Private Capital, Public Good

Leveraging Impact Investing to Support a Just & Equitable Recovery | December 2020

The confluence of challenges facing the United States today is unprecedented. Private sector solutions to societal issues are being overwhelmed, and Americans are collectively looking to leaders in Washington to help chart the course for a just and inclusive recovery.

Investors and the private sector will have a role to play in that recovery alongside government, philanthropy and civil society. With astute federal leadership, today’s moment of crisis can become tomorrow’s opportunity, and we can emerge from this moment with a new set of economic systems that invigorate deliberately underinvested communities while placing value on the social and environmental impacts of investment and corporate activity.

Impact investors have been at the forefront of seeding market innovations that are already revolutionizing the way capital and markets interact and shape our institutions. The White House and Congress can be champions for this change, but it is critical that our leaders rise to the moment we find ourselves in and take action swiftly in the next two years.

Impact Investors Call on Policymakers in Washington to Lead

This report will seek to identify a discrete set of recommendations for policymakers in Washington—ones that are based on the experience of impact investors, financial intermediaries, community stakeholders and informed policymakers. They build on a decades-long history of bipartisan federal policymaking. Apart from the specific policies advanced here, this report should be viewed as a call for continued and renewed leadership from today’s leaders in Washington.

The report is intentionally focused on how policy can influence investment decisions either by promoting investor impact transparency or by incentivizing more private capital into investments with positive impact. There is a universe of other policy priorities that fall outside that scope but are no less important – from social and welfare policy, to environmental and workplace regulation. The themes and proposals explored in this report complement those priorities by bringing investors to the table in confronting underlying societal challenges.

The report is structured around two narrative themes –transforming community investing to confront inequality and advancing stakeholder capitalism to restore American economic leadership. These themes are intimately related, but they are meant to give life to the broader societal shifts to which recommended policies respond and contribute.
Summary of Recommendations

I. Transform Community Investing to Confront Inequality
   - Community development financial institutions (CDFIs) and minority depository institutions (MDIs) should be fortified and scaled while also seeking to develop new models to close gaps that have left Black, Brown, rural and tribal communities underserved.
   - Regulators should reassert the purpose of the Community Reinvestment Act – to counter decades of explicitly racist banking practices – and modernize it to address the financial system as it exists today.
   - Congress should renew and reform community investing tax policies, ensuring that they are transparent and accountable, and that incentives are aligned with community outcomes.

II. Advance Stakeholder Capitalism to Restore American Economic Leadership
   - Regulators should ensure that corporations have clear, consistent disclosure requirements on environmental, social and governance issues to enable investors and other stakeholders to account for and manage impact.
   - Regulators should provide clarity to investors – including retirement plans and charitable endowments – around their duties as fiduciaries and their ability to consider the long-term materiality of impact factors.
   - Congress and the Administration should leverage the tools and lessons of development finance to reinvest in American infrastructure and industry to foster an economy that provides security and quality jobs for all.
I. Transform Community Investing to Confront Inequality

Inequality is no longer an open secret that American leaders can afford to tolerate. Black, Latino, Indigenous, urban and rural communities have for generations been excluded from the dividends of economic growth. This was not accidental. Systemic bias and the all-out pursuit of short-term profits enabled the hollowing out of communities. That reality cannot and must not be sustained.

The COVID-19 crisis has struck so deeply because it did so where America was already at its weakest. Our small businesses – once the economic engine of a prospering middle class – have been decimated alongside the communities they sustained. The resilience and determination of American entrepreneurs cannot withstand this crisis alone, but the few lifelines they have are falling short. We must move urgently to invest in communities, building their wealth and pathways to opportunity to close systemic racial, gender, income and other gaps.

The cruel irony is that we have had the tools to invest in thriving, inclusive and sustainable communities all along, but we must act urgently to scale them to our current challenges. Innovative tax policies – from LIHTC to NMTC to Opportunity Zones – have mobilized billions of dollars in private capital to serve underinvested communities. The Community Reinvestment Act (CRA) helped to begin reversing the generational effects of red lining. And CDFIs and MDIs have worked for decades, building affordable housing and fostering small businesses with only modest support from public and private investment. If there is a benefit to the current crisis, it is that we see plainly just how vital these tools and institutions are, and this should compel policymakers to redouble their commitment to the policies that enable them.

CDFIs and MDIs should be fortified and scaled while also seeking to develop new models to close gaps that have left rural and tribal communities underserved.

Millions of Americans live in places – both rural and urban communities – that have little or no access to basic banking services. Technological shifts and industry consolidation have only exacerbated the trend, which disproportionately affects Black and Brown communities. When residents in these places look to purchase a home or start a new business, the lack of banking options can be a serious impediment. This fact was put into stark focus through the COVID-19 crisis as federal policymakers struggled to extend lifelines to Main Street businesses that were hurting the most.

