

# THE PHILANTHROPIC CAPITAL STUDY

22.11.2022

Final Report

Understanding the capital of philanthropic organisations, and its potential to support investments as an additional means to deliver on their mission with the support of InvestEU.

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## Acronyms used in this document

Acronym	Full Form
<b>ABI</b>	<b>Italian Banking Association</b>
<b>ABS</b>	Asset Back Security
<b>ACRI</b>	Associazione di Fondazioni e di Casse di Risparmio
<b>CDFS</b>	Centre for Development Finance Studies
<b>CDP</b>	Cassa Depositi e Prestiti
<b>CEE</b>	Central & Eastern Europe
<b>CEIC</b>	Closed-End Investment Companies
<b>CGD</b>	Center for Global Development
<b>COPs</b>	Certificates of Participation
<b>DAFNE</b>	Donors and Foundations Networks In Europe
<b>DFC</b>	Development Finance Corporation
<b>DFI</b>	Development Finance Institution
<b>EC</b>	European Commission
<b>EFC</b>	European Foundation Centre
<b>EFSI</b>	European Fund for Strategic Investments
<b>EIAH</b>	European Investment Advisory Hub
<b>EIB</b>	European Investment Bank
<b>EIF</b>	European Investment Fund
<b>EMCAF</b>	Emerging Market Climate Action Fund
<b>ERNOP</b>	European Research Network on Philanthropy
<b>ESUS</b>	Entreprise Solidaire d'Utilité Sociale
<b>EU</b>	European Union
<b>EVPA</b>	European Venture Philanthropy Association
<b>FCDO</b>	Foreign, Commonwealth & Development Office
<b>FCPR</b>	Fonds Commun de Placement à Risques
<b>FPS</b>	Fonds Professionnel Spécialisé
<b>GSG</b>	Global Steering Group for impact investment
<b>IFC</b>	International Finance Corporation
<b>IFU</b>	Investeringsfonden for Udviklingslande
<b>IPO</b>	Initial Public Offering
<b>IRS</b>	Internal Revenue Service
<b>KIF</b>	Danish Climate Investment Fund
<b>LCFP</b>	Luxembourg-EIB Climate Finance Platform
<b>LDC</b>	Least Developed Countries
<b>LSE</b>	London Stock Exchange
<b>MCPP</b>	Managed Co-Lending Portfolio Program
<b>MRI</b>	Mission Related Investment
<b>NAB</b>	National Advisory Board for impact investment
<b>NAV</b>	Net Asset Value
<b>NPI</b>	National Promotional Institution
<b>ODI</b>	Overseas Development Institute
<b>OPIC</b>	Overseas Private Investments Company
<b>PF4EE</b>	Private Finance for Energy Efficiency
<b>PIDG</b>	Private Infrastructure Development Group
<b>PRI</b>	Programme Related Investment
<b>R&amp;D</b>	Research & Development
<b>RIDW</b>	Research, Innovation & Digitisation Window
<b>SDG</b>	Sustainable Development Goals
<b>SDUF</b>	Sustainable Development Umbrella Fund
<b>SHF</b>	Social Housing Foundation
<b>SISW</b>	Social Investment & Skills Window
<b>SIW</b>	Sustainable Infrastructure Window

<b>SME</b>	<i>Small and medium-sized enterprise</i>
<b>SMEW</b>	<i>SME Window</i>

# 1. Preamble

In the past years, the European Union has faced many shocks that brought to surface our biggest challenges, but also some essential opportunities. It highlighted the power of solidarity, illustrated through the powerful actions of philanthropic organisations, of grassroots movements but also through the financial instruments the EU created for a proper recovery and consolidated resilience.

The EU's Philanthropic Capital Study is an important endeavour, because the question it seeks to answer is important. It is important because the people, the institutions and their causes are important. As the world's ills gain in magnitude and society's resources, public and private are increasingly stretched, strained and short of the needs they are asked to meet, the unique role of philanthropic organisations grows in importance.

The debate surrounding the potential mobilisation of the capital available to philanthropic organisations to enable them to further deliver on their missions, to deliver good, is not and cannot be an investment phenomenon, a capital markets trend. It is, and must remain a mission delivery innovation, an additional tool put at the disposal of philanthropy's greatest assets, its people and its knowhow.

In this context, the InvestEU Programme is an opportunity for philanthropy in Europe. An opportunity to leverage off an ambitious, continental scale mobilisation programme powered by a commensurate EU budget guarantee facility to accelerate the development of the mission investing concept. An opportunity to bring together EU institutions, notably the EC, the EIB and the EIF and philanthropic organisations to address pressing social needs, environmental challenges and threats to democracy, to culture and to free media, working to preserve the soul and the ideals of the union.

The EU is now at a turning point in which it can either keep supporting current practices or start bringing innovation in the social field and change the mind-set. When investing, too often a government, a company or a person thinks only of the financial return, forgetting that social return is becoming more and more relevant in today's economy. In the aftermath of the pandemic, one important step for our recovery is to revisit our old conception of investments and spending. What the society needs right now are market solutions to people's needs. It is time to pass from reactive spending to prevention investment. One cannot adapt to the green and digital transitions with no investment in people and in the social field. More room is needed for leveraging private investment and in particular for social impact investment.

Financial instruments unavoidably must be employed to mobilise mission related investments by philanthropic organisations. However, they must remain the means and never become the end.. Such instruments must be complex enough to deliver on the mission, but simple enough that they do not become the mission. They must adopt standards, not as restraints but to make the most efficient use of scarce resources. They must promote transparency to allow the many to learn from the hard-

earned achievements of the few. The Philanthropic Capital Study is an important exploration in this respect.

A proper recovery and consolidated resilience can be obtained when we will have an inclusive Union. Not in theory, not conceptually, but in practice. This starts with rethinking and redesigning the concept of investment to generate both economic and social return. Social impact investments could benefit from a constant, multiannual financing perspective as they generate long-term positive outcomes in particular for the most vulnerable citizens.

An inclusive society is the one in which we manage to deliver at community level, in which integrated community services are understood as the key solution for social and territorial cohesion. After all, real generosity towards the future lies in giving all to the present. This is what our next generation truly needs.

Investments in skills, in education, in health prevention cannot only be brick and mortar measures. One cannot adapt to the green and digital transitions with no investment in people. We need to redefine budgetary rules and the way we do multi-annual budgeting and to accept social investment with clear returns at par with brick-and-mortar investment and not reject it as spending. We need to leverage private investment in the social field. This should be the next moving-forward element of the European agenda, and the present study is an important step in this direction.

Dragos Pislaru,

Member of European Parliament

Chair, EP Committee on Employment and Social Affairs



## 2. Executive Summary

The Philanthropic Capital Study was mandated by the European Investment Advisory Hub (EIAH) in the context of the European Social Economy Action Plan, which recognised philanthropic organisations as key actors of the social economy in Europe.

Philanthropic organisations are essential actors, uniquely positioned to deploy valuable funding to address societal challenges. Though grant making continues to be the main instrument of mission delivery, mission related investments ('MRIs') are a growing if nascent feature. Beyond delivering a financial return, these investments do in addition seek to have a positive societal impact in line with philanthropic missions and values.

This dedicated study sets out to review the stocks and flows, as well as the nature and the structure of a sample of European philanthropic organisations. It does so through a series of high-level interviews held with philanthropic actors to establish how they deploy their capital towards investments contributing to the pursuit of their philanthropic objectives. It further seeks to establish how these actors strive to build on their early achievements in developing the MRI concept, and how financial instruments, as public policy tools, can enhance the impact of the funds they currently deploy or enable additional actors to join the fray.

In recognition of the potential of such investments for the advancement of common missions shared by the EU and philanthropic organisations, this analysis introduces the opportunity to bring to bear the InvestEU Programme in support of those actors that want to use investments as additional means of achieving their mission. It should be underlined that while philanthropic actors do of course support their missions through donations as well as through investments, largely but not exclusively made from their endowment, the present study shall focus solely on the latter, which have to date been used to a lesser extent for this purpose.

Building on a series of Philanthropy Focus Groups hosted by the European Commission in 2021, the study finally provides inputs towards the potential design of a dedicated facility under InvestEU.

The approach selected was to conduct in-depth interviews with senior representatives at a sample of twenty-three philanthropic organisations dedicating resources to the public good, across an array of sizes, structures and EU Member States, to which a desktop research overlay was added. Chapter 3 of the study provides an overview of the research methodology. The sample's aggregate assets are estimated to be worth €255 billion.

Chapter 4 thus presents considerations pertaining to the landscape of European philanthropic capital as observed through the lens of the sample. To allow for the analysis of a diverse landscape, the study makes use of six structural categories, ranging from diversified endowment, umbrella or fundraising foundations to shareholder foundations who own large stakes in some of the EU's largest enterprises.

The analysis of the assets held by this sample of philanthropic organisations unveiled high level of concentrations across a few very large actors belonging to the latter category of shareholder foundations. These are found to be prevalent in those Member States where legal frameworks allow philanthropic and corporate objectives to cohabitate within the same structure. This model has implications for the availability and accessibility of capital for mission investing. Because these organisations are tasked with holding significant stakes in specific related businesses, it follows that only over a quarter of the aggregate assets held by the sample of organisations are in fact ‘accessible’ for deployment in other assets, which is of course directly relevant to their ability to make mission related investments.

The landscape of the EU’s philanthropic capital comprises a few large actors, equipped with significant amounts of capital and commensurate investment capabilities. The study shows that these attributes are not equally distributed and argues that if the funding needs of a diverse and fragmented universe of social economy actors are to be met, it is necessary to keep in mind that an equally diverse set of funders must be mobilised. This should include those less well equipped to carry out large or complex transactions.

The analysis of the sample organisations’ asset allocation reveals no standard approach, but a conservative level of risk appetite across much of the sample of organisations. This stance is in part explained by the demands of the perennity of grant making programmes for endowment foundations. The analysis further suggests that the high levels of risk concentration inherent to savings banks foundations for example result in comparatively low levels of equity exposure in the rest of their portfolio. With a few notable exceptions, private equity holdings are comparatively low, and the associated know-how is unevenly distributed, which may have direct implications for MRI dynamics.

In Chapter 5, a second layer of the landscape is presented through an analysis of the mission related investment activities currently conducted by the sample’s organisations. Data pertaining to over 220 individual investments were captured and findings pertaining to instrument type, size, sector allocation, source of capital, risk and return are discussed.

This analysis found equity to be the preferred instrument of mission related investing, either directly or through funds. MRIs tend to be small, with 86% of the mapped investments below the €10 million mark, and approximately half are dedicated to the policy areas linked to ‘Social Investment & Skills’, a category matching the relevant policy window of the InvestEU Programme. The European Union is home to more than 80% of the total Euro amount of these investments, three quarters of which were funded from the relevant organisation’s endowment capital.

The interviews conducted with sample organisations reveal how early adopters that have deployed significant resources and high levels of creativity to build mission investing expertise, capabilities and processes are present in the European philanthropic sector. They have in fact done so in the absence of a conducive or harmonised legal and fiscal environment, and the study found that the lack of

harmonised rules is proving counter-productive to ongoing efforts to add investments to the philanthropic set of mission-delivery tools.

These interviews further indicate that European philanthropic organisations have often brought to bear the specific know-how they derive from their origins or from their nature to deploy investment capital where they knew it to be most needed and were best positioned to do so, combining grants and investments to create pipelines, and laying the foundations for the social economy within their community.

These factors suggest that initiatives dedicated to the mobilisation of philanthropic capital for mission investing should not approach organisations that have been central to the early development of the concept as passive product-takers, but rather as co-creators capable of bringing a unique value proposition to the table.

Conversations provided these philanthropic actors with the space to discuss the significant obstacles to the growth of mission investing they have identified through their efforts. While there were calls for reform of existing frameworks or the creation of new ones to deliver guidance or combat impact washing, many of the volunteered stumbling blocks were the recognisable symptoms of early-stage market building pains.

This leads to a fundamental finding from the study pertaining to the need for market building discussed in Chapter 6. Mission investing in the EU is at a stage of its development where a systemic approach to the deployment of financial instruments can set standards and help unlock the momentum that will ensure the sector's considerable achievements are leveraged upon and have a lasting impact. Some of the key hurdles identified by interviewees can indeed be cleared through the completion of a market building process, a process that uses the concepts of operational efficiency, replicability, and transparency as cornerstones.

Acknowledging that the first and most important requirement of market building, self-motivated actors, is more than met by the sector, the study offers guidance for future EU mobilisation efforts drawn from comparable contexts including development finance. It identifies, where relevant, the potential need for the application of grant funding from philanthropic or public sources.

Having highlighted the need to consider the use of financial instruments in the context of the purpose they serve, an array of mobilisation structures for acceleration or adoption is presented. It serves to illustrate how the sector can draw on tried and tested solutions through which mission related investments may be either accelerated, or through which their adoption by additional actors might be facilitated.

Bringing the focus to the InvestEU Programme, Chapter 7 documents a high degree of alignment between current MRI portfolios and InvestEU's policy windows, which in turn means that the programme could conceivably play a key catalytic role in the mobilisation of philanthropic capital for

MRIs targeted at common missions. Some of the instruments at the disposal of its current implementing partners were confirmed to be a fit for further mobilisation purposes.

