face difficulty in attracting capital because of their high risk, low return model.<sup>28</sup>

In July 2010, the U.S. government established the \$50 million (USD) Social Innovation Fund with the intent to engage a 3:1 public-private funds match to expand effective solutions in three key areas: economic opportunity, healthy futures, and youth development and school support.<sup>29</sup>

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<sup>26</sup> Kroszner, page 1.

<sup>27</sup> U.K. Ministry of Justice, page 3.

<sup>28</sup> Carter and Man, pages 6-7.

<sup>29</sup> <[www.nationalservice.gov/about/serveamerica/innovation.asp](http://www.nationalservice.gov/about/serveamerica/innovation.asp)>.

Two Canadian provinces have taken steps toward recognizing the value of social enterprise by introducing tax incentives: Manitoba with the Manitoba Community Economic Development Tax Credit and Nova Scotia with the Community Economic Development Investment Funds (Nova Scotia) and the Nova Scotia Equity Tax Credit. We also understand that Ontario is looking closely at legislating concessions to social investing, but there are currently only four community loan funds and one credit union micro-credit program in this province.<sup>30</sup>

## Development of Infrastructure, Tools and Standards

There is an evolving infrastructure of intermediaries and standards in the United States and the United Kingdom that is being watched with interest in countries with smaller markets, like ours. The players are diverse and are drawn together with common purpose and in collaborative initiatives.

**Social return on investment (SROI)**, is a concept first defined by the San Francisco-based philanthropic fund REDF (formerly the Roberts Enterprise Development Fund) in the early 1990s as they attempted to compare social investments based on impact value in dollars.<sup>31</sup> Refinements have since been made to the process that take into account various social and environmental impact factors. In 2003, the U.K.-based think tank, New Economic Foundation (NEF), adapted this approach when evaluating their portfolio. In Canada, the SiMPACT Strategy Group has been actively working with funding agencies, non-profits and government agencies in evaluating their SROI to achieve maximum value from their social investments.<sup>32</sup>

The **Global Impact Investment Network (GIIN)** is a more recently formed group working to deliver some of the infrastructure necessary for impact investing to gain traction with investors.<sup>33</sup> GIIN had its genesis informally in October 2007 at the Annual Clinton Global Initiative and was formally constituted in June 2008 at a meeting of 40 institutional investors to discuss the opportunities and challenges of the industry. The group included the Bill and Melinda Gates Foundation, E+Co, the Rockefeller Foundation and JP Morgan Chase & Co. In 2009, GIIN members built the **Impact Reporting and Investment Standards (IRIS)** – a common framework for defining, tracking and reporting on the performance of impact investments. IRIS is developing a system of common definitions and metrics to be applied across geographies and sectors of investment.

The **Global Impact Investing Ratings System (GIIRS)** is a tool to assess the social and environmental impact of companies and funds using a ratings approach similar to

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<sup>30</sup> Cameron, pages 13-15.

<sup>31</sup> <[www.redf.org](http://www.redf.org)>.

<sup>32</sup> <[www.simpactstrategies.com](http://www.simpactstrategies.com)>.

<sup>33</sup> Godeke and Pomares, pages 79-80.

Morningstar Investment Ratings or S&P credit risk ratings. The focus of GIIRS is to rate the impact of sustainability and mission-focused private equity and debt investments using a series of surveys focused on Leadership, Employees, Environment, Community and Products and Services. GIIRS will provide current and historical analyses of impact performance for both company and fund impact ratings using the IRIS definitions and metrics. Investors will be able to use GIIRS to access data for a target company or fund, benchmark the social and environmental performance or track the social and environmental impact of their investments. GIIRS makes impact investing more accessible to institutional investors and financial services intermediaries. For companies seeking mission-aligned growth capital, that is motivation to get a GIIRS rating.<sup>34</sup> Just recently, on October 4, 2010, GIIRS announced the 12 North American Pioneer Funds, which will be the first funds to receive GIIRS ratings.<sup>35</sup>

With the development of ratings systems, including the SROI model and the GIIRS, tools are emerging to standardize the measurement of social impact, making it easier to compare project to project and investments across regions, classes and portfolios. This coupled with broader sharing of information about projects and products is leading to greater understanding and market acceptance by more mainstream investors.