A bright spot emerged, however, in the form of the network of CDFIs. Along with MDIs, these community financial institutions proved uniquely suited to working with borrowers and communities most in need of support. That these relatively small institutions were prepared to step up where larger banks were absent speaks to their potential to serve on the frontlines of a just and inclusive recovery.

Impact investors have long supported CDFIs, with their mandates to serve low- and moderate-income communities, and their relationships with residents overlooked by traditional banking. Indeed, many CDFIs have been seeded through innovative philanthropic investments. Over the years, CRA and tax credit motivated private capital alongside strategic public support through the CDFI Fund have helped...
the field mature into a stable and effective sector of the broader financial industry. But CDFIs remain relatively small, and they need patient risk capital if they are to scale to meet the needs of the moment.

MDIs similarly boast strong ties to Black and Brown communities, and they have continually shown to be more effective in supporting entrepreneurs of color. Unfortunately, Black-owned banks have been shuttering due to economic crises and industry consolidation. Stemming this tide and rebuilding the MDI sector is a critical step to ensuring that Black and Brown communities can participate in the economic recovery.

**Policy Recommendations:**

- Use the Federal Reserve and Treasury to Backstop “Equity-Like” Investment in CDFIs and MDIs
- Expand the CDFI Fund to at Least $1 Billion

Regulators should **reassert the purpose of the Community Reinvestment Act** – to counter decades of explicitly racist banking practices – and modernize it to address the financial system as it exists today.

The Community Reinvestment Act (CRA) has become perhaps the single most important source of capital for small businesses, affordable housing and retail banking, and effective reform could unlock tens of billions of dollars in new investments. The landmark civil rights policy which seeks to counteract decades of intentional, systemic racism in the financial sector is in need of modernization to keep pace with the changing banking sector.

Beginning in 2017, the Treasury Department worked to identify issues – from how the rise of branchless banking is exacerbating “CRA deserts” to a lack of innovation in financing strategies. Unfortunately, despite widespread agreement on these challenges, the Office of the Comptroller of the Currency (OCC) advanced a version of reform that lacked support from financial institutions, community advocates or fellow regulators. The CRA ecosystem is now fragmented, with different financial institutions set to begin playing by different rules depending on which of three regulators is responsible for the CRA examination. The incoming administration should move quickly to restart a cohesive CRA modernization, building off the emerging framework in the Federal Reserve’s bipartisan Advance Notice of Proposed Rulemaking (ANPR).

A renewed effort should be grounded in a reassertion that the purpose of the CRA is countering systemic racism. While all low- and moderate-income communities would benefit from effective modernization, it is Black and Brown communities that have slipped furthest behind in terms of CRA-motivated investment in small businesses, affordable housing and community facilities.

Regulators should also seek to provide greater transparency and accountability to the program. Regulated banks and their co-investors should have greater clarity around what projects and what communities qualify for CRA credit. And scoring should be reformed to provide more effective incentives to banks to work in higher need communities or to deploy more catalytic capital.

Finally, changes to the banking industry have led to a decline in the proportion of financial institutions covered by the CRA, gradually narrowing this critical source of community investing capital, and with it,
banks’ accountability to their communities. Lawmakers should explore options to extend the coverage of the CRA to a wider range of institutions.

Policy Recommendations:

- Restart Efforts to Modernize the Community Reinvestment Act in Keeping with the Federal Reserve ANPR
- Extend the Coverage of the Community Reinvestment Act

Congress should renew and reform community investing tax policies, ensuring that they are transparent and accountable, and that incentives are aligned with community outcomes.

Tax policy has proven to be a powerful tool to direct capital towards historically underinvested communities. When these policies work as intended, target communities see the benefits of expanded economic activity and better community infrastructure – from more affordable housing to improved community facilities. The tax benefits to investors serve to reward positive impact, and administration of incentive programs ensures they are held accountable.

But the suite of community investment tax policies – including NMTC, HTC, LIHTC and now Opportunity Zones – has never been treated as a comprehensive set of policies. Rather, each successive program has emerged over time, sometimes correcting past faults but other times replicating them. Tax policies can fail when they are too cumbersome to attract investor interest, too complex to be implemented by local communities or when they fail to maintain transparency, accountability and meaningful disclosures.

A robust policy agenda aimed at unlocking capital for impact should include a comprehensive review of existing tax credits and incentives ultimately leading to a reform effort grounded in ensuring that the benefits investors see are properly aligned with the impact their investments have on communities. Short of that, individual programs should be scrutinized and improved.

Policy Recommendations:

- Reform of the Opportunity Zones Program to Ensure Accountability and Build Community Trust
- Make New Markets Tax Credits Permanent
II. Advance Stakeholder Capitalism to Restore American Economic Leadership

The global economic order was built through American economic leadership. After the Great Depression, the United States led the way in establishing modern capital markets regulations. After World War II, American finance fueled reconstruction and industrialization. And starting in the 1970s, the United States was central in shaping the economic systems that unlocked the period of globalization and increased trade.