The study's concluding chapter suggests an approach and a set of implementation steps that could be taken by willing philanthropic organisations and relevant EU institutions, notably the EC, the EIB and the EIF to work towards the co-creation of a pilot facility. Beyond the investment it would deliver in pursuit of a common mission, such an instrument should set a precedent and should set standards and the bulk of its value should be clearly understood to lie in its future replication rather than in its first iteration.

The Philanthropic Capital Study finds that European philanthropic organisations have through a combination of the expertise of their teams, the allocation of resources and rarely observed levels of self-motivation laid the foundations for what could become a 'good' market for mission related investments. A 'good' market that, set on the path to deliver on its promises with public support from the EU, could do much to serve the common missions the philanthropic sector shares with the European project.

## 3. Methodology

### 3.1. Objectives

The present study does not aim to provide an exhaustive and accurate account of the stocks and flows of philanthropic capital in Europe, nor does it set out to map the entire array of investment instruments and other forms of funding deployed by philanthropic actors in the pursuit of their missions. Senior professionals at some twenty-three foundations were interviewed to discuss how they conduct their investment activity, with a focus on the deployment of their endowment capital, as were senior experts and representative bodies for the philanthropic sectors. They are recognised at the end of the study. The very important deployment of programmatic budget, i.e donation based, funding is not considered in the present study except in instances where it is conducted in a financial investment context. It is acknowledged that the deployment of grants, including their combination with endowment capital, warrants further research.

The study thus aims to share findings pertaining to the MRI activities of a sample of foundations, offering an overview of the instruments used, of their characteristics and of some of the constraining factors philanthropic organisations have to contend with. Individual case studies that may serve as inspiration are also volunteered. Considerations are made as to how the public sector and notably the EU institutions, the EC, the EIB and the EIF, may support and what role financial instruments could play.

### 3.2. Challenges

Initial conversations with practitioners and researchers active in the philanthropic sector provided consistent warnings of its inherent diversity and complexity. Contrary to widely held beliefs, capital and its deployment through investments only allow for a finite and manageable number of permutations and scenarios, none of which are truly complex. The very real difficulties associated with mapping philanthropic capital in the European Union do however indeed stem from challenges linked to the continent's diverse and complex legal landscape. These challenges are many, but it is perhaps useful to pause to single out two main elements: definitional hurdles and the lack of consistent and transparent access to data.

#### ***Definitional***

It is tempting, and broadly correct, to assume that foundations are, among philanthropic organisations, understood as entities donating private resources towards the public good, the most relevant actors if the research focus is capital. The concepts of endowment and ownership are closely associated with the foundation model, and some of the most visible and proactive proponents of the mission investing concept have to date been found amongst public benefit foundations.

Were this study focused on the United States of America, the accuracy of this assumption would in fact be a sufficient basis for mapping purposes. The Tax Reform Act of 1969 had a life-changing simplification impact on private sector foundations, legislating on how much private, tax-exempt foundations should spend, and limiting their ability to hold on to controlling stakes in ‘related’ corporations<sup>1</sup>. This effectively all but put an end to the use of foundations for non-primarily-philanthropic pursuits.

Whilst there do exist rules at the national level within the European Union, a significant number of Member States do allow for foundations to serve a variety of purposes, of which philanthropy is only one, and not necessarily the most important one. Conversations with academic researchers do in fact suggest that agreeing on a definition for what a foundation is at the European level remains a significant hurdle to a comprehensive mapping exercise.

Equally there are examples of philanthropic organisations who have ownership of significant assets, and display most of the characteristics of an endowment-based foundation but are not incorporated as a foundation.

Thankfully it is not necessary to systematically catalogue the capital of all philanthropic organisations to develop an understanding of what their capital can or cannot do, of what it will or will not do. The sample approach described below therefore circumvents this definitional issue by focusing on relevance. Because it was not necessary to design a filter that could be applied to the entire universe of philanthropic organisations in the EU, the organisations on which this study is based were selected on the basis of their relevance to the development of a practical understanding of factors affecting the willingness and ability of philanthropic organisations to invest for impact in alignment with their public good mission.

It was thus deemed useful to select organisations covering a range of asset sizes, in recognition of the different investment equations they must solve. The sample included organisations whose differentiated structures, often a function of their origins, equally affect their ability to deploy capital, for example through the mandatory holding of core assets. Organisations were selected across geographies, where they are operating within different legal, regulatory and fiscal frameworks, which in places include guidance on diversification or asset allocation. In recognition of the complexity of some philanthropic structures, organisations that form part of a wider system were included alongside stand-alone entities.

The approach to the sample’s selection, as well as its limitations are further discussed in section 3.3.

### ***Consistent and transparent access to data***

Another useful feature of the American model is the standardised, publicly available filing of tax returns by private foundations. Here again, central registries or mandatory publicly available filings

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<sup>1</sup> Hackney, P. (2020). *The 1969 Tax Reform Act and Charities: Fifty Years Later*. *Pittsburgh Tax Review*

are a feature in some EU Member States, but the fact that this is not the case everywhere, and that where they exist, public disclosure standards are not aligned, makes a systematic data-based mapping extremely challenging. Book value accounting does in any event mean the value of some of the data is at times questionable.

To be clear, there are instances of readily available and transparent access to very high-quality data, as is for example the case with the Italian savings banks foundations sector. It is in fact possible in such instances to have much better access to data than is the case in the USA. The annual report published by the Associazione di Fondazioni e di Casse di Risparmio ('ACRI') for example provides a very thorough analysis of the investment activities of the Italian savings banks foundations sector<sup>2</sup>. The real issue is the consistency of this availability across the European Union.

Transparency beyond mandatory disclosure is in fact a very real issue on both sides of the Atlantic. The overwhelming majority of the sample of philanthropic organisations selected for the purpose of the study were fully transparent. There were isolated instances of organisations not responding or rather transparently not wishing to engage at all. Whilst this did not significantly impair the ability of this study to arrive at a relevant level of understanding of the aspect of the sector it is focused on, it would of course be problematic in the context of a full mapping exercise.

### 3.3. A Sample Based, Qualitative Approach

Thankfully it is not necessary to account for every Euro of capital to analyse the investment dynamics of a sector. Perhaps counterintuitively, numbers are not as important to understanding the capital of organisations as the objectives and the rules that shape its use. And because the diverse European legal landscape means that some of the largest philanthropic actors may not be exclusively focused on philanthropic objectives - some are for example tasked with owning a specific asset - adopting an exclusive definition would mean providing a distorted picture of the sector's potential.

This study therefore opted for an in-depth interview approach focused on a representative sample of twenty-three private sector organisations that clearly identified philanthropic pursuits as one of their missions. The sample sought to cut across three main dimensions:

- **Category:** This refers to the nature – which in turn often informs the structure – of the organisation. Each category is described in more detail in 4.2. In the absence of a generally accepted taxonomy - and of the pretention to create one - engagements were sought with:
  - Endowment foundations
  - Shareholder foundations
  - Savings banks foundations
  - Umbrella foundations
  - Lottery foundations

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<sup>2</sup> [www.acri.it/wp-content/uploads/2022/07/Rapporto-annuale-2021.pdf](http://www.acri.it/wp-content/uploads/2022/07/Rapporto-annuale-2021.pdf)



▪ Fundraising foundations



Figure 1: Sample Overview – Each letter represents an organisation

- **Geography:** Organisations domiciled in ten different EU Member States were interviewed. Whilst this may not be comprehensive, the observable patterns of the concentration of capital in the EU mean this was considered an acceptable basis for the limited objectives of this study. One organisation is legally registered in the USA, but 100% of both its staff and its activities are located in the EU.
- **Size:** The size of the assets of the organisations the sample is comprised of range from €60 million to €94 billion. This diversity is important given that the problematics of investment are size-conscious, in particular through the linked availability of human resources and know-how.



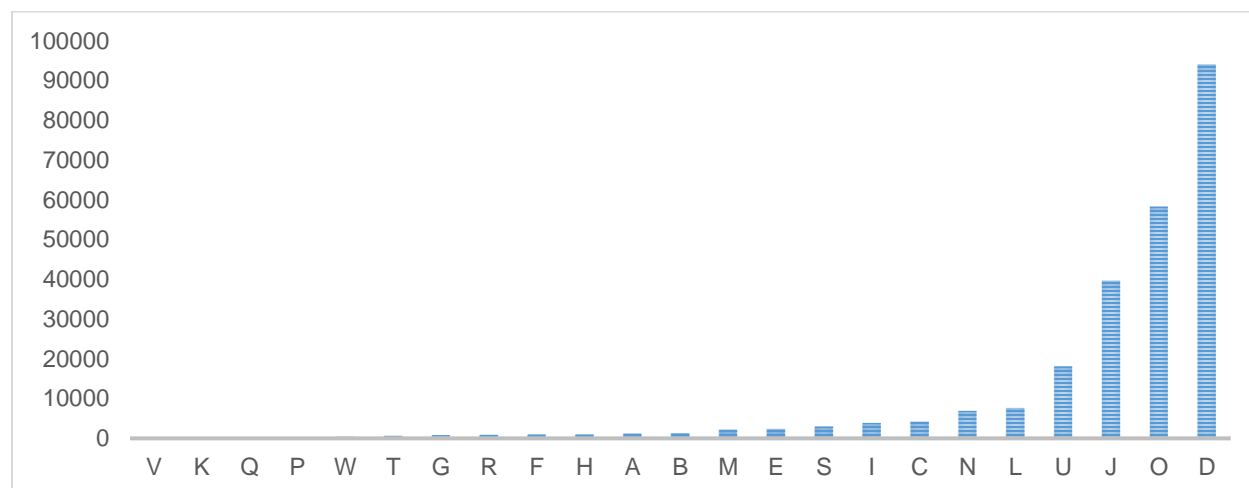


Figure 2: Sample Organisations Assets in millions of Euros

### ***Stock and flow:***

Further to early engagement with stakeholders from the philanthropic sector, a decision was made to include organisations that were not originally endowed with a ‘stock’ of capital, but whose activities are funded by a ‘flow’, whether it is for example derived from public donations or lottery revenues, and who do nonetheless invest capital in the pursuit of their philanthropic missions.

### ***Root and branch:***

To understand the capital of a specific organisation, it was at times necessary to analyse a group of entities. In one such example, a public benefit foundation for example derives all its income from a ‘related’ shareholder foundation, which itself delegates the management of the financial assets it holds outside of its core corporate holding to a third foundation. Although it is largely expressed through one of them, all three entities have a charitable purpose. In another instance a foundation derives all its income from an organisation with which it also shares ownership of its only investment asset. There is nothing inherently problematic with multi-entities setups, but it is necessary to have access to all components to build a fit-for-purpose understanding of the funding available to deliver on philanthropic objectives.

### ***Limitations:***

The sample was defined to inform the needs of the analysis of an investment scenario by a capital markets practitioner. It does not seek to provide a definitive statistical account of the EU’s philanthropic sector. It was discussed with and augmented according to the recommendations of representative bodies for the sector. Given the absence of aggregate data pertaining to the number, categorisation, legal structures or asset sizes of philanthropic organisations, conversations with academic researchers with specific expertise in the field confirmed that a much larger research

exercise will need to be conducted before a more statistically representative sample can be arrived at.

### 3.3.1. Line of Enquiry

The primary objective of the study is to build an understanding of the nature and the structure of the capital available to European philanthropic organisations as well as the income derived from this capital, and to determine how this can be mobilised or leveraged to support investments that contribute to the delivery of their mission and the European Common Good.

The interview format was designed so as not to be overly prescriptive and to ensure that the representatives of each organisation were allowed to guide the conversation towards those aspects they believed to be most relevant. Whilst the focus of each individual conversation was of course on their organisation, interviewees were encouraged to flag those parameters they believe to be relevant to the wider sector. Core questions were however focused on three areas:

#### ***The constraints the capital of the organisation is subjected to.***

These include 'external' legal, fiscal & regulatory frameworks, but also 'internal' governance, policies, and mandates. It should be noted that where 'internal' policies were defined by the founders, whether they be individuals or institutions, they can be very difficult to modify, and are therefore almost akin to law. Often as important in an investment context are the established but more informal practices, guidelines and ways of working that may not be explicitly written but play a determining role in the management of capital, and therefore should be understood. Whilst in examining the constraints, the focus was understandably put on the frameworks applicable to investments, spending rules, for example, expressed as a percentage of income were identified as directly relevant, as were rules, internal and external, limiting the use of grants to make or support investments.

#### ***How the organisation's capital is invested***

Where relevant, interviews covered the portfolio's asset allocation, benchmarking & risk/return targets, and how and by whom these are determined. The implementation of the investment strategy was also discussed, and in particular the respective roles of internal investment teams and external fund managers.

#### ***The organisation's policy pertaining to mission related investments.***

The primary objective was to understand the organisation's stance on the use of investments as a means of mission delivery, how this has been expressed to date and how it will be implemented going forward. It was deemed particularly important to understand how such investments had been made in the context of the organisation's structure and set of constraints, and whether use was made of endowment capital or income usually earmarked for grant making. Interviewees were asked to share

their assessment of what the main hurdles to the concept's development were, both from their own organisation's standpoint and the wider sector's.