Alongside the development of ratings systems, U.S.-based B-Lab has been working on a certification program known as '**B Corporation**' (or 'Benefit' Corporation) since 2006. A B Corporation is a designation that identifies businesses as being socially responsible and provides an assessment of the business's level of social responsibility. B Corporation status lends credibility and may attract capital inasmuch as it conveys a third-party approval rating.<sup>36</sup> Efforts are underway to gain preferred tax status for B Corporations. Since 2006, 285 companies in North America have earned the B Corporation designation — seven of them being Canadian. In April 2010, Maryland became the first state to sign B Corporation legislation designating preferential tax status to corporations that identify themselves as a 'Benefit Corporation' in their charter. Other states considering similar legislation include Vermont, Colorado, New York, North Carolina, Oregon, Pennsylvania, and Washington.<sup>37</sup>

## Challenge and Opportunity in Canada

Today, the social investment industry in Canada is structured with philanthropy and profit-maximization at the two ends of the financing spectrum.<sup>38</sup> The existing legislative, tax, legal and regulatory frameworks that have been developed over generations to

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<sup>34</sup> The Rockefeller Foundation, 2008.

<sup>35</sup> See press release: <<http://hosted.verticalresponse.com/445754/51e3270375/137096895/4e884af1e4/>>.

<sup>36</sup> B Lab, 2009.

<sup>37</sup> B Lab, 2010.

<sup>38</sup> Harji and Hebb, page 10.

support that reality presents hurdles for the development of new mechanisms better suited to impact investing. Structures have been legislated into existence in the U.S. and the U.K., as noted above, but Canadian entities still face challenges.

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Imagine the possibilities for our province [Ontario] and our nation.

We could help provide affordable, comfortable shelter for low-income families in Ontario through new housing projects. We could help start-up or growing small businesses make our communities more sustainable through green products and services, from solar panels to cleaning supplies. We could secure the sustainability or provide a platform for growth for larger, for-profit social ventures so they can scale their business and their ability to provide solutions to social and environmental problems at a local, regional or global level.

Adam Spence, Founder, Social Venture Exchange, April 2010

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Since impact investing is still very young in Canada, individual investors and advisors have struggled to find investment opportunities of sufficient scale to justify the fixed costs associated with sourcing, analyzing and monitoring outcomes.<sup>39</sup> Institutional investors interested in impact investing have to commit significant resources in order to conduct due diligence and craft their own deals, a significant hurdle for most investors, advisors and consultants.

Support from provincial and federal governments has been slow to materialize in developing frameworks to encourage more mainstream acceptance of impact investing. Canada does not yet have structures comparable to the CICs in the U.K. or the L3Cs in the U.S., complicating access to capital for social enterprise. The Canadian *Income Tax Act* does not allow investments in charitable organizations to include activities such as a social enterprise among eligible charitable activities. The Canadian Revenue Agency does permit some social enterprise activity by charities, but only within limits and with nowhere near the latitude permitted to charities elsewhere.<sup>40</sup> Currently, charitable organizations and public foundations may conduct business activities that relate to their purpose, but may not engage in unrelated businesses. Private foundations may not conduct any business activity, thereby reducing access by social enterprises to this source

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<sup>39</sup> Monitor Institute, page 21.

<sup>40</sup> Carter and Man, page 3.

of capital – a source that, philosophically, is generally predisposed to funding social and environmental projects.<sup>41</sup>

In order to proceed, some charities have begun to utilize an intermediary entity (such as a for-profit company, a non-profit corporation or a business trust) as a means to carry on business activities that they would not otherwise be able to conduct. These structures demand resources, both financial and human to fit the “square peg” of impact investment initiatives into the “round hole” of the *status quo* legal and tax structures. Despite the challenges, there are 57 non-governmental MBI and community investment funds in Canada today, half of which receive capital from private investors.<sup>42</sup> More investment opportunities are being developed such as the Community Forward Fund, spearheaded by Nora Sobolov and modelled after the Non-profit Finance Fund (NFF) in the U.S. Similar to NFF, the Canadian Community Forward Fund is a loan and investment fund for charitable and non-profit organizations, providing services including financial advisory.<sup>43</sup>