This leadership helped generate enormous wealth and lifted billions out of poverty around the world, but we cannot ignore its faults. Too much of that wealth accumulated in the hands of too few, market liberalism has led to a new era of overbearing monopolies, and rapid economic growth came with dramatic environmental and social costs. In the financial industry, a schism formed between speculative trading and the reality of Main Street economies that ultimately led to the financial crisis and the Great Recession. For decades, these negative impacts have been shifted onto marginalized people and communities, both at home and abroad.

That cannot continue, and global capital markets are now demanding sustainability, transparency and accountability from corporate actors and financial institutions. Maintaining America’s economic leadership in the 21st century and beyond demands that we commit to a new vision of markets and capitalism that values the impact of investment and business decisions on all stakeholders. At the same time, we must also consider the effects that globalization has had on our domestic markets, and we must reinvest in the economic security and sustainability of our nation.

Regulators should ensure that corporations have clear, consistent disclosure requirements on environmental, social and governance issues to enable investors and other stakeholders to account for and manage impact.

The Business Roundtable declared in 2019 that the purpose of the corporation is to benefit all stakeholders – including customers, workers, suppliers, communities, physical environment and investors. This was a stark break with the decades-old paradigm of shareholder primacy. This refreshed approach to corporate purpose was a welcome affirmation of each stakeholder’s role in value creation, and investors can be important partners in this shift. In exercising their ownership rights, investors can pursue financial returns while still helping to set the table for other stakeholders to be represented. But in order to do so, they need access to clear and consistent disclosure on impact.

Portfolio management has advanced rapidly as investors of all types and sizes increasingly grapple with the reality of long-term and systemic risks posed by global crises and challenges. In particular, a sophisticated industry has developed to help track and manage so called environmental, social and governance (ESG) metrics as a core part of an investment strategy. Academic research has traced the financial materiality of these metrics, and fund managers are increasingly adroit at applying this type of analysis to mitigate risk and to achieve market-rate and even premium rates of financial returns. Now, regulators should acknowledge these advances and set clear, consistent standards for mandated corporate ESG disclosure.

Private and voluntary standards have developed important and effective models for a wide range of impact reporting strategies. But just as financial accounting standards needed to be harmonized in the
form of GAAP reporting, impact reporting needs to be standardized and, in the case of ESG metrics, disclosure should be mandated. Clear and consistent reporting will lead to more transparent and efficient market and simplify the reporting process for corporations.

It is worth noting that this process is well underway in other markets, with Europe and the United Kingdom in particular moving quickly to adopt nonfinancial reporting standards. American investors have as much right to this information as their international peers and continued American economic leadership will depend on the ability of corporations to develop robust sustainability practices informed and shaped by this type of impact reporting and mandated disclosure.

**Policy Recommendation:**
- Adopt Clear Public Company Reporting and Disclosure Standards on ESG Factors
- Study Opportunities and the Need for Disclosure by Other Large Corporations

Regulators should provide clarity to investors – including retirement plans and charitable endowments – around their duties as fiduciaries and their ability to consider the long-term materiality of impact factors.

In recent years, some policymakers have sowed confusion with investors around their rights and responsibilities to manage impact, including the use of ESG metrics in investment decision making. These policy trends have persisted despite rising investor demand for the ability to consider impact driven both by a desire to create positive impact and an evolving understanding of financial materiality. In particular, investors and fiduciaries who invest for the long-term, such as pensions and endowments, need certainty that consideration of these factors is in keeping with financial regulation and their fiduciary duty.

In part due to the inconsistency of corporate reporting, and in part due to dated conceptions of impact and its relationship to risk and financial return, some have sought to discourage even basic impact management practices. Whether it is consideration of ESG factors or voting on shareholder resolutions, impact management has been conflated with political activism in ways that ultimately harm investors and the functioning of the capital markets.

For pensions, with their duty to preserve the retirement assets of workers, this has led to the silencing of worker voices in important management decisions. Workers have a deeply vested interest in the sustainable management of their employers, and tools like proxy voting, analysis of ESG metrics and other impact management activities can have critical implications for their near- and long-term economic wellbeing.

For endowments, created to advance or sustain an explicit charitable purpose, the lack of fiduciary clarity has constrained the growth of mission-aligned investment practices. These approaches can leverage endowed assets to have outsized impact on mission while still being wholly consistent with prudent investment practices.
Ultimately, every investor should have a right to consider impact factors. And as evidence of financial materiality mounts, it is increasingly clear, particularly for long-term investors, that consideration of impact factors should in fact be a component of fiduciary duty.