### 3.4. Desktop Research Overlay

A guiding principle for the study was that the time generously made available by senior representatives of philanthropic organisations should not be utilised to obtain readily available information. Publicly available information pertaining to the sample of organisations was therefore systematically reviewed and analysed, both ahead and in the light of the interviews. This served to advance three main workstreams:

#### ***Financial analysis***

This was largely conducted through the analysis of annual reports and financial statements, although on one occasion a research note on a specific sub-sector conducted by an investment bank was drawn from. This yielded aggregate portfolio sizes, asset allocations and the ability to differentiate between core or strategic holdings and 'accessible' financial portfolios.

It was in addition necessary to assess the value of some of the large shareholdings that make up a significant share of some of these organisations' capital. Whilst corrections are easily made where underlying assets are publicly traded and therefore have an observable price, holdings of equity in private companies are more problematic. For the purpose of this study, these holdings were valued using the shareholder equity reported in the latest available financial statements for the relevant corporation and the percentage of the equity held by the philanthropic organisation. Whilst it has its limitations, this approach is considered adequate given that the objective is not to provide a perfect calculation but rather an order of magnitude. A calculation using an average price-earnings ratio for the corresponding listed sector on public equity markets in combination with the reported earnings for the business was used to verify that this order of magnitude was not erroneous.

#### ***Legal framework***

Publications of European and national level representative bodies and academic papers provided a solid basis. The authors of Philea's 2021 "Comparative Highlights of Foundation Laws"<sup>3</sup> must be singled out for specific expressions of gratitude. The report is a valuable cornerstone, as are the individual underlying country reports it published earlier. In addition, it was at times necessary to read the original relevant laws and regulations, in particular where there was an observed discrepancy between the interpretations of the texts among practitioners.

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<sup>3</sup> Philea. (2021). *Comparative Highlights of Foundation Laws*. Brussels.

### ***Precedents & principles***

An important component of the research process beyond the interviews related to the identification of relevant precedents from which lessons could be drawn. The deployment of investment capital as a means of mission delivery is not equally novel in all contexts, and the development finance sector<sup>4</sup> has built decades-worth of financial and impact track records and accumulated a wealth of failures and successes that should contribute to like-minded pursuits in other fields. More generally, if and as philanthropic organisations seek to efficiently deploy more of the assets at their disposal in the pursuit of their mission, some of the basic principles of financial market building should at least be considered.

Proprietary knowledge built through personal experience in both these contexts was drawn on, as well as the knowledge and expertise of senior practitioners in development finance and capital markets provided through in-depth conversations.

## **3.5. Taxonomy & Anonymity**

The search continues for a generally accepted definition for investments not primarily, or solely, undertaken to generate a financial return. This study will not join the fray, but it is necessary to at least explain the approach taken.

In matters of investments, the generally accepted approach is to turn to the most powerful institution for definitional guidance: the relevant tax authority. The United States' Internal Revenue Code has provided a definition for what a Program-Related Investment (PRI) is in the USA<sup>5</sup>. It has, regrettably, not yet extended this to define impact investments or MRIs. It can at least be safely inferred that they are not PRIs.

**For the purpose of this study, mission-related investments are defined as repayable investments not made solely to generate a financial return, but also to generate a positive societal impact aligned with an organisation's missions and values.**

As outlined above, the study does not provide an analysis of the significant grant based activity of philanthropic organisations, but is focussed on repayable investments, whether they are made from endowment capital or other sources.

There are of course investments that do seek to generate such an impact but are not *per se* aligned with an organisation's specific set of missions. Given the absence of a legal, fiscal or regulatory status for MRIs, the observations yielded by this study are often equally applicable to this subset.

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<sup>4</sup> See: <https://www.oecd.org/development/development-finance-institutions-private-sector-development.htm>

<sup>5</sup> See: <https://www.irs.gov/charities-non-profits/private-foundations/program-related-investments>

Very much like their pure profit seeking relatives, some MRIs will be riskier than others, some will turn out to be more profitable than others, and some will be funded by one pocket, or another, or both. Money is fungible, risk is a spectrum, returns are unpredictable.

Interviewee foundations are neither listed nor identified in the part of the study that is more specifically focussed on describing portfolios and structures. Some of the information underpinning the analysis is not public. In this regard, the high level of transparency and engagement provided by organisations is acknowledged with gratitude. The - hopefully - useful points discussed below revolve around concepts, not names.

## 4. The Landscape of EU Philanthropic Capital

### 4.1. First Glance

The twenty-three organisations interviewed for the purpose of this study hold aggregate assets worth approximately €255 billion. The lack of an accurate summation of the assets of all philanthropic organisations in the EU makes it impossible to ascertain how large a proportion of the total number the sample represents. The definitional challenges highlighted above mean that even comparisons with dated efforts (EFC in 2008, DAFNE in 2014) are hazardous at best. As discussed below, the fact that some of the largest organisations serve a dual purpose and cannot therefore be directly compared with their American counterparts is a further complication.

It must however be remembered that mission investing, even in its most ‘mature’ incarnations, is in the early stage of its - potential - growth path. Here too, there is a lack of reliable market sizing as self-reporting, and a desire on the part of promotion agencies to show aggressive growth, limit the value of the available statistics. For example, reports on mission investment activity are too often distinguished by optimistic extrapolations of market sizes and opportunities.

This study strives to avoid similar quixotic traps. The fact remains however that the study’s sample of twenty-three organisations, which are purposefully not simply the twenty-three largest, own assets in excess of those of the top 25 US foundations<sup>6</sup>. This fact suggests that the EU’s philanthropic sector is equipped with the financial potential necessary to play as significant a role in the growth of mission investing as its hitherto more visible US counterpart.

As is the case in the development finance space<sup>7</sup>, it seems clear that the bottleneck that constrains capital mobilisation is not likely to be the quantum of the supply of capital, but a combination of its ability and motivation to meet a nascent, scattered and too often opaque demand pipeline. The key question is therefore not how much available capital there is, but what it wants to do, and what it can do.

### 4.2. Nature & Structure

As stated above, the sample of organisations was broken down into six categories. It is the purpose of this section to provide a very brief description of each. It must be noted that hybrid situations, whilst not being the norm, are not exceptions. Umbrella foundations typically have an endowment, as have some fundraising foundations, while there are instances of endowment foundations receiving corporate donations.

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<sup>6</sup> Candid. (2020). <https://candid.org/explore-issues/us-social-sector/organizations>

<sup>7</sup> See: [https://www.ifc.org/wps/wcm/connect/Topics\\_Ext\\_Content/IFC\\_External\\_Corporate\\_Site/Upstream/](https://www.ifc.org/wps/wcm/connect/Topics_Ext_Content/IFC_External_Corporate_Site/Upstream/)

### ***Endowment foundations***

This is perhaps the most recognisable category. The foundation is endowed with a diversified portfolio of financial assets. It derives a significant portion, although not necessarily the entirety, of its budget from the returns generated by this portfolio. The foundation may have been endowed by an individual or family, or by a public sector entity, for example as a result of a privatisation process.

It is worth noting that one of the endowment foundations interviewed is in fact an association, but from an investment standpoint there are enough similarities to justify this amalgamation.

### ***Shareholder foundations***

There are different legal structures, but essentially shareholder foundations hold one (or more) core, typically controlling, shareholdings in one or more specific businesses to which they are closely related.

The shareholding in the related business(es) can be publicly listed or privately held. It can be the foundation's only significant asset or sit alongside a more diversified financial portfolio.

A key concept is that as discussed above, although the shareholder foundations included in the sample all have a charitable purpose, they also have a 'business' purpose. This can for example be to ensure the perpetuity of the business through the 'ownerless' nature of the foundation, to equip it with the independent long-term financing means of its growth, or to avoid complications linked to inheritance. The prioritisation of the business objective over the charitable purpose - or vice-versa - is not always clearly defined, but it is important to recognise that this is a legitimate reality of the European philanthropic landscape, if only because some of these organisations are among its largest grant makers.

It is also interesting to recognise that significant, often controlling, ownership of the business by a philanthropic organisation can have an equally significant, and potentially positive influence on the manner in which it conducts its affairs. The impact of this model is not in the scope of this study but does warrant further research.

### ***Savings banks foundations***

Savings banks have been a long-standing feature of the European financial landscape. In many scenarios, they originally were ownerless or mutual or cooperative entities, and often were conceived to serve their community.

Whilst the scenarios vary, the difficulty to finance growth, or survival, without easy recourse to external capital triggered the separation of these entities into a more market friendly joint-stock bank and a shareholder foundation.

The direction of travel has differed from country to country. Some savings banks foundations are more aligned to the shareholder foundation model and remain primarily or exclusively invested in

the transferee bank. Others have, sometimes as a result of market turbulence, been pushed to diversify away and are on a trajectory towards the endowment model.

Whilst they could in theory be distributed across the two previous categories the fact that specific savings banks foundations national laws are typically in place, forms the basis for a distinct categorisation. In some cases, the savings bank itself continues to have a community mission culture and could be seen as aligned with the foundation's philanthropic mission.

### ***Umbrella foundations***

These refer to foundations which, typically alongside their own endowment, manage a number of 'hosted' foundations on behalf of third parties, whether they be corporate entities or individuals, whether they be currently in operation or departed.

This is akin to the 'Donor Advised Fund'<sup>8</sup> model, and is essentially an outsourced philanthropic model, where the administrative, grant making and asset management functions are outsourced to a central organisation.

There is typically a varying degree of 'customisation' afforded to these hosted foundations. In some cases the assets are centrally pooled, in others they are left in the custody and under the management of third party private banks.

### ***Lottery foundations***

Whilst there are few lottery-funded foundations, they are important examples of 'flow' based private sector philanthropic organisations, and it is for example worth noting that with an aggregate grant volume of over €800 million in 2020<sup>9</sup>, Postcode Lotteries are collectively one of the world's largest donors.

Two such 'systems' of organisations were interviewed for the purpose of this study; both have also been pioneers in the use of investment in private businesses as a vehicle for mission delivery, demonstrating that this needs not be the preserve of organisations endowed with a 'stock' of capital.

### ***Fundraising foundations***

These are also 'flow' based organisations, that derive their income from donations, which can originate from the public, corporate entities or government sources.

Although the associative sector is not the focus of this study, they open a window on what could be an additional source of support for mission investing.

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<sup>8</sup> See: <https://www.nptrust.org/what-is-a-donor-advised-fund/>

<sup>9</sup> <https://www.acl.eu/charities>



The EU's philanthropic organisations form a diverse landscape, even at the basic structural level. The study makes use of six categories, which do by necessity run the risk of over-simplification. Where the study of their capital is concerned however, the study found that it is possible to discern a manageable number of models.

## 4.3. Concentration Patterns

### 4.3.1. Entities, Structures & Geographies

The most striking feature of the emerging landscape of Europe's philanthropic capital is a very significant level of concentration. This is true at the organisation level, with the three largest organisations accounting for roughly three quarters of the sampled assets.

It must be noted that the size of the assets of some philanthropic organisations is highly correlated to the share price of one or more core holdings. This means that the landscape discussed here is necessarily a snapshot associated with a specific point in time and can be significantly altered by market movements. It is however important to take stock of the fact that the landscape is dominated by a group of giants, as indeed is the case in the USA.

Perhaps more importantly, shareholder foundations account for 75% of the sample's assets.. The percentage of the entire aggregate sector they represent may well be lower but even if a comprehensive picture of the aggregate landscape was available, it would still be a significant part thereof.

A key finding is therefore that a very significant portion of the sector's aggregate capital is held by large organisations who have both a charitable purpose and a corporate *raison d'être*.

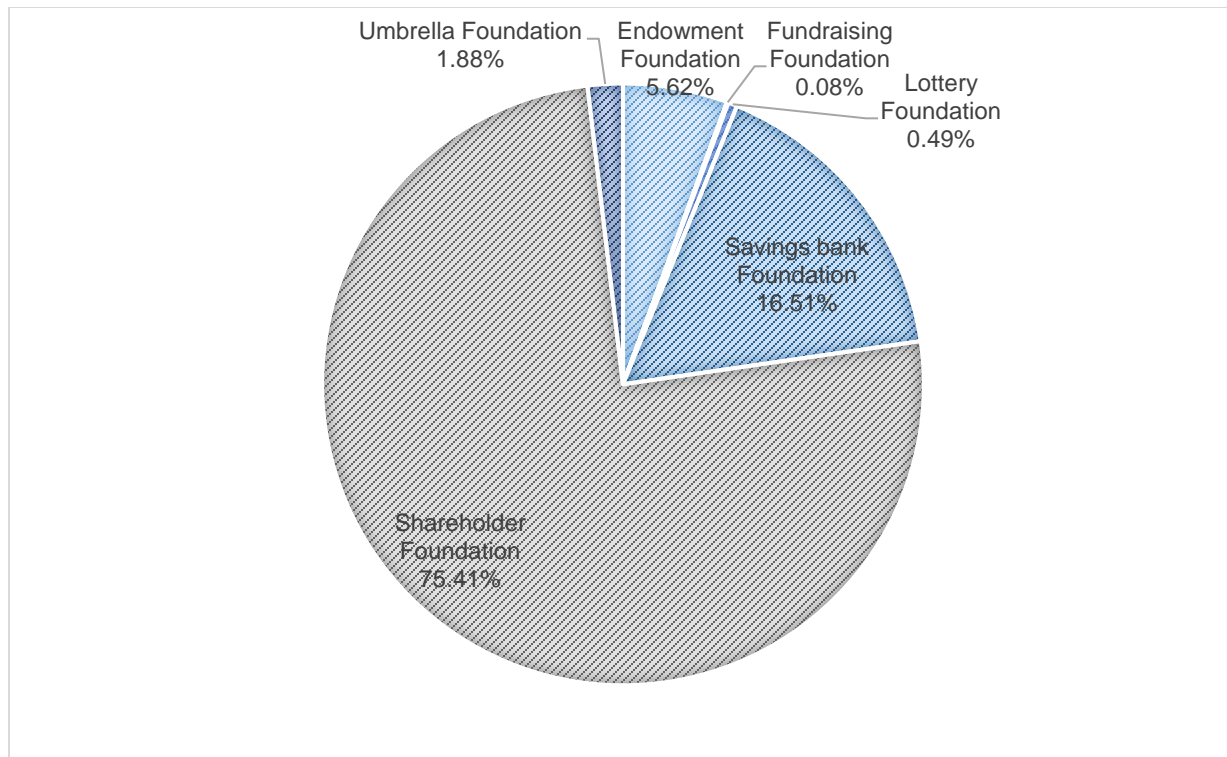


Figure 3: Breakdown of sample organisations assets by category

The implication for the geographical concentration pattern is clear, and with the notable but diminished exception of the Italian savings banks foundations sector, the philanthropic capital landscape seems to be skewed towards those countries in northern Europe where the dual mission shareholder foundation model is more prevalent. Data from the Danish Fondenes Videnscenter<sup>10</sup> for example suggests that the 20 largest Danish enterprise foundations ('Erhvervsdrivende fonden') alone have combined assets exceeding €170 billion. Shareholder foundations are also a prominent feature of the German landscape according to the Bundesverband Deutscher Stiftungen<sup>11</sup>, although a reliance on book value accounting means a meaningful aggregate size datapoint is not available. This is of course in no way suggesting that there do not exist philanthropic organisations with large endowments elsewhere, or that the gravity centre of philanthropic activity or expertise follows this pattern.

By contrast, in EU Member States where the dual-purpose model is either not permitted by the legal framework or not widely used, the concentration of capital is much lower. Foundations in France, with an economy roughly seven times larger than Denmark's, for example held €29.5 billion in assets

<sup>10</sup> See: <https://fondenesvidenscenter.dk/>

<sup>11</sup> See: <https://www.stiftungen.org/startseite.html>

as of 2019 according to the 2021 edition of the Baromètre de la Philanthropie<sup>12</sup> (Observatoire de la Philanthropie, 2021).

It should come as no surprise that concentrations of capital held by philanthropic organisations are observed where legal frameworks allow corporate interests and philanthropic pursuits to cohabitate. The efficiency with which this model generates overall philanthropic activity in an economy, and the extent to which it creates the conditions for mission-aligned investment activity, should be the subject of further investigation.

The analysis of the assets held by the sample of philanthropic organisations unveiled high level of concentrations across a few very large actors. This concentration is in turn observed to be associated with the shareholder foundations model, prevalent in those jurisdictions where legal frameworks allow philanthropic and corporate objectives to be pursued concurrently.

### 4.3.2. Accessible Capital

When assessing the potential of this level of concentration from a pure capital mobilisation standpoint, there is however a need to introduce the concept of accessibility. Although the terms used varied, those interviewees to whom this is most relevant made frequent references to this notion.

Shareholder foundations were often incorporated for the specific, if not exclusive, purpose of owning significant stakes in related businesses. Accordingly, they are either through their founding statutes, the decisions of their internal governance bodies, or more rarely through their national framework laws, mandated to maintain these holdings.

Some shareholder foundations hold strategic holdings in more than one business, whether because of a legacy corporate strategy, or as the expression of a current one.

No common approach to the management of these holdings could be established across the sample. Interviews brought to light an array of different dynamics, ranging from a proactive drive to increase the shareholding in the related business or a minimum stake being ‘passively’ preserved through participation in share buybacks, to minimum or maximum levels of exposure set by law or through agreements with the relevant authorities.

The relevant fact is that, once holdings in the transferee business and strategic stakes are deducted, only 28% of the assets held by the sample are at least theoretically ‘accessible’ for allocations to other investments. Where only ‘accessible’ assets are concerned, the concentration around shareholder foundations is lesser, if still significant, with 53% of total accessible assets. It is fully understood that

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<sup>12</sup> *Observatoire de la Philanthropie. (2021). Baromètre de la Philanthropie. Paris.*

not all strategic investments are meant to be permanent, but the assumption is made that they are nonetheless not susceptible of being divested to make way for MRIs.

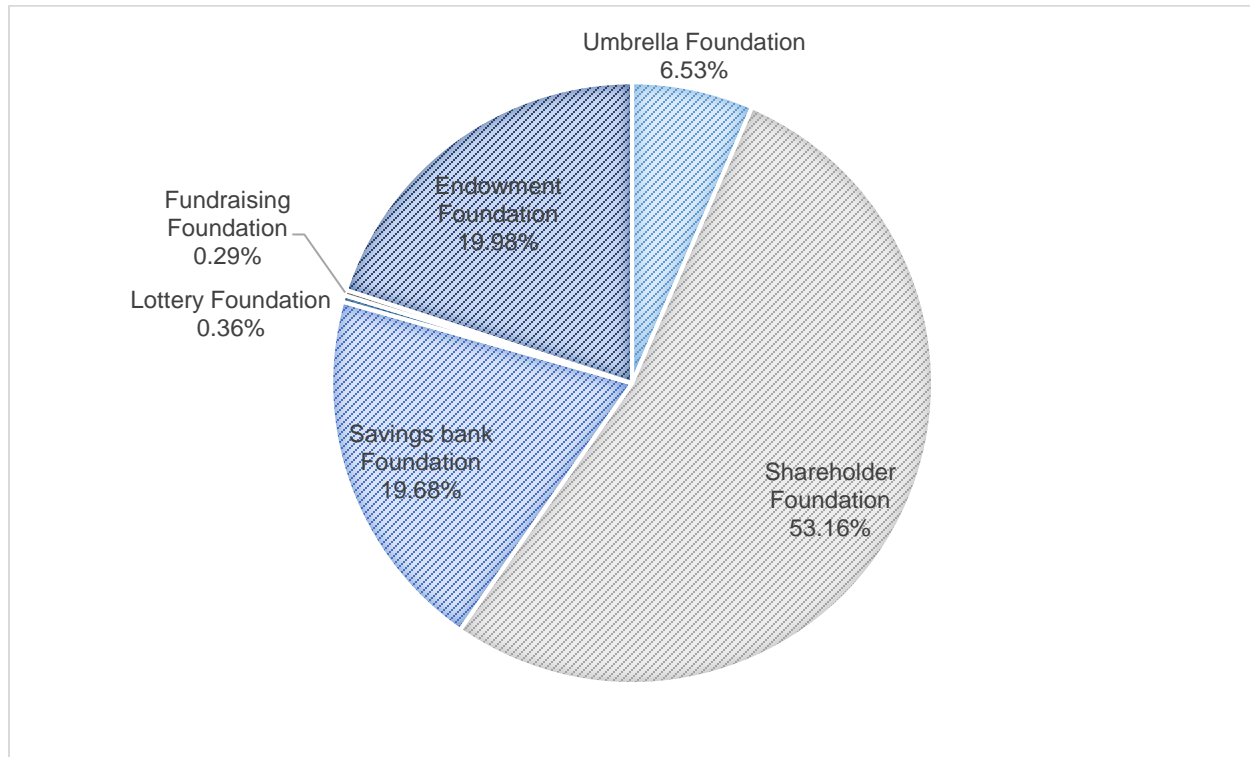


Figure 4: Breakdown of sample organisations accessible assets by category

The non ‘accessible’ assets, which are referred to as ‘tied’ are of course generating a return for their owner organisations, and it is not within the scope of this study to establish whether they may in fact be aligned with philanthropic purposes. It is simply necessary to recognise the implications for the availability of capital for other types of investments, including MRIs.

A direct consequence of the prevalence of the shareholder foundation model is that a highly significant proportion of the assets held by the sample of philanthropic organisations is ‘tied’, as the ownership of these assets is inherent to the mission of some organisations. It follows that only 28% of the assets held by the sample are ‘accessible’, and therefore theoretically available for allocation to MRIs.

### 4.3.3. Concentration and Mobilisation

High levels of concentration do, perhaps counter-intuitively, represent a challenge for mobilisation dynamics.

For asset managers seeking to run MRI mandates on behalf of philanthropic organisations, a high level of assets concentration in the hands of a few, readily identifiable, sophisticated institutional investors may be deemed an optimal situation. The process could in theory be efficient with relatively

few conversations leading to relatively large individual investment tickets. Where scalable mission-aligned investment opportunities do exist, for example in the field of sustainable infrastructure, this may indeed play out. It could even be argued that the level of geographical concentration might help address the generally observed demand for 'local' mission investing opportunities on the part of philanthropic organisations.

Scale is however not currently the hallmark of the mission investing phenomenon. The field is in fact characterised by a wide array of small enterprises and investment managers offering correspondingly sub-scale investment opportunities.

Even where significant human resources and investment capacity exist, managing a very large portfolio of assets comes with its own efficiency constraints. These typically cannot accommodate small individual investments. Whilst the philanthropic nature of these large organisations may - and indeed in places does - lead them to overlook these constraints to make investments below their natural thresholds, there will likely be limits to how small, and how often they are prepared to go.

Not all philanthropic organisations are equally afflicted by this size issue, and should a market successfully emerge for their capital, an efficient allocation process could address this issue by matching demand with size-compatible supply.

The risk is however that, as has long been the case in the context of development finance, an ill-advised, singular focus be put on the largest asset owners, whether it be for political reasons or because of an imperfect understanding of market dynamics. The efficiency of market-based resource allocation is correlated to the number and the diversity of its actors, and this should be kept in mind when drafting mobilisation strategies.

Whilst the existence of very large actors in the EU's philanthropic landscape can have obvious benefits for the feasibility of large-scale MRIs, it should not overshadow the realities of an early-stage, fragmented MRI market. For the sector to thrive, it is necessary for a diverse universe of investors to be engaged. The focus should therefore not solely be on the largest organisations.

## 4.4. Asset Allocation, Risk & Return

### 4.4.1. Aggregate Picture

The combination of an analysis of financial statements and information yielded by interviews made it possible to construct an aggregate asset allocation for the sample. Since the study's primary concern is with the assets from which organisations may decide to make an allocation to MRIs, the analysis of the accessible assets is of specific relevance. Figures 5 and 6 present the aggregated allocation inclusive of 'tied' assets as well as that of the accessible assets alone.

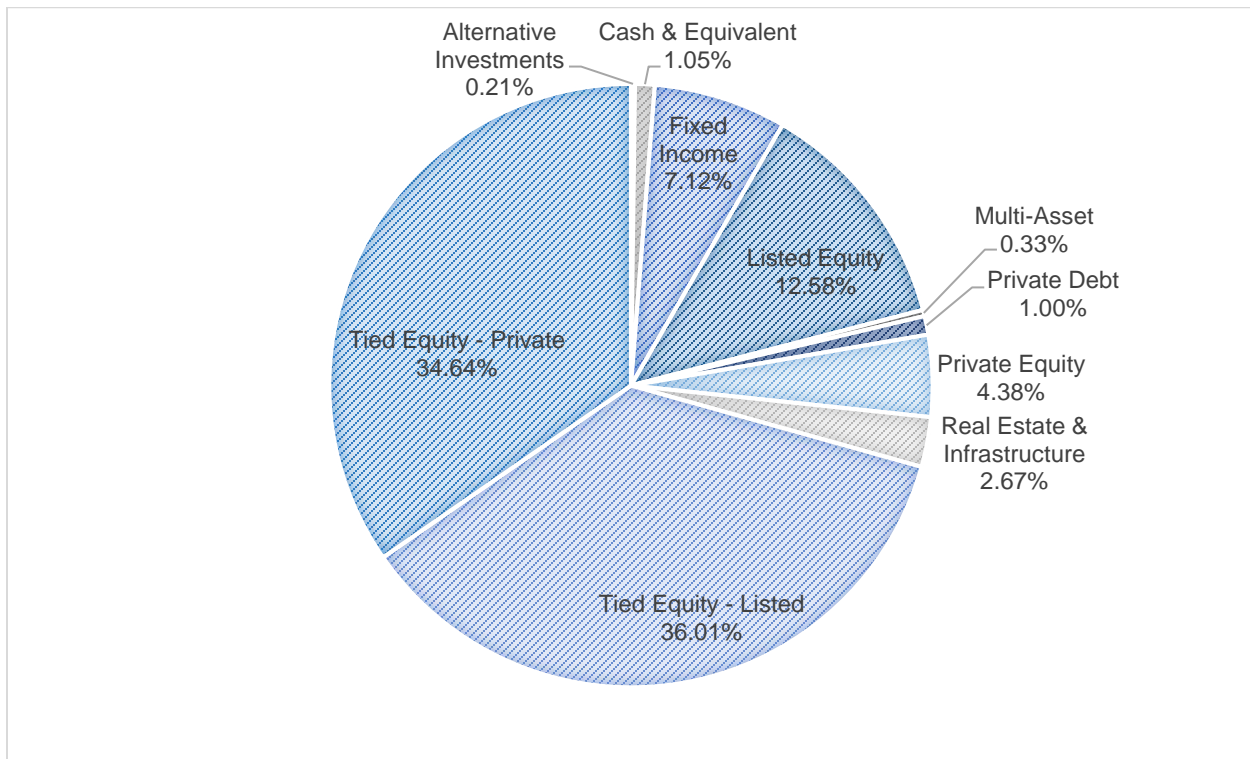


Figure 5: Aggregate asset allocation of sample organisations

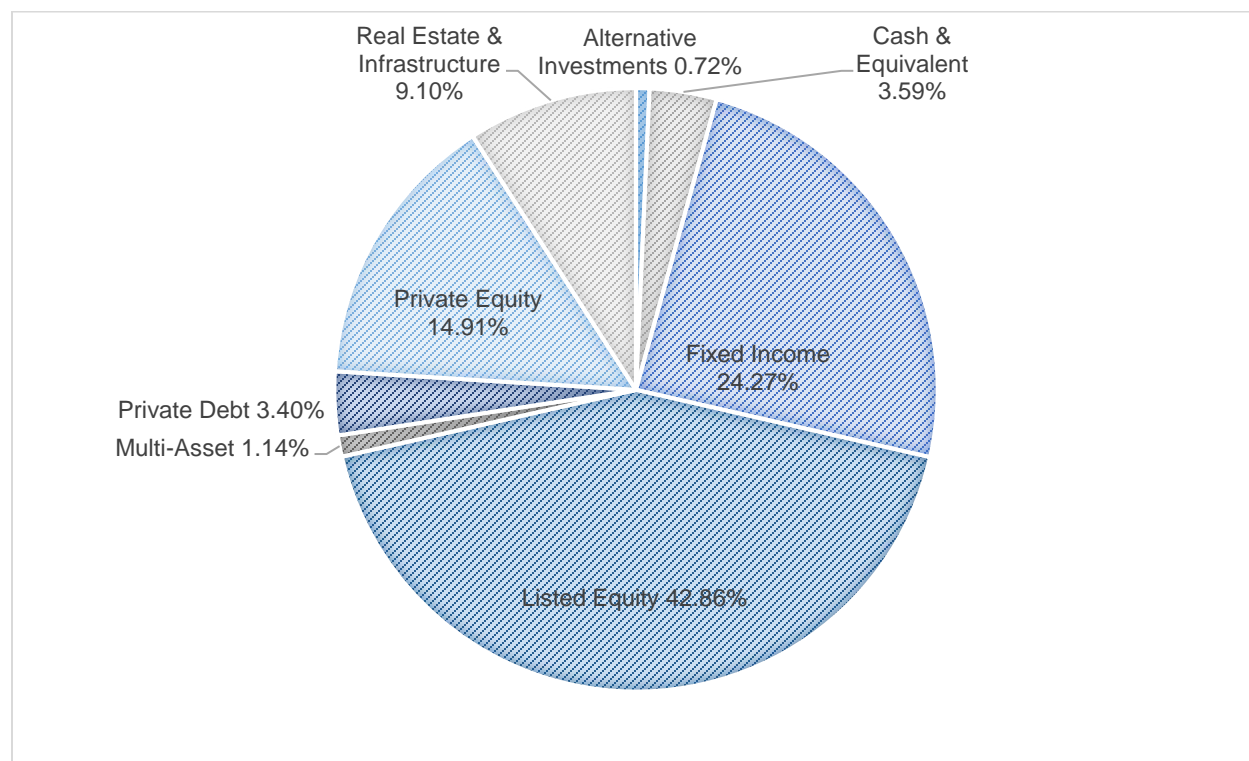


Figure 6: Aggregate accessible asset allocation of sample organisations

There is a high observable level of intermediation, with investments through funds, passive and active being observed across much of the sample. This includes recourse to multi-manager vehicles, although in some instances the fund of funds manager is part-owned by the philanthropic organisation.

This aggregate picture is useful to the analysis of the overall amounts allocated by the sample, but significant differences between individual organisations. There should therefore be no suggestion that there is at this stage a 'model' asset allocation for European philanthropic organisations. These differences are observed between categories, but also within categories, although patterns do emerge within the sample.

Umbrella foundations for example share an observable recourse to large, more or less equally weighted allocations to listed equity and bonds. Shareholder foundations in the sample take on large equity exposure through their accessible portfolios in addition to their 'tied' holdings.

There is divergence within the savings banks foundations category. This is at least in part tied to differing national legal frameworks, which in places do not allow for diversification away from the transferee bank, and in others mandate it. Some display comparatively low exposure to equity risk within their 'accessible' portfolio. This could be explained by the necessity to offset the high concentration of risk linked to the 'tied' assets. Asset allocations need to take into account large, undiversified equity allocations, and essentially diversify away from these. This can be done by

adopting an overweight stance to fixed income assets for the accessible portfolio, or by all but excluding the sector the tied assets are exposed to from the rest of the portfolio.

Endowment foundations on the other hand have no such concentration issues to contend with, and therefore tend to have more balanced, if not uniform, asset allocations with larger equity exposures. Here again however, national, legal frameworks drive asset allocations patterns. German endowment foundations may for example only use 'ordinary' income (e.g. interest, dividends or rental income) to fund grant making activities. Conversely 'extraordinary income' including capital gains can only serve to augment or preserve the endowment capital. This mechanically creates an incentive for German foundations whose budget is predominantly reliant on their endowment to allocate comparatively large proportions of their assets to fixed income. Figures 7 and 8 illustrate the respective aggregated asset allocation for the savings banks foundations and endowment foundations in the sample.

It should in addition be noted that organisations often maintain stabilisation funds, reserves accumulated to ensure that giving volumes can be maintained for a few years should the endowment fail to deliver the required returns.

Philanthropic organisations are, with the noticeable but to date rare exception of spend-down foundations, long term investors. They should therefore in theory have large investment risk budgets, given their ability to weather short-term financial storms. The aggregate accessible asset allocation does indeed show large equity allocations, but the relative situation of different categories is as discussed contrasted.

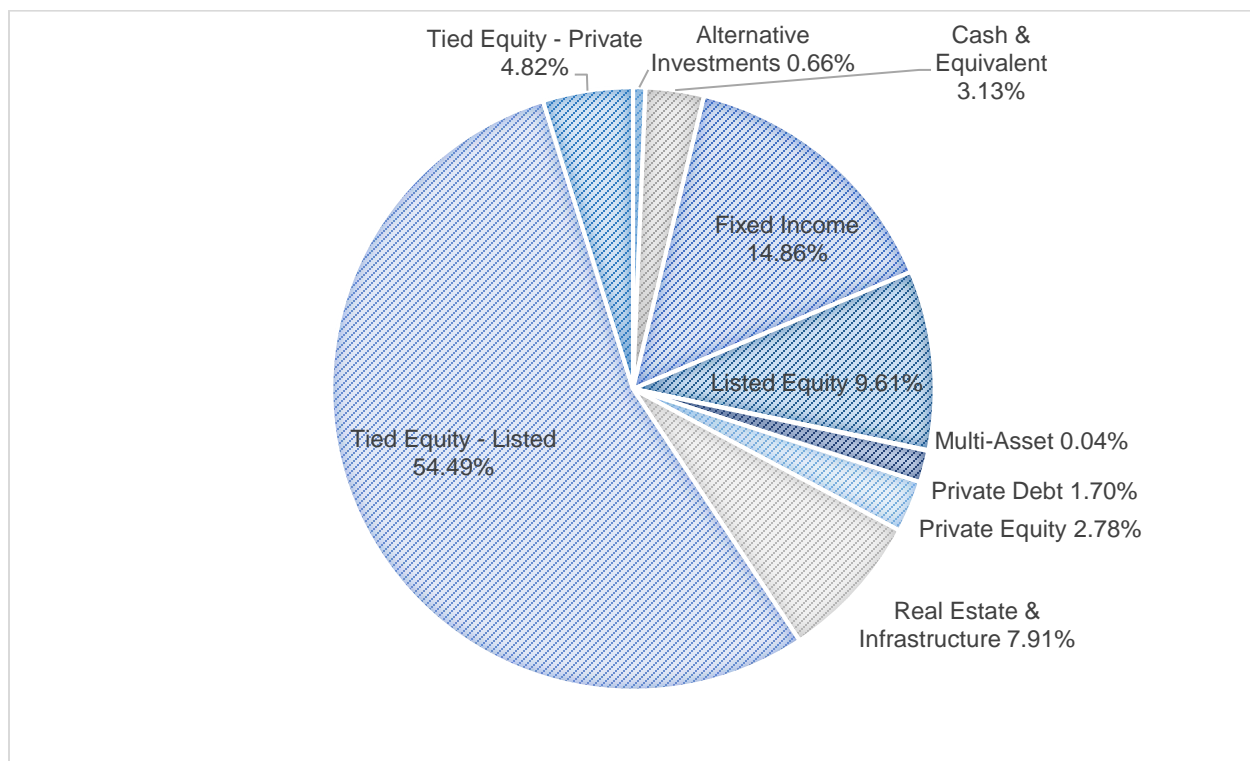


Figure 7: Aggregate asset allocation of the sample's savings banks foundations



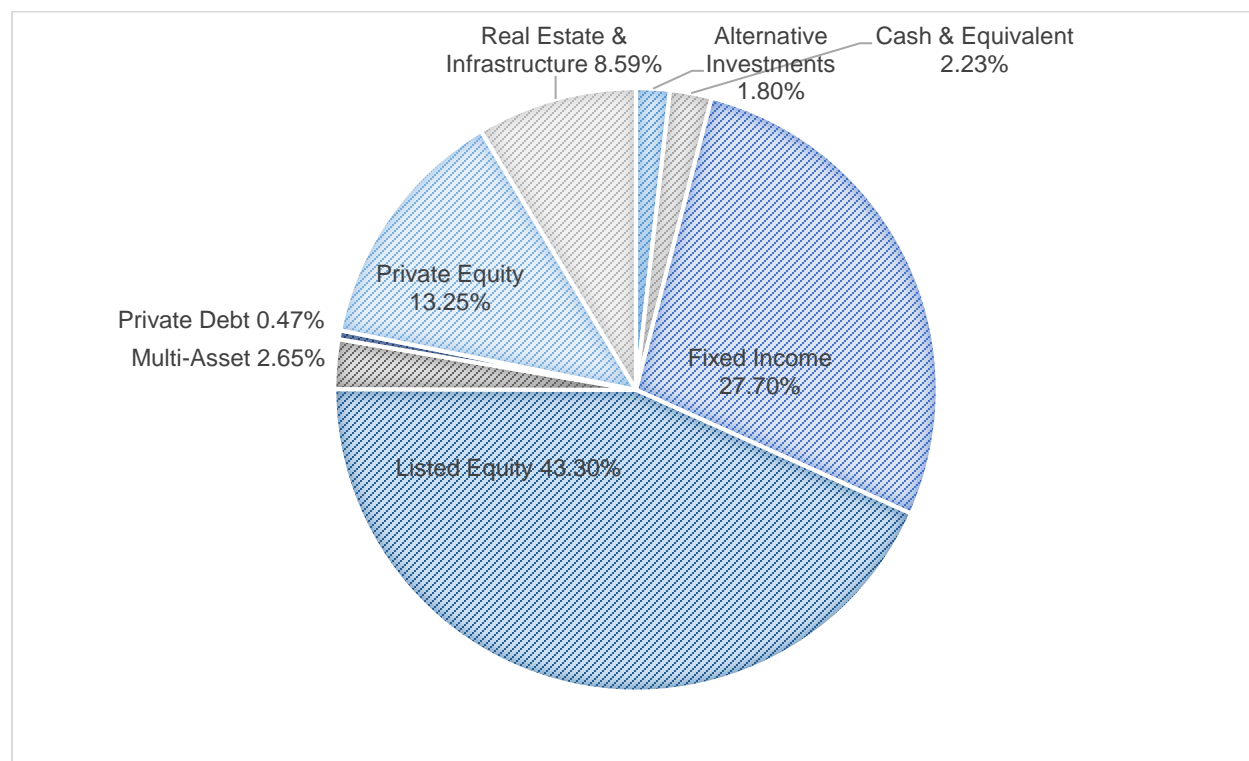


Figure 8: Aggregate asset allocation of the sample's endowment foundations

The relatively low exposure to private equity observed across much of the sample should be compared to the large private equity allocations of US endowments. In its 2020 Endowments and Foundations Study<sup>13</sup>, BNY Mellon indicates the average allocation to private equity in its sample group is 16.88%, a number that reaches 25.81% for endowments larger than \$1 billion. Some of this divergence might be explained by European institutional investors' lower overall exposure to private equity when compared with their US counterparts<sup>14</sup>.

Although the sample's endowment foundations have a comparable allocation to private equity at circa 13%, only two have an allocation of over 20%. Umbrella foundations in the sample on average allocate less than 1% of their assets to private equity.

