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Back to Basics: Impact Investing

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BACK TO BASICS: IMPACT INVESTING

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I. INTRODUCTION.

Philanthropic organizations often seek to complement their grant-making and programmatic activities with so-called impact investments. Impact investments include mission-related investments, program-related investments, investments in hybrid structures like low-profit limited liability companies, joint ventures between for-profit and not-for-profit entities, applications of investment screens and investment restrictions, social investment fund investments and proxy voting and advocacy. Increased public interest in and awareness of impact investing may be attributable, in part, to recognition that market solutions can be harnessed to accomplish mission-related objectives, interest in deploying all available tools to achieve mission-related outcomes and the availability of legal guidance and authority expressly authorizing not-for-profit organizations to consider their missions when making investment decisions.

The first part of this outline presents the legal background relevant to mission-related investing by philanthropic organizations. In this outline, a mission-related investment (or "MRI") refers to an investment made with the intention of both furthering the investing organization's mission, and also generating a recovery of principal or financial return. This outline addresses both state law prudence standards relevant to most philanthropic organizations, as well as the federal tax rules relevant to investments by private foundations, including jeopardizing investments and program-related investments. Although the prohibition against jeopardizing investments and the exception for program-related investments apply only to private foundations, the relevant law, regulations and rulings provide helpful guidance for public charities and social welfare organizations interested in mission-related investing. The second part of this outline uses the legal background to raise practical considerations for a philanthropic organization seeking to develop policies and procedures around the making of MRIs.

II. LEGAL BACKGROUND.

1. Uniform Prudent Management of Institutional Funds Act.

The Uniform Prudent Management of Institutional Funds Act ("UPMIFA") was drafted by the Uniform Law Commission in 2006 to replace the then-existing Uniform Management of Institutional Funds Act ("UMIFA"), which was drafted in 1972. UPMIFA has since been enacted in forty-nine states, Washington, D.C., and the U.S. Virgin Islands.[1]

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[1] UPMIFA has not been adopted by either Pennsylvania or Puerto Rico. Adopting states have made modifications to the uniform law. For example, New York has enacted the

UPMIFA was drafted to provide modern articulations of the prudence standards for the management and investment of charitable funds and for endowment spending.[2] UPMIFA provides guidance and authority to institutions related to the management and investment of institutional funds, and imposes duties on those who manage and invest institutional funds.[3]

Under UPMIFA, "charitable purposes" are the relief of poverty, the advancement of education or religion, the promotion of health, the promotion of a governmental purpose, or any other purpose the achievement of which is beneficial to the community.[4] For purposes of UPMIFA, "institution" means (A) a person, other than an individual, organized and operated exclusively for charitable purposes; (B) a government or governmental subdivision, agency, or instrumentality, to the extent that it holds funds exclusively for a charitable purpose; or (C) a trust that had both charitable and non-charitable interests, after all non-charitable interests have terminated.[5] An "institutional fund" means a fund held by an institution exclusively for charitable purposes. The term does not include: (1) program-related assets; (2) a fund held for an institution by a trustee that is not an institution; or (3) a fund in which a beneficiary that is not an institution has an interest, other than an interest that could arise upon violation or failure of the purposes of the fund.[6]

UPMIFA sets forth a detailed prudence standards that institutions must follow in managing, investing, and appropriating funds. UPMIFA's duties apply to those who govern an institution, including directors and trustees, and to those to whom the directors or managers delegate responsibility for investment and management of institutional fund, including officers and employees of an institution and agents who invest and manage institutional funds, including as volunteers.[7]

New York Prudent Management of Institutional Funds Act ("NYPMIFA"), which differs in certain important respects from UPMIFA. Therefore, it is important for a philanthropic organization to comply with the appropriate version of UPMIFA applicable to it.

2 *See* Uniform Prudent Management of Institutional Funds Act (2006) ("UPMIFA"), at 1 (Prefatory Note).

3 *See* UPMIFA at 1 (Prefatory Note).

4 *See* UPMIFA section 2(1). Importantly, UPMIFA's definition of charitable purposes is sufficiently broad to capture in the definition of institution entities that are not classified as charitable organizations under federal tax law, including organizations classified as social welfare organizations.

5 *See* UPMIFA section 2(4).

6 *See* UPMIFA section 2(5).

7 *See* UPMIFA at 15 (Comment).

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