Policy Recommendations:

- Reverse or Greatly Clarify Department of Labor Regulations and Guidance to ERISA-Regulated Fiduciaries
- Codify “Mission Related Investment” Guidance for Private Foundations and Other Charitable Endowments

Congress and the Administration should leverage the tools and lessons of development finance to **reinvest in American infrastructure and industry** to foster an economy that provides security and quality jobs for all.

All investments ultimately depend on the strength of the American economy and the public goods that undergird it. Unfortunately, it has been apparent for years that our collective investment in economic infrastructure – from physical roads and broadband, to small business and advanced manufacturing – is not keeping pace with demand. This deficit has only been exposed and exacerbated by our ongoing crises, and public sector investment alone cannot make up the difference. However, we have a proven set of tools for how government can incentivize and leverage private capital to reinvest in infrastructure and industry, creating sustainable jobs and a more competitive American economy in the process.

In emerging markets, the United States has led the deployment of development finance for decades, first through the Overseas Private Investment Corporation (OPIC) and now the U.S. International Development Finance Corporation (USDFC). The experience of those agencies has shown that targeted public investment can strengthen markets, attract private capital and ultimately create security through economic prosperity. While American markets are more developed and complex, policymakers have the opportunity to craft a domestic development finance strategy that is just as effective and impactful.

For physical infrastructure, this strategy should prioritize sustainability and equity. A 21st Century economy cannot survive or compete on the built infrastructure of the last century, and the increasing stresses of climate change must be accounted for today. Nor will the economy prosper if vast swaths of the country are physically or digitally unmoored from the opportunity to participate in growth.

But this strategy should also address critical gaps in business finance, for both small business and strategical industries. The COVID-19 crisis made clear that our existing financial tools are not prepared to address either, and the experience of international development finance efforts underscore that access to capital is essential to unlocking economic innovation. Domestic development finance can be used to appropriately incentivize reinvestment in our small businesses and strategically strengthen our industrial base and supply chains.

Finally, the tools of international development finance have been instrumental in flowing capital to small and medium-sized businesses and infrastructure projects thereby contributing to economic stability in emerging markets and strengthening U.S. national security. A turn to include a domestic development finance vehicle should be coupled with a redoubled commitment to international
development finance activity. USDFC and USAID should continue to provide technical assistance and innovative financing solutions to sustain the global impact investing ecosystem in which American investors have played a crucial role and which helps sustain American competitiveness around the world.

Policy Recommendations:

- Establish a domestic vehicle to invest in and promote inclusive economic growth, sustainable job creation and American economic competitiveness
- Leverage international development finance to sustain a robust global impact investing ecosystem, creating opportunities for American investors and industry

What’s Next?
This report frames a set of strategies that policymakers can adopt to leverage impact investing as a tool to engage investors and the private sector in the collective response to the crises and challenges facing the nation today. Detailed position papers and additional resources are available for each of the policy priorities indicated and will remain updated as circumstance change and opportunities arise.

For more information on any of the policy priorities identified, visit www.impinvalliance.org or contact info@impinvalliance.org.

Conclusion
This report is being delivered at a dynamic, polarizing and challenging moment in American history. It seeks to identify the steps that can be taken quickly by leaders in Washington to respond to a prolonged moment of crisis. To that end, the recommendations are responsive to a moment in time, and the needed policy responses will continue to evolve alongside the crises, challenges and opportunities themselves.

The field and practice of impact investing has grown strongly in recent years. Indeed, trillions of dollars in private capital have been catalyzed – from ESG investments and green bonds, to community development finance and microfinance – thanks to the pioneering work of impact investors. The practitioners conducting this work today will continue with renewed determination in the face of our current crises, and the U.S. Impact Investing Alliance will continue to support them.

But if want to truly unlock the potential of private capital for public good at the scale of investment and impact this moment demands, we must address the themes and challenges articulated in this report. Systems that produce unequal outcomes and shortsighted thinking will not be reimagined through one off or uncoordinated action. Rather, we need determined leadership and radical cooperation among everyone with a stake in these systems to act together in reordering them.

The goal of this report is to underscore the tremendous opportunity present today. Policymakers, in partnership with the private sector, philanthropy and communities, have the chance to reimagine our economic systems in ways that better align the incentives of corporations and investors with their social, economic and environmental impacts on people, places and planet.
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About the U.S. Impact Investing Alliance
The U.S. Impact Investing Alliance (“the Alliance”) is a non-profit organization dedicated to building the impact investing ecosystem by bridging market gaps and addressing shared challenges. The Alliance’s long-term vision is to place measurable social, economic and environmental impact alongside financial return and risk at the center of every investment decision.

The Alliance is grateful to receive the support and guidance of its Advisory Board, whose members represent leading impact investing institutions and intermediaries from across the ecosystem.

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