Private equity and private debt remain the most used strategies for delivering impact through investment activity, and the appetite for private assets exposure on the part of European philanthropic organisations may have significant implications for mobilisation dynamics.

<sup>13</sup> See: <https://www.bnymellon.com/us/en/insights/all-insights/bny-mellon-endowments-and-foundations-study-2020.html>

<sup>14</sup> Prequin. (2019). 2019 Prequin Global Private Equity and Venture Capital Report

The asset allocation of the sample's organisations yields a contrasted picture. 'Tied' assets and corporate missions do wield considerable influence on the deployment of accessible assets. The former do in places result in comparatively low allocations to equity risk. Importantly for MRI dynamics, private equity exposure is on aggregate comparatively low and uneven across the sample.

#### **4.4.2. Why it Matters: Resources & Know-How**

Investment is not solely a matter of risk and return. Decisions are also a function of an individual institution's familiarity with, access to, and understanding of asset classes and financial instruments. They are also dependent on its capacity to assess opportunities, conduct due diligence and go through sometimes complex, lengthy, and therefore costly contracting processes. As discussed below, an organisation may be prepared to shoulder the risk and return implications of mission investing, but not have the technical and practical ability to do so due to other factors.

Even absent any legal, regulatory, or governance-based constraints, philanthropic organisations are not therefore equally positioned to deploy their capital across the entire universe of investment opportunities, an observation that also applies to the mission related investing subset. Some sample organisations own asset management subsidiaries, others share the services of such an entity with a related corporation or with the founding family's private investment vehicle or with other foundations. More, within and certainly without the sample, do not have access to this level of expertise and rely on the externally procured advisory services they can afford and on collective investment vehicles that were not specifically designed for them.

The relevance of the asset allocation of the sample of philanthropic organisations is not therefore limited to what their capital does. It is also indicative of what they can do and know how to do.

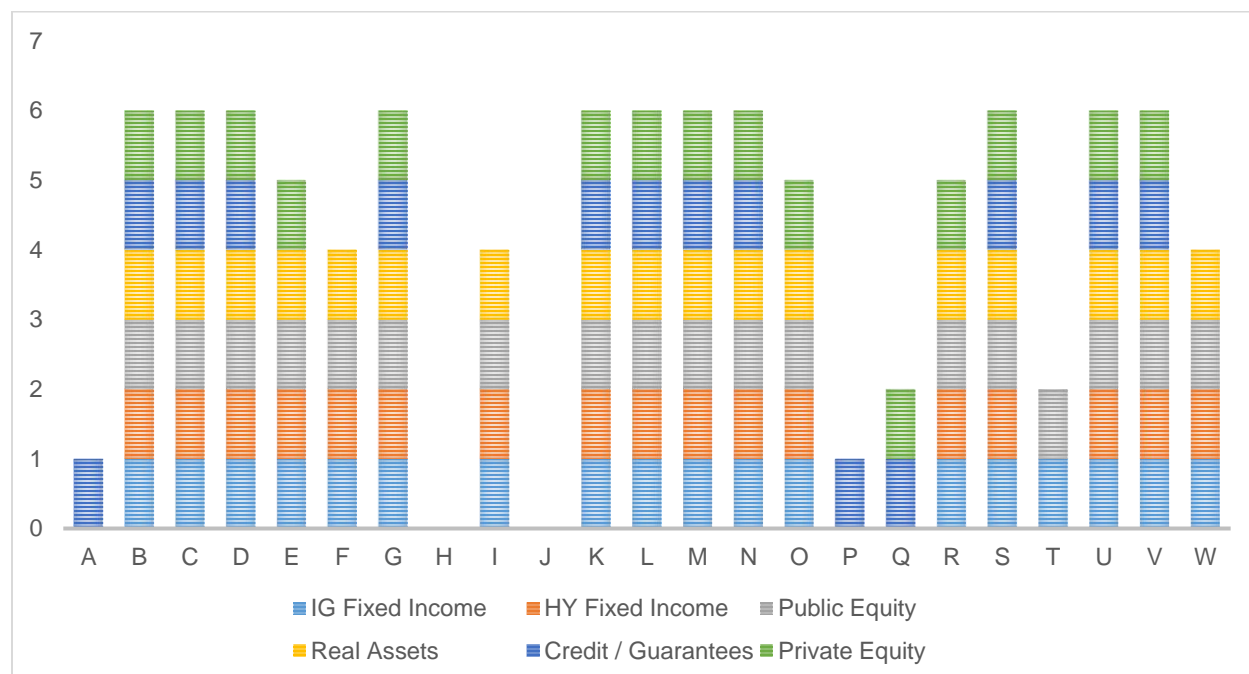


Figure 9: Asset classes allocated to by sample organisations

Figure 9 provides a visualisation of the individual asset class exposure, or lack thereof, for the sample of philanthropic organisations. The associated level of know-how is not evenly distributed, and it must be remembered that it is skewed in line with the sample's own bias towards large organisations. Investing directly or through a collective investment vehicle involves different capabilities, and this analysis does make a simplifying assumption. Where an organisation holds a private equity stake in a business in circumstances that clearly suggest that such a deployment of capital is neither a frequent occurrence nor part of an investment programme, it is not deemed to be relevant.

It is to be noted that seven of the organisations have no exposure to private equity, and eight no exposure to private debt. Two out of the three umbrella foundations in the sample have little or no exposure to either, and therefore at least little or no experience or presumably capability to process investments where these asset classes are concerned. This is of course not to say that individuals lack this expertise, the observation only applies to the organisation. In addition, some of the smaller organisations resort to external advisory services to execute private assets funds transactions.

Large philanthropic organisations have both the skills and the expertise necessary to execute transactions across the spectrum of investment opportunities, including complex private assets models. It must however be noted that these are not equally distributed. These findings may present a significant hurdle to the growth of the MRI concept and should inform the design of mobilisation initiatives.

### 4.4.3. Risk and Return

Where available, the aggregate total return objectives of the sample range from inflation- adjusted low single-digit return targets, often aligned with informal target spending rates, to the performance of the MSCI world equity index. The latter is an outlier, and by and large stated objectives are conservative. In a context where there are few constraints relating to minimum spending level rules to be found in tax law, statutes, or indeed written governance, the focus on capital preservation and the conservative investment strategies observed at all but a few of the interviewed organisations does suggest that there is a relatively low level of risk appetite across much of the sector.

This is however an evolving picture, and conversations with key actors in the sector highlighted the fact that the financial crisis had a profound effect on how many philanthropic organisations view the asset management component of their fiduciary duty, leading to a drive towards diversification. The subsequent quantitative easing and the resulting downward pressure on interest rates led to increased equity risk allocations according to the stakeholders consulted. It was suggested that this heightened focus on the management of endowments in turn contributed to the rising interest in the MRI concept.

For shareholder and savings banks foundations, a highly concentrated position in one or a few businesses can have very real implications for the management of the foundation's capital. Portfolio management theory is almost entirely based on the principle that such high levels of idiosyncratic risk should not be allowed to exist and offers little in the way of effective mitigation solutions.

Where the primary objective of the foundation is to own the business, and the funding of philanthropic activities is therefore inevitably exposed to the volatility resulting from risk concentration, the point is moot.

Where however the foundation's philanthropic activity is the primary concern, whether as defined by law, statutes or because of the important role its giving plays in its community, this financial risk translates into real life risk for the foundation's ability to deliver, or in extreme cases, to survive.

The highly leveraged, deeply cyclical banking business model for example means that savings banks foundations with low or no diversification away from the transferee bank are highly exposed to economic cycles, as is their ability to maintain their philanthropic activity. The stormy waters ahead were correctly identified by Mediobanca's Andrea Filtri in his important 'Italian Banking Foundations' report<sup>15</sup>. The demise of the Monte dei Paschi di Siena serves as a cautionary tale and in 2015 the Italian ministry of economy and finance entered into an agreement (Protocollo d'intesa) with the savings banks sector through its representative body ACRI, limiting their exposure to transferee banks to a third of their endowment. This in turn may help explain why the listed equity exposure in the accessible portfolios of the Italian savings banks foundations in the sample is comparatively low.

<sup>15</sup> Filtri, A. (2012). *Italian Banking Foundations*. London: Mediobanca Securities

Beyond the unequal distribution of the resources necessary to gain exposure to the entire spectrum of investment opportunities discussed above, the level of financial expertise built into the governance of an individual organisation through its people is a key determinant of its attitude to financial risk.

The philanthropic sector has a responsibility to maintain and grow its giving volumes to meet societal challenges. This is at times combined with non-diversifiable risk concentrations among other idiosyncratic factors. There is across much of the sector a focus on capital preservation expressed through relatively conservative investment strategies.

## 5. Mission Related Investments

### 5.1. The MRI Landscape

Information pertaining to over 220 Mission Related Investments (as defined in section 3.4.) made by the sample of organisations was compiled. The corresponding Euro aggregate commitment is approximately €1.9 billion.

A first observation is that MRIs are not a universal feature of the sample. Fifteen of the organisations have to date made MRIs. One obvious factor is that not all missions are equally compatible with mission investing. A focus on social housing provides a straightforward scenario. Supporting fundamental research through investments does in contrast pose serious challenges.

A few points of methodology are necessary to give context to the data:

- Because one of the objectives is to understand how much capital is dedicated to which MRI instruments by the organisations and given the intricacies of the cash cycle of private funds, commitments numbers were, when available, preferred to accounting entries for private funds.
- For direct equity holdings, values reported in financial statements were used, unless a more accurate valuation could be obtained, either from the organisation or through publicly available data.
- Where a portfolio of direct investments is managed by an entity owned or controlled by the organisation, and where the organisation is the sole investor, this was recorded as direct investments rather than as a fund investment.
- The taxonomy debate is never far away, and there are instances of investments made by different organisations with the same missions into the same entity, but not uniformly labelled as MRI by all organisations. For the purpose of this study, in the case where one organisation labelled an investment as MRI, it was considered as such for the others if their mission areas were aligned. It is understood that this approach is debatable, as assumptions tend to be.
- Several instances of equity holdings in specialist fund management businesses required a categorisation decision. Given the primary objective is here to understand the instruments used for MRIs, an equity holding in a real estate or infrastructure fund manager - not a real estate infrastructure fund - is categorised as a direct private equity investment. An investment in a real estate or infrastructure fund is categorised as exactly that.
- Simplifying assumptions were made for small allocations where single assets weights were not made available. These are considered to have no meaningful statistical relevance.

### 5.1.1. Instruments

Table 1 provides a count of individual sampled MRIs by instrument, and Figure 9 provides a breakdown by instrument of the total Euro amount.

Instrument	Number of MRIs in the sample
Securitisation	1
Real Estate Fund	18
Private Equity Fund	47
Private Equity FoF	2
Private Equity Direct	95
Private Debt Fund	19
Private Debt FoF	1
Loan	7
Listed Equity Fund	4
Listed Equity Direct	4
Listed Debt Fund	1
Infrastructure Fund	5
Convertible Loan	21

Table 1: Instruments used by the sample's organisations to make MRIs

Where the instruments are concerned, it is interesting to note that:

- Private equity holdings, whether direct, through funds or through funds of funds accounts for over 60% of the total Euro amount of MRIs.
- Direct lending is statistically negligible as an MRI instrument, either by volume or number of line items, as is the use of private debt funds. There is only one example of an Asset Back Security ('ABS') securitisation. This is not surprising given philanthropic organisations are neither structured nor regulated as lending institutions, notwithstanding restrictions specific to individual Member States legal frameworks.
- Direct equity investments by philanthropic organisations or their MRI vehicles account for over 45% of the total Euro amount of the sample of MRIs. As is observed in the development finance field, convertible loans feature alongside equity investments in SMEs.
- The picture is similar when looking at the number of investments for each instrument rather than at their value, although the proportion of private equity funds is higher when using this metric.
- There are very few investments into funds of funds, suggesting that there is a preference for a relatively low level of intermediation.

- Unsurprisingly given the early-stage nature of the MRI space, publicly listed MRIs only account for a small number of MRIs. It is however important to note that the nature of an investment is what determines its position in the mission investing debate, not its structure.

#### *Zoom in on direct private equity MRIs*

Direct equity holdings in private companies are the largest component of the sample's MRIs analysed for the purpose of this study. They do therefore warrant closer scrutiny.

In terms of size, they are inscribed within a very wide range, from just over €20 thousand to several tens of millions.

There is no apparent prevalence of any complex structuring, and the norm is for a straightforward equity investment. It is however for example interesting to take note of the 'Impact Grant' structure developed by FSVGDA and deployed for its investment in the Vesti Solidale social cooperative. A third of its contribution to a capital increase is made in 'self-extinguishing' ('autoestinguibili') shares that will essentially become a grant should the investee reach specific Impact objectives<sup>16</sup>.

These investments do span a wide variety of sectors in line with the mission areas specific to each philanthropic organisation, ranging from business active in arts, culture, education or agri-tech to microfinance institutions.

Given the capacity building role at times played by philanthropic organisations, it is perhaps not surprising to observe that some of the philanthropic organisations in the sample hold significant equity stakes in fund management businesses focussing on mission related sectors and geographies.

The sample of MRIs analysed for the purpose of the study does clearly suggest that equity is the preferred instrument. Although direct equity participations outnumber fund investments, private equity funds (including venture capital) and social housing real estate funds are also prominent features and are potentially better suited to mobilisation pursuits.

<sup>16</sup> <https://startupitalia.eu/79921-20220621-fsvgda-lancia-in-italia-il-primo-impact-grant>



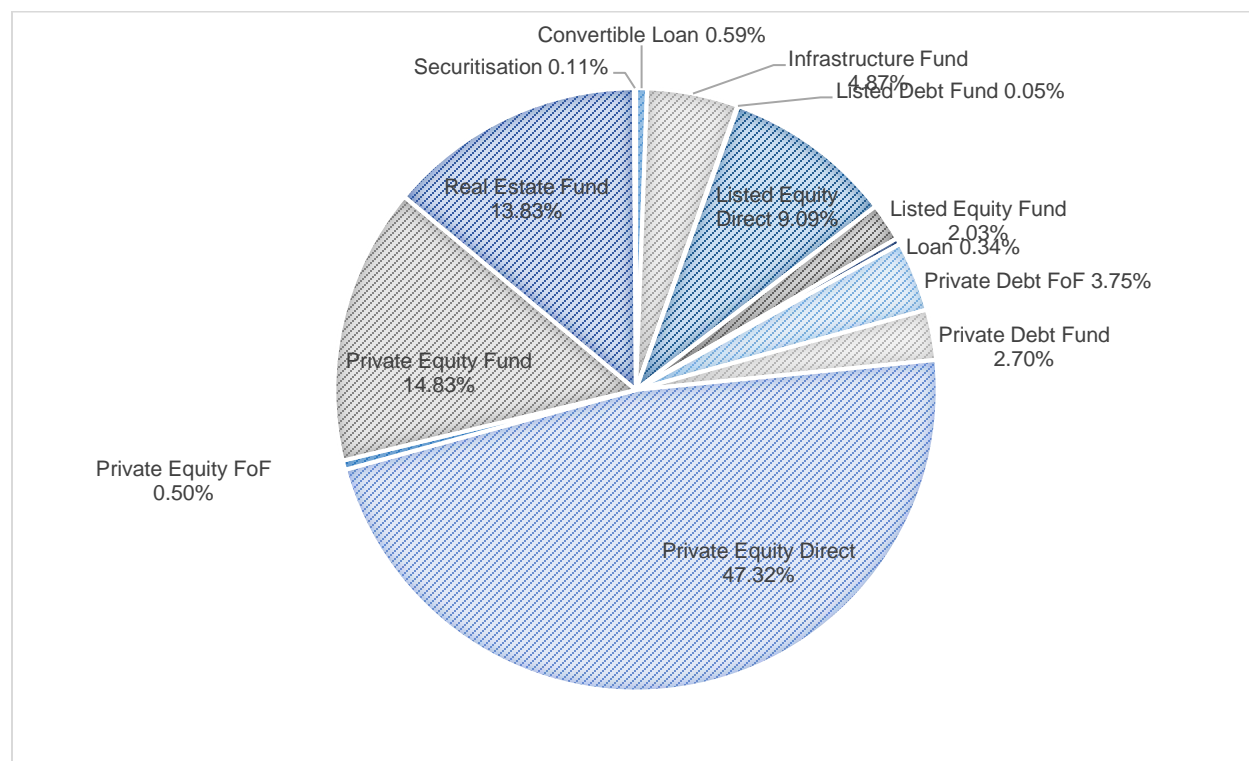


Figure 9: MRIs made by sample organisations by asset class as a percentage of the total Euro amount

### 5.1.2. Size

The average size for the sample's MRI is skewed by one large size outlier. Correcting for this single line item, the average individual MRI is €6 million. A perhaps more useful illustration of the repartition of individual MRIs across size buckets is provided below.

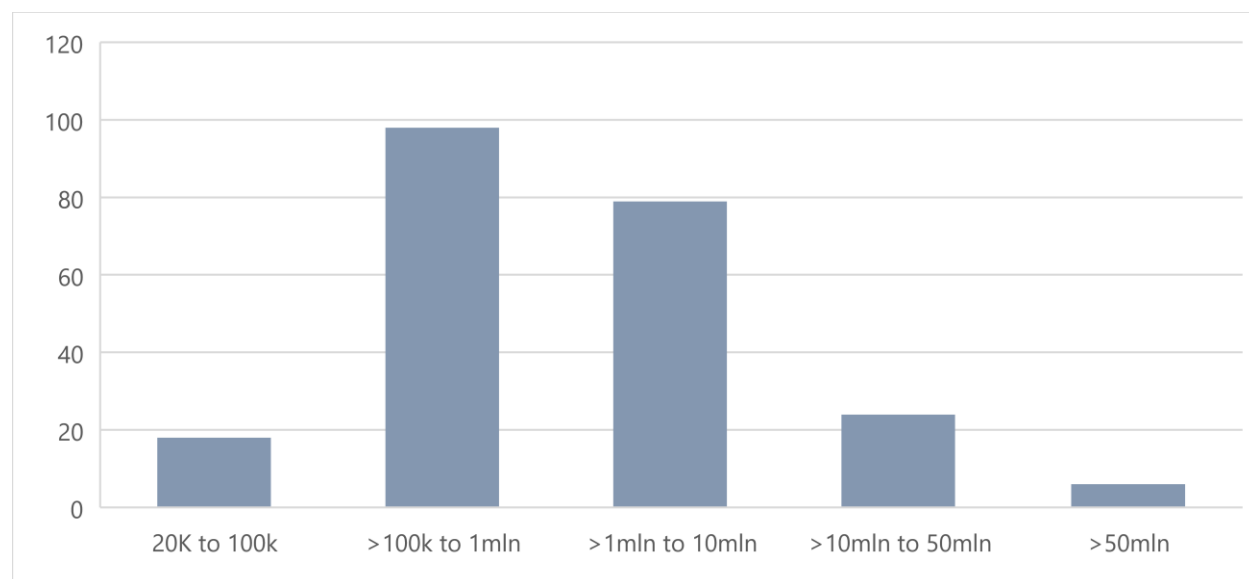


Figure 10: Number of MRIs made by sample organisations by size buckets in Euros

The wide range is indicative of the diversity of the MRI landscape, ranging from small equity holdings in SMEs to the ownership of large industrial or asset management companies that are specifically dedicated to mission aligned activities.

MRIs made by the sample's organisations tend to attract comparatively small amounts, with a high level of concentration below the €10 million mark. This is typical of an early-stage market development scenario with few large-scale actors on the investee side.

### 5.1.3. Sectors & Geographies

As is the case in most impact-related fields, taxonomy is the curse of the observer of the philanthropic space. Categorising MRIs does come with significant challenges as there is no generally accepted nomenclature in use by philanthropic organisations. Whilst there is a growing tendency to refer to the United Nation's Sustainable Development Goals, the rate of adoption is not sufficient to be helpful. Absent a generally accepted nomenclature, MRIs were mapped against InvestEU's four policy windows – to fit Sustainable Infrastructure, Research, Innovation & Digitisation, Small Businesses and Social Investment & Skills.

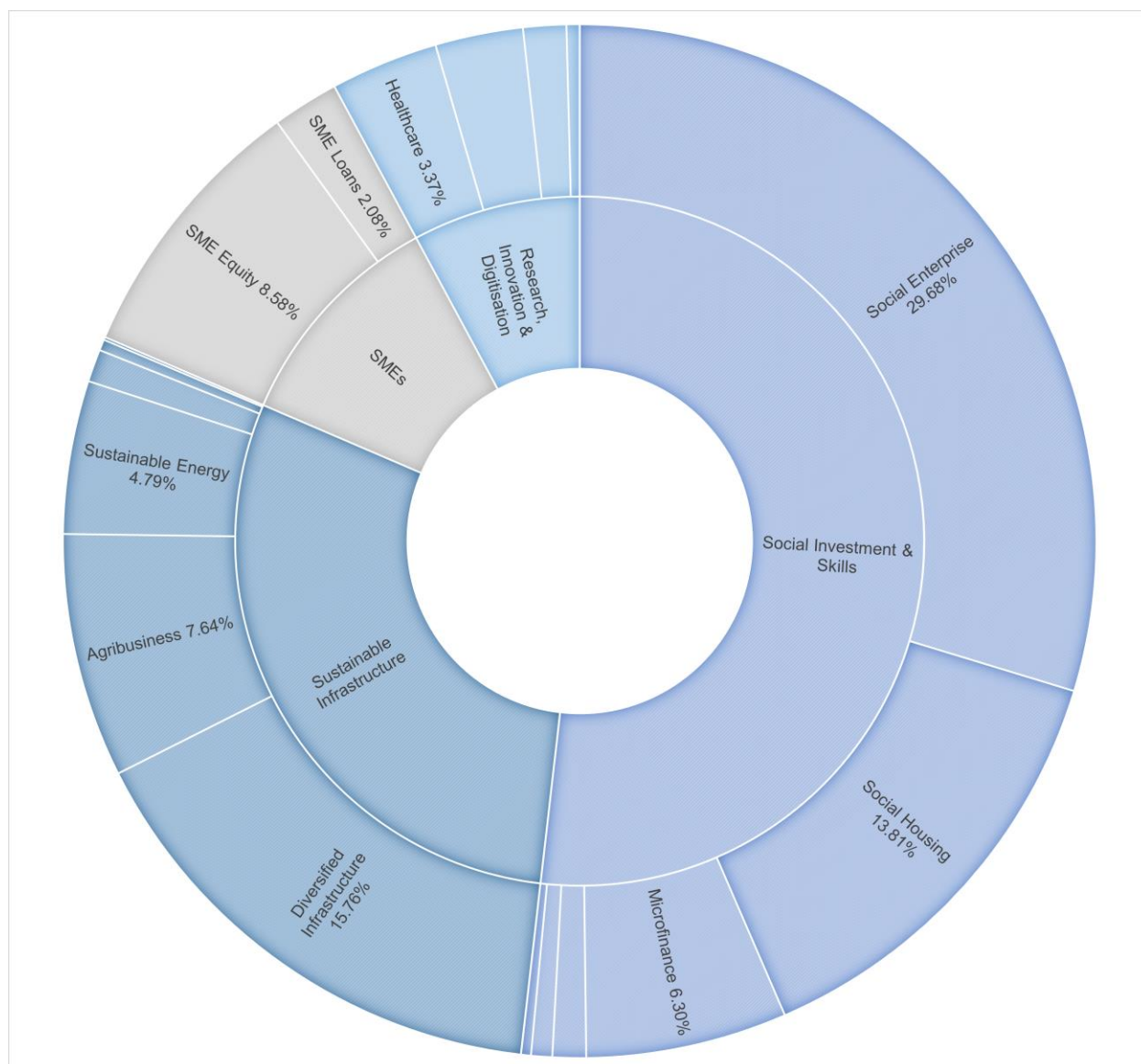


Figure 11: MRIs made by sample organisations by theme and subsector

82% of the total Euro amount of the sample's MRIs are allocated to the EU. Emerging markets account for an additional 12%, with the US, the United Kingdom and global mandates making up the balance.

Perhaps unsurprisingly, over 80% the total Euro amount of these investments are located in the European Union, and almost half of the capital allocated to the MRIs made by the sample's organisations are targeted at Social Investment & Skills. Social enterprises and social housing account for the bulk of this. Elsewhere, investments towards the development of sustainable infrastructure are also a significant feature.

#### 5.1.4. Sources and allocations

Once an investment is made, the source of the capital deployed is not readily identifiable. The use of purpose-built structures to make MRIs makes the desktop analysis of the origins of this capital more complicated. Interviews however made it possible to categorise the sample's MRIs across three categories:

- Investments made directly from endowment assets
- Investments made either directly or indirectly from the income generated by the endowment (in some cases through grants being made from this income to external structures)
- Investments made from donations received by the philanthropic organisation from an external source (government, general public, corporate entities)

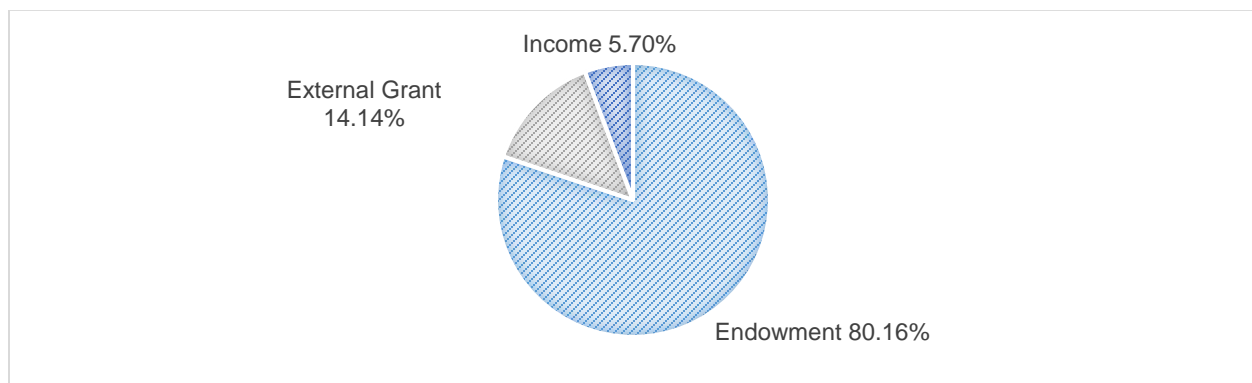


Figure 12: Source of MRI capital

Correcting for one large outlier, which was the result of an event unlikely to occur again, it is possible to establish that over three quarters of the sample's MRIs are indeed made from the endowment.

Where MRIs are made from the endowment and where target, or maximum, allocations to MRIs are a feature, they range from 2 to 5% of the aggregate portfolio and are not yet fully deployed. There is one notable outlier, a foundation already allocating 30% of its endowment to MRIs, and this statement does of course not apply to the endowments of 'special purpose' foundations created by a 'mothership' organisation to be entirely dedicated to MRIs, but rather to foundations that were not created with the specific purpose of making MRIs.

Over eighty percent of the Euro amount of the MRIs analysed are made from the endowment of the relevant organisations. Whilst there are exceptions, allocations to MRIs, whether or not they are formally defined in investment policies, tend to be in low single digits percentage points.

### 5.1.5. Risk & Return

There is an almost complete absence of historical data pertaining to the financial performance of MRIs. This is a serious inhibitor to the sector's growth as will be discussed later.

With regards to risk and return criteria applied to MRIs at the selection stage, few organisations volunteered detailed information. The general impression is that those interviewees with a comparatively longer track record in MRIs tend to have lower risk-adjusted return expectations when selecting MRIs, and only two interviewees stated that MRIs were expected to deliver market level risk-adjusted returns for their asset class. Another explained that there was no in principle assumption that MRIs would underperform, given they address issues society seeks a solution to, but that the level of uncertainty was higher.

Where criteria were mentioned, they generally were expressed in absolute, inflation-adjusted return terms, and ranged from 0 to 4%.

Against this backdrop, it is also useful to discuss the specific nature of the risks, perceived or real, associated with mission related investments. It is telling that the analysis of the portfolios held by organisations operating on the same model and subjected to the same set of rules and regulations revealed situations where the exact same investments were deemed fit for inclusion in the endowment by some and not by others. This not only highlights that risk is often a question of judgement but also that the importance of these judgement calls is higher where there is a lack of observable track record. Because some of the business models underpinning MRIs are relatively new, there is simply insufficient data to fully understand their risk and return characteristics.

More broadly, interviews yielded the observation that the MRI space is itself very diverse and encompasses different asset classes. It is therefore evidently difficult for a single risk/return criteria to be defined for the entire concept. Where interviewees expected MRIs to perform in line with other investments, they are benchmarked against the criteria applied for their respective asset class. There was otherwise no instance of an MRI 'table' of risk/return criteria per asset class.

The absence of sufficient and publicly available financial performance data pertaining to MRIs in each relevant asset class makes the definition of criteria and targets difficult. Interviews highlighted the existence of a grey area, which is once again likely to be an obstacle to the growth of MRIs.

## 5.2. Creatio Ex-Philanthropia

The most striking feature of the European MRI landscape is however not a quantitative one but emerges from conversations and from the more granular study of individual mission related investment stories. It is the level of involvement in co-creation philanthropic organisations are ready to accept to make MRIs a reality. Information pertaining to such initiatives, for example Gulbenkian's

MAZE, Fondation de France's France 2i, Erste Social Finance, Novo Nordisk Fonden's REPAIR Fund or DOEN Participaties to name but a few, can be accessed readily online.

This readiness to dedicate considerable time and resources, human and financial, to the conception of products is not only largely foreign to traditional institutional investors but goes beyond what is observable in the more comparable development finance space.

Examples of interventions leading to MRIs range from the use of grant funding or equity capital to create fund managers, to lobbying efforts to create institutional coalitions and secure public co-funding, to advocacy efforts verging on third party marketing to bring fellow philanthropic organisations to co-invest.

The structural work undertaken by Italian savings banks is not only an illustration of what has been done but also an illustration of the possible. Cariplo's ground-breaking investment and key role<sup>17</sup> in the launch of the aptly named *Fondo Abitare Sociale 1* (Social Housing Fund 1) and the resultant scaling of this sector is a prime example of what can be achieved.

Cariplo had long identified the provision of social housing in the Lombardy region of Italy as a key need when in 2004 it decided to take a more systemic approach to tackling the issue. That year, with the support of the Lombardy Regional Administration, it created a special purpose foundation Fondazione Housing Sociale (Social Housing Foundation). Then in 2006 Cariplo created the first Italian social housing fund, Fondo Abitare Sociale 1 (Social Housing Fund 1), to invest in residential real estate targeted at those who were unable to afford homes at prevailing market prices but did not qualify for public housing.

Fondo Abitare Sociale 1 has subsequently gone on to deploy approximately €600 million towards meeting the growing social housing needs of Lombardy. In doing so the fund demonstrated the extent of the demand for social housing and the investment returns available, and ultimately was the inspiration for the Sistema Integrato di Fondi di Housing Sociale (Integrated Social Housing Funds System).

The FIA was created as a collaboration between Cassa Depositi e Prestiti ('CDP')<sup>18</sup>, the Italian Banking Association (ABI) and the Italian savings banks association ACRI. It is managed by CDP and now holds some €3 billion in assets. This is a clear and important case of a philanthropic institution, through collaboration and the deployment of its unique risk-tolerant capital as an MRI, creating a systemic intervention that addresses an identified social problem with private capital and at scale.

Cariplo is now working to recreate this success through the establishment of the Fondazione Social Venture Giordano Dell'Amore (FSVGDA). The FSVGDA follows the model of the SHF in that it is a foundation that has been established by Cariplo with the express purpose of making MRIs in

<sup>17</sup> <https://www.fondazionecariplo.it/en/projects/social-services/housing-sociale/housing-sociale.html>

<sup>18</sup> See: <https://www.cdpisqr.it/social-housing/fia/piano-nazionale-edilizia/piano-nazionale-di-edilizia-abitativa-sistema-integrato-di-fondi.html>

businesses with social intent and social impact funds and of “...spreading the culture of impact investing in Italy”.

FSVGDA was launched in 2017 and predominately invests equity. It has to date made 28 MRIs. Of these investments 6 are social impact funds and the remainder are social enterprises. The foundation has also set up an ‘evaluation lab’ which makes public its assessment of the impact of FSVGDA’s investments.

The responsibility for making a contribution to building the pipeline of opportunities that they are uniquely placed to make, given their ability to deploy both grants and investments, is one European philanthropic organisations do appear to be acutely aware of.

This in turn means that the mobilisation of philanthropic capital differs significantly from other private capital mobilisation dynamics, where the ‘target’ institutions are typically not meaningful participants in the field their capital is invited to invest in.

Philanthropic organisations have and continue to play a central role in the development of an early-stage market for MRIs.

Whereas mobilisation in other contexts is focussed on delivering products to passive ‘external’ institutional investors, a different approach should be adopted for the philanthropic sector, one that focusses on co-creating, rather than on fund-raising.

### 5.3. The Benefits of Specialisation

Institutional investors such as pension funds and insurance companies are generalists *par excellence*. The mobilisation of their capital is therefore generally not linked to anything unique to their organisations beyond the specific parameters commanding the deployment of their capital (asset and liability management, Solvency II, etc...).

The endowment of US foundations is generally - and naturally with exceptions - separated from their programmatic functions by Chinese walls of such height as to be equally void of any foundation-inspired thematic or specialist overlay. This might be changing as a result of the development of ‘place-based’ impact investing<sup>19</sup>, and the increasing prevalence of MRIs, but not at a relevant scale to date.

The landscape of European philanthropic capital derived from this study is on the contrary showing high degrees of specialist expertise and know-how, in places applied to MRI programmes, and which may constitute a specific strength of the European philanthropic model.

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<sup>19</sup> <https://www.impactphl.org/news-archive/perspectives/vol7>

The study revealed that leading philanthropic organisations for example benefit from one or more of:

- A deep understanding of the challenges faced by the sector or the geography their mission is focussed on
- A commensurate knowledge of and links to relevant actors
- An enhanced ability to build and maintain a pipeline of MRI opportunities
- An access to the underlying sector-specific and generic investment skills necessary to execute MRIs

This may for example stem from:

**The sector in which the related business of a shareholder foundation operates.** Novo Nordisk Fonden was for example able to leverage off the expertise of Novo Holdings as a global life-science investor as well as the group's deep understanding of the biotech sector to launch and manage its REPAIR impact fund. ErsteStiftung makes use of its symbiotic relationship with its transferee bank to deliver on its financial inclusion mission across CEE countries.

**The origins of the organisation.** RealDania's roots in xxx mean that it is positioned to deliver on its mission, focussed on the built environment both through what it defines as philanthropic investments, which combine grant funding with investment capital, and MRIs, for example through investments in 'proptech funds'.

**Regional or national mandates.** These can result in a deep understanding of local needs and opportunities. It can be true of community-focussed foundations in a European context. Italian savings banks foundations again provide a good illustration of the central role philanthropic organisations can play at the regional level. Further afield, the experience of LDC issues Oxfam-NOVIB has developed through its grant making activities for example allows it to identify access to finance gaps.

**The sector in which the philanthropic activity is focussed.** Institut de France or Fondation Bettencourt-Schueller do for example occupy unique positions in the French artistic and cultural sectors. This equips them with a superior understanding of the issues and knowledge of the actors, as well as a level of visibility within these sectors that means they are most likely to be made aware of relevant new initiatives.



### *Novo Nordisk Fonden and the REPAIR Impact Fund*

With over 100 staff and five offices across the globe, Novo Holdings, the 100% asset management subsidiary of Novo Nordisk Fonden, is not exactly a standard feature of the EU's philanthropic landscape. An important part of its activity is the management of a circa DKK 95 billion (approximately €12.7 billion) life sciences portfolio, which holds stakes in 135 businesses across the funding continuum, from start-ups to listed companies<sup>20</sup>.

It is therefore equipped with both the required sector expertise and the investment know-how to source, select and execute investments in the sector. This in turn meant that Novo Nordisk Fonden was able to task Novo Holdings with the 2018 creation and management of the REPAIR Impact Fund, to which the foundation made a USD 165 million commitment to target what it identified as a gap in the research and development spectrum. The fund has thus far made ten of the twenty investments it set out to make 'in companies involved in discovering and the early-stage development of therapies targeting resistant microorganisms'<sup>21</sup>.

The REPAIR Impact Fund is a useful example of how the specific know-how of the corporate entity owned by a shareholder foundation can be put at the service of the latter's philanthropic mission.

The lack of pipeline is a well identified issue, and the capacity of philanthropic organisations to contribute to the creation of investment opportunities based on the above-mentioned strengths is key. Whilst this is done in places through building the infrastructure necessary for external opportunities to emerge, for example by funding incubators, there are also instances of organisations directly building businesses aligned with their core mission.

### *ONCE and ILUNION*

Grupo Social ONCE (ONCE Social Group) is such an example. When in the late 1980s, the revenue from the sale of lottery ticket experienced a four-fold increase, authorisation was given to ONCE and the recently incorporated Fundación ONCE to invest in mission aligned business activities. A decision was made to use this opportunity to demonstrate that it was possible for businesses to employ people with disabilities.

A little over thirty years later, the ILUNION group that resulted from these investments is – behind ONCE itself – the largest employer of disabled people in Spain, with operations across six divisions ranging from hotels and retail to healthcare and services and a turnover of €904 million in 2021. All profits are reinvested and ILUNION is not expected to contribute to its owners' budget. Fundación ONCE owns 52.5% of ILUNION's equity, the balance being held by ONCE. It is the foundation's only investment and synergies are created, for example through the provision of training services by the foundation to ILUNION employees.

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<sup>20</sup> <https://www.novoholdings.dk/wp-content/uploads/Novo-Holdings-Annual-Report-2021.pdf>

<sup>21</sup> <https://www.repair-impact-fund.com/about/>

Importantly, ILUNION is a net borrower, suggesting that, even where the capital of philanthropic organisations cannot be mobilised through external financial instruments funding external opportunities, it can in places be the provider of investment opportunities.

Fundación ONCE has in addition been running an acceleration programme, providing support to start-ups led by people with disabilities or designed to propose solutions in the disability sector, but also projects aimed at the modernisation of, or the increased use of energy efficiency measures at insertion businesses.

This is another illustration of the pipeline generation efforts deployed by philanthropic organisations. Linking such initiatives to MRI programmes would presumably enable ONCE and others to leverage on the important work already conducted.

Whilst some have at their disposal the financial resources necessary to turn the pipeline they help generate into investments without external input, a key ingredient is the deep understanding of the issues and of the relevant actors. This specific expertise is not necessarily linked to the ownership of capital.

To be effective, mobilisation initiatives should accordingly ensure that philanthropic organisations are integral to the conception phase, not merely seen as ‘product-takers’, and are involved based on their mission related expertise, not solely on that of the capital they may invest.

European philanthropic organisations have demonstrated both the will and the ability to combine their capital with the specialist know-how they derive from their origins, their nature or simply long years of mission delivery. This confirms the observation that they have a central role to play in the development of the MRI space, whether by dint of their pipeline identification and generation capacity, of their understanding of the underlying issues or of the resources embedded in related businesses.

## 5.4. Constraints & