COMMUNITY FOUNDATIONS OF CANADA | The Learning Institute

Navigating Impact Investing: A Legal Perspective

March 21, 2024



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Introducing

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NAVIGATING IMPACT INVESTING

A LEGAL PERSPECTIVE

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Agenda

1. What is Impact Investing?
2. Overview of Relevant Laws
3. Prudent Investor Standard
4. Public Benefit Requirement
5. Program-Related Investments
6. Impact Investing Policies
7. Questions

What is Impact Investing?

- Investment made with the intention of generating a positive measurable social and/or environmental impact alongside financial return
- Differs from traditional investment by having 2 additional characteristics:

1) **Intentionality**: core business activities seek to generate both financial and social value and the investor seeks both a social and financial return
2) **Measurable Impact**: there is the ability to quantify and measure the intended impacts

What is Impact Investing?

- A different way of mobilizing private capital to tackle societal challenges
- Many associated terms/ concepts
  - Mission investing
  - Social finance
  - Socially responsible investing or ESG investing
  - Program-related investing

PUTTING IMPACT INVESTING IN CONTEXT

Financial focus → Impact focus

			Impact investing		
Traditional	**Negative screening**	**ESG integration**	**Financial-first**	**Impact-first**	**Philanthropy**
Very limited or no focus on environmental, social and governance (ESG) factors underlying investment analysis	Seek to avoid harm by removing investments with negative ESG factors or are not aligned to values	More actively consider investments with positive ESG factors and which benefit all stakeholders	Focus on specific social issue areas that create attractive risk-adjusted financial returns and require a direct contribution to solutions	Focus on specific social issue areas (esp. underserved or high need) that require a direct contribution to solutions and provides modest financial returns	Focus on addressing a social need and will accept partial or full capital loss. Growing desire to measure outcomes and catalytic nature of funding.

Competitive risk-adjusted financial returns

Manage ESG risks and opportunities

Impact-driven solutions (direct, intended, measurable)

MaRS

Source: Adapted from the *Impact Investing in Canada: State of the Nation Report*, 2014, MaRS Centre for Impact Investing; Impact Management Project (IMP); Bridges Fund Management; and UK National Advisory Board (NAB) on Impact Investing.

Community Foundations and Impact Investing

- CFs have made a huge impact with mission-driven programming and granting
- Opportunity for more positive impact = investing endowment funds
- As registered charities, there are certain legal restrictions and requirements that apply to investments made by CFs

The Law – What do we need to think about?

- Legal issues are provincial and federal
- Provincial
  - Trust law
  - Social investment rules
- Federal
  - *Income Tax Act* and charity law
  - CRA administrative policies

Prudent Investor Standard

- Charities are generally subject to the prudent investor standard in legislation that governs trust property
- Requires charity to exercise the “care, skill, diligence and judgment that a prudent investor would exercise in making investments”
- This means various factors need to be considered when evaluating an investment, including: economic conditions, overall portfolio, expected ROI, preservation of capital, etc.

Social Investment Rules

- In Ontario, the *Charities Accounting Act* imposes specific social investment rules
- When a charity makes a social investment, the prudent investor rules are replaced with the statutory duties under the Act, including:
  - determining whether the charity should seek advice with respect to a potential social investment; and
  - satisfying itself that it is in the best interests of the charity to make an investment, having regard to the expected benefit
- Other jurisdictions may adopt similar rules

Public Benefit Requirement

- A charity must be established for the benefit of the public or a sufficient segment of the public.
- From a CRA perspective, lending or investing done by a registered charity must not provide excessive private benefit to non-charitable beneficiaries

CED Activities

- CRA recognizes some Community Economic Development (“**CED**”) activities improve economic opportunities and social conditions of communities, and therefore can further a charitable purpose
- CED activities include program-related investments (“**PRIs**”)

Program Related Investments

- PRIs are intended to further a recognized charitable purposes and are not “investments” in the traditional sense
- PRIs involve more than a financial return – likely would not meet the prudent investor standard. The return of capital is contemplated, but it is typically below market rates

Program Related Investments (cont.)

- Charities can make PRIs in qualified donees without restriction
- PRIs that are “investments” in non-qualified donees are more complex
    - Either the investor charity must maintain ongoing direction and control; or
    - The investment must be a permissible qualifying disbursement

Program Related Investments (cont.)

- Investor charity must ensure that it has appropriate agreements
  - Ensure there is monitoring, reporting and an appropriate exit mechanism for the investor charity to withdraw if public benefit is no longer achieved, or turn it into a regular prudent investment
- CRA suggests charities adopt a written policy for PRI activities

Program Related Investments – Examples

- *Investment in Shares in a for profit corporation*
  - Non qualified donee that operates an apartment complex. The investment is supported by a written agreement whereby the company guarantees a number of apartment units will be rented to individuals who satisfy the investor charity's criteria. The agreement provides for direction and control
- *Low Interest Loans*
  - Loan made to a non qualified donee at a less than market rate of interest and with little security. Loan agreement provides funds are to be used for training individuals as part of a job skills training program – terms provide for monitoring and reporting to ensure direction and control

Qualifying Disbursement Rules

- The new rules potentially provide more scope for investing for impact by permitting grants to non-qualified donees in certain circumstances
  - The charity must ensure that the grantee or investee used the funds to further a charitable purpose of the charity

Impact Investing Policy

- CFs should adopt an Impact Investing Policy, which includes:
  - Portion of endowment used for impact investing
  - How investment opportunities are evaluated (i.e. whether it is a prudent investment or a program-related investment)
  - Who makes recommendations (e.g. Impact Investing Committee)

Questions?

To request this presentation in an accessible format, please contact archives@millerthomson.com.