Effective vehicles will be needed for impact investment proponents to entice mainstream Canadian investors. The Social Venture Exchange (SVX) is an example of an organization whose purpose is to develop an ethical financial market online that links investors with social venture opportunities via various financing vehicles.<sup>44</sup>

## Conclusion

Although impact investing offers a means by which to align beliefs with investments and deliberately pursue social or environmental as well as financial objectives, the impact investing marketplace with attendant systems, structures, participants and metrics is not yet sufficiently developed in Canada for it to gain widespread acceptance among institutional investors. That said, developments in the U.S. and U.K. may serve to demonstrate the possibilities for comparable developments in the Canadian context.

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<sup>41</sup> Carter and Man, pages 7-9.

<sup>42</sup> Strandberg and Cameron, page 8.

<sup>43</sup> <<http://communityforwardfund.ca/>>.

<sup>44</sup> About the Social Venture Exchange, <[http://socialventureexchange.org/?page\\_id=2](http://socialventureexchange.org/?page_id=2)>.

## Appendix One

### Examples of Impact Investing

#### Initiatives in Canada

Socially responsible investing has existed in Canada for decades in the form of investment screening, proxy voting and shareholder activism.

An example of a targeted investment vehicle created for institutional investors is the Ottawa-based, *Alterna Community Alliance Housing Fund*, a unique partnership between the Public Service Alliance of Canada (PSAC), Alterna Savings and The Ottawa Community Loan Fund. The PSAC Staff and Officers Pension Plan seeded this housing fund through a \$2 million (CAD) investment, which is held at Alterna Savings. Alterna ensures a market rate of return through 5-year guaranteed income certificates issued to the pension plan. The Housing Fund is used to supply low-cost, second mortgage financing for developers and other groups who want to build, maintain or expand affordable housing projects in the Ottawa region.<sup>45</sup>

#### British Columbia

A number of social investors in British Columbia have had and continue to have a positive effect in the betterment of many communities and the development of local businesses. One such institution is *VanCity Credit Union*, which offers two deposit products to VanCity community investment members: a local deposit product and a global deposit product. The investments earn slightly lower rates of interest and, through a partner organization, benefit low-income communities through credit availability in the credit union's service area or around the world. VanCity's Capital Corporation and Community Foundation also hold social capital portfolios and programs of mission-based investing. In addition, VanCity provides two micro-loan programs for small businesses and has established financing and support programs for businesses seeking to improve the environment through their products, services or internal practices.<sup>46</sup>

#### Alberta

The *Edmonton Social Enterprise Fund* was launched in February 2008 to serve the Edmonton community. The aim of the fund is to help non-profit organizations and co-ops create or expand strong business ventures or develop affordable housing. The Edmonton Community Foundation, City of Edmonton and United Way of Alberta Capital Region financed the fund with the goal to secure \$11 million (CAD) for loans and have the

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<sup>45</sup> SHARE, page 12.

<sup>46</sup> Strandberg and Cameron, pages 10-12.

repayments reinvested into the fund.<sup>47</sup> Loans range from \$50,000 to \$150,000 (CAD) for social enterprises and up to \$500,000 (CAD) for housing projects, with terms typically ranging from five to eight years. The decision-making process for disbursing funding takes into account whether a project is offering blended value returns – that is whether a project is financially sustainable and is able to yield social returns.<sup>48</sup>

### **Manitoba**

*The Jubilee Fund*, a community development loan fund, was designed to facilitate financing for community-based businesses, housing projects and social services in low-income Winnipeg neighbourhoods. Investors have the opportunity to purchase a Jubilee Investment Certificate of \$500 (CAD) or more, for a 3- or 5-year term, at 2% below regular term deposit rates. One of the key strengths of the program is its ability to raise private capital in partnership and thereby increase the overall impact potential for the community.<sup>49</sup>

### **Saskatchewan**

In Saskatoon, *The Quint Development Corporation* aims to strengthen the economic and social well being in five core neighbourhoods. Quint facilitates affordable housing loans for and is also concerned with neighbourhood revitalization, employment assistance and business development in these communities.<sup>50</sup>

### **Quebec**

In Quebec, an interesting multi-stakeholder partnership resulted in the formation of the *Société de Capital de Risque Autochtone du Québec (SOCARIAQ)*, also known as the Quebec Native Venture Capital Partnership. Five organizations, including the Quebec Federation of Labour, two Aboriginal Capital Corporations, the Native Benefits Plan and Desjardins, financed the SOCARIAQ, investing \$6 million (CAD) in an equity investment fund aimed at providing financing to new and existing businesses controlled by members of Quebec's First Nations.<sup>51</sup> The fund can be used to purchase all or part of a company or to provide various types of loans and aims to help strengthen the sustainability of Native communities.<sup>52</sup>

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<sup>47</sup> <[http://socialenterprisefund.ca/?page\\_id=2](http://socialenterprisefund.ca/?page_id=2)>.

<sup>48</sup> Causeway, page 8.

<sup>49</sup> Strandberg and Cameron, page 10.

<sup>50</sup> <<http://www.quintsaskatoon.ca/aboutquint.html>>

<sup>51</sup> Strandberg and Cameron, page 11.

<sup>52</sup> Government of Canada, *Update - Developments of interest to Aboriginal people* (Autumn 2002), page 1. Accessed November 11, 2010 <<http://dsp-psd.pwgsc.gc.ca/Collection/R2-209-2002-3E.pdf>>.

## Ontario

In Ontario, *Meritas Mutual Funds Inc.* has established itself as the only mutual fund in Canada committed to allocating 2% of their assets to community development investing (CDI).<sup>53</sup>

The *Ottawa Community Loan Fund* is also considered to be an impact investor. The fund aims to help more people become self-sufficient through self-employment and provides short-term loans of up to \$15,000 to small business owners, social enterprises, aspiring entrepreneurs, internationally trained professionals and community groups. This facilitates the access to loans that would otherwise not be available from traditional financial institutions.

*Social Innovation Generation (SiG)* “...seeks to engage partners across sectors to create a culture of continuous social innovation.”<sup>54</sup> To that end, SiG has launched a national collaboration with MaRS Discovery District, a centre dedicated to assisting science, technology and social entrepreneurs, and other key partners to develop Causeway – a group aiming to “...fast-track Canada’s adoption of social finance, ensuring there is a healthy social finance marketplace supported by mainstream financial institutions serving as a national constituency of social enterprises, social economy entities, community economic development institutions, cooperatives and social purpose businesses.”<sup>55</sup>

Additionally, in October 2010, SiG and MaRS launched the Task *Force on Social Finance*, an initiative that has been mandated to deliver recommendations related to the development of an investment marketplace dedicated to addressing social and environmental challenges in Canada.<sup>56</sup>

In February 2010, the *Social Investment Organization (SIO)* received a grant of \$90,000 (CAD) from the Ontario Trillium Foundation for a new project called “Impact Investing: a feasibility study for social enterprise financing.” The purpose of the grant is to investigate and develop the early stages of an investment vehicle that would make it easier for private capital to be invested in not-for-profit social enterprise ventures in Ontario.<sup>57</sup>

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<sup>53</sup> Strandberg and Cameron, page 12.

<sup>54</sup> [Our Work](http://sigeneration.ca/our-work.html) (Social Innovation Generation) <<http://sigeneration.ca/our-work.html>>.

<sup>55</sup> Causeway web site, accessed November 11, 2010 <<http://pages.socialfinance.ca/>>.

<sup>56</sup> <<http://socialfinance.ca/taskforce/>>

<sup>57</sup> The Ontario Trillium Foundation, news release February 9, 2010; and Social Investment Organization web site, accessed November 10, 2010 <[http://www.socialinvestment.ca/News&Archives/news\\_Feb2010\\_TrilliumGrant.htm](http://www.socialinvestment.ca/News&Archives/news_Feb2010_TrilliumGrant.htm)>.

## International Examples

### *United Kingdom*

Established in 2002, U.K.-based **Charity Bank** offers depositors a capital guarantee and a modest amount of interest through a variety of products. The bank uses 100% of the deposits to provide affordable loan finance and advice to enable charities, community associations, voluntary associations, community businesses and social enterprises predominantly across the U.K. to grow. Loans are made to organizations within the areas of social/health care, affordable housing, education, sustainable development and the arts.<sup>58</sup>

**Bridges Ventures** has two venture funds totalling £150 million, the first of which was launched in 2002. The firm has evolved its strategy to a balanced fund approach in which 25% is in early stage ventures, 25% is in buyouts of small and mid-sized enterprises and the balance is in businesses that have some form of asset backing, for example derelict buildings that are being refurbished. Bridges tracks the employment impact of their investments.<sup>59</sup> Because of superior performance, including a financial returns target for the fund and net of fees and losses of 3 to 5%, Bridges has been able to attract some very large asset pools such as Deutsche Bank.<sup>60</sup>

Founded in 2006, **Tridos Investment Management**, which offers its services to European Union member countries, launched an open-ended Renewables fund with a total committed capital of approximately £30 million. The fund generally takes significant minority stakes in small- to medium-sized renewable energy projects with proven technology.<sup>61</sup>

Another group called **Generation Investment Management (GIM)** represents an investor group of government agencies, foundations, high net worth individuals and institutional funds. GIM manages approximately \$3.5 billion (USD) through their Global Equity Strategy and Climate Solutions Fund. In 2008, the U.K. Environment Agency selected GIM to manage £50 million of its £1.5 billion Active Pension Fund. The fund's targets are to outperform the MSCI World Index by 9 to 12% over three years (gross of fees).<sup>62</sup>

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<sup>58</sup> Bridges Ventures and The Parthenon Group, page 26.

<sup>59</sup> Strandberg (2007), pages 11.

<sup>60</sup> Bridges Ventures and The Parthenon Group, page 28.

<sup>61</sup> Bridges Ventures and The Parthenon Group, page 19.

<sup>62</sup> Bridges Ventures and The Parthenon Group, page 20.

## **United States**

In the U.S., *JP Morgan Urban Renaissance Property Fund* raised \$175 million (USD) from the government and from impact investors with the focus on urban development and redevelopment of affordable housing using ‘green’ specifications from solar heating to recycled building materials in New York. The fund has a projected return of approximately 15% net of fees.<sup>63</sup>

*RSF Social Finance (RSF)* was incorporated in 1936 and offers funds catering to a range of individual and institutional investors. RSF’s funds cater to impact investments in three main areas: food & agriculture, education & the arts, and ecological stewardship. The organization’s platform includes a core lending program of short-term notes that support non-profit and for-profit social enterprises, a mezzanine debt fund providing growth capital and a program-related investment (PRI) fund catering to foundations, who do not have the in-house capacity to invest in PRIs directly. Social impact for RSF’s donor-advised funds are measured by a combination of quantitative and qualitative factors with a focus on investment outputs such as the number of affordable housing units financed, low-income mortgages made and environmental impacts achieved.<sup>64</sup>

The founders of California-based *KL Felicitas Foundation (KL Felicitas)* saw impact investing as a logical extension of their core beliefs and personal interests in sustainability, mission and social investments. The Foundation’s aims to enable social entrepreneurs and enterprises worldwide to grow sustainably, placing an emphasis on rural communities and families. KL Felicitas is able to maximize their impact through alignment of their mission with annual grantmaking/investing by using various tools including loans, loan guarantees and private equity. KL Felicitas conducts impact investing activities in four areas: sustainable investments, mission-related investments, program-related investments and social-component investments. KL Felicitas seeks both Impact First and Financial First investments.<sup>65</sup>

*Calvert Foundation* was launched in 1988 and focuses on maximizing the flow of capital to disadvantaged communities in an effort to effect a more equitable and sustainable society, while also seeking to provide a modest financial return. The Foundation operates three main programs that were launched in 1995 as a result of collaboration between Calvert Group (a mutual fund company) and the Ford, McArthur and Mott Foundations: Community Investment Notes, Community Investment Partners, and The Calvert Foundation Giving Fund. The Notes are a taxable, low-volatility fixed-income product.<sup>66</sup>

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<sup>63</sup> Bridges Ventures and The Parthenon Group, page 3.

<sup>64</sup> Godeke and Pomares, pages 26-27.

<sup>65</sup> Godeke and Pomares, page 27.

<sup>66</sup> Godeke and Pomares, pages 28-29; and Calvert Foundation web site, accessed November 11, 2010. <[www.calvertfoundation.org](http://www.calvertfoundation.org)>.

## Other Countries

**The International Finance Facility for Immunization (IFFIm)** based in the U.K. raised funds by issuing bonds in the capital markets. By leveraging future grants from developed countries, these bonds have been issued at market rates to both commercial and retail investors and hold AAA/Aaa ratings. Managed by the World Bank, IFFIm has raised \$1.6 billion (USD) to-date in two issues.<sup>67</sup> The IFFIm pays bondholders an agreed interest rate and will pay back the value of the bonds as money pledged by donor governments become available over the duration of the program.<sup>68</sup>

**Root Capital** in Africa provides access to funds and also creates sustainable partnerships between farmers and buyers. They use contracts with agricultural buyers like Starbucks to mitigate the lender's risk while providing below market rate return to investors. Having raised \$48 million (USD), Root Capital has been able to drive significant impact in farming communities in Tanzania, contributing to the growth of GDP in poverty-stricken rural areas.<sup>69</sup>

Switzerland-based **BlueOrchard Finance S.A.** has been in existence since 2001 and has disbursed over 800 loans totalling about \$1.1 billion (USD) to microfinance institutions. In aggregate, the BlueOrchard companies manage close to \$1 billion (USD at December 31, 2009).<sup>70</sup> Sixty per cent of the investors in The Dexia Micro-Credit Fund (managed by BlueOrchard) are institutional investors with the remainder being high-net-worth individuals. The fund invests in debt instruments of up to three years in maturity issued by microfinance institutions internationally.<sup>71</sup> At July 1, 2009 the fund was valued at \$502 million and the USD share class's annualized 5-year performance was 5.34%.<sup>72</sup>

**BelAir Sustainable Alternatives Fund** based in Luxembourg has assets in excess of \$345 million (USD, 2009). The fund was the first fund-of-hedge-funds firm to sign the UNPRI initiative. The BelAir 'universe' of screened companies consists of 2,800 companies as of Q1 2009. All underlying hedge funds in BelAir constrain themselves to only be exposed to the SRI approved list of instruments.<sup>73</sup>

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<sup>67</sup> Bridges Ventures and The Parthenon Group, page 3.

<sup>68</sup> The International Finance Facility for Immunisation, page 5.

<sup>69</sup> Bridges Ventures and The Parthenon Group, page 3.

<sup>70</sup> BlueOrchard, [Social Performance Report 2010](#), page 4. Accessed November 11, 2010 <<http://www.blueorchard.com/jahia/Jahia/pid/522>>.

<sup>71</sup> Bridges Ventures and The Parthenon Group, page 18.

<sup>72</sup> BlueOrchard presentation "The Dexia Micro-Credit Fund" (Geneva, July 2009), slides 11 and 12. Accessed November 11, 2010 <[http://www.blueorchard.com/jahia/webdav/site/blueorchard/shared/Products/DMCF/DMCF%20Presentation/0907\\_DMCF%20Presentation\\_Eng.pdf](http://www.blueorchard.com/jahia/webdav/site/blueorchard/shared/Products/DMCF/DMCF%20Presentation/0907_DMCF%20Presentation_Eng.pdf)>.

<sup>73</sup> Bridges Ventures and The Parthenon Group, page 25.

## Appendix Two Organizations Active in Impact Investing

### Canadian Organizations

Alterna Savings - <http://www.alterna.ca/Default.aspx?langtype=1033>

CAPE Fund - <http://www.capefund.ca/>

Central 1 Credit Union of British Columbia - <http://www.central1.com/>

Charity Intelligence Canada (CI) - <http://www.charityintelligence.ca/>

Community Foundations of Canada (CFC) - <http://www.cfc-fcc.ca/>

F.B. Heron Foundation - <http://www.fbheron.org/>

Jubilee Fund - <http://www.jubileefund.ca/>

LBG Canada - <http://www.lbg-canada.ca/>

Mennonite Economic Development Associates (MEDA) - <http://www.meda.org/>

Meritas Mutual Funds Inc. - <http://www.meritas.ca/>

Ottawa Community Loan Fund (OCLF) - <http://www.oclf.org/>

Philanthropic Foundations of Canada (PFC) - <http://pfc.ca/>

Planned Lifetime Advocacy Network (PLAN) - <http://www.plan.ca/>

Sarona Asset Management - <http://www.saronagroup.com/>

Social Capital Partners (SCP) - <http://www.socialcapitalpartners.ca/>

Social Enterprise Fund - <http://socialenterprisefund.ca/>

Socialfinance.ca - <http://socialfinance.ca/>

Social Innovation Generation (SiG) - <http://sigeneration.ca/>

Social Investment Organization (SIO) - <http://www.socialinvestment.ca/>

Social Venture Exchange (SVX) - <http://socialventureexchange.org/>

The Insurance Corporation of British Columbia - <http://www.icbc.com/>

The Quint Development Corporation - <http://www.quintsaskatoon.ca/>

The Social Enterprise Fund (Edmonton) - <http://socialenterprisefund.ca/>

Vancity - <https://www.vancity.com/>

## International Organizations

Aavishkaar - <http://www.aavishkaar.in/>

Access Capital Strategies - <http://us.rbcgam.com/>

Acumen Fund - <http://www.acumenfund.org/>

The BelAir Initiative - <http://www.harcourt.ch/cms/hauptseite/zeigeBereich/115/the-belair-initiative.html>

BlueOrchard Finance S.A. - <http://www.blueorchard.com/>

Bridges Ventures - <http://www.bridgesventures.com/>

Calvert Foundation - <http://www.calvertfoundation.org/>

Charity Bank - <http://www.charitybank.org/>

Dexia Micro-Credit Fund - <http://www.blueorchard.com/jahia/Jahia/pid/463>

Generation Investment Management (GIM) - <http://www.generationim.com/>

The Global Impact Investing Network (GIIN) - <http://www.thegiin.org/cgi-bin/iowa/home/index.html> ; and Impact Reporting & Investment Standards (IRIS) - <http://iris.thegiin.org/>

International Finance Facility for Immunization (IFFIm) - <http://www.iff-immunisation.org/>

JP Morgan Social Finance (SF) Unit -

<http://www.jpmorgan.com/pages/jpmorgan/investbk/solutions/ssf>

KL Felicitas Foundation - <http://www.klfelicitasfoundation.org/>

Marmanie Consulting Ltd. - <http://www.marmanie.com/>

Mission Markets - <http://www.missionmarkets.com/>

Mix Market - <http://www.mixmarket.org/>

More for Mission - <http://www.moreformission.org/>

The Rockefeller Foundation - <http://www.rockefellerfoundation.org/>

Rockefeller Philanthropy Advisors - <http://rockpa.org/>

Root Cause - <http://www.rootcause.org/>

RSF Social Finance - <http://rsfsocialfinance.org/>

Social Finance UK - <http://www.socialfinance.org.uk/>

Social Return on Investment Model (SROI) - <http://sroi.london.edu/>

Tools and Resources for Assessing Social Impact (TRASI) - <http://trasi.foundationcenter.org/>

Tridos Bank - <http://www.tridos.com/>

United National Principles for Responsible Investment - <http://www.unpri.org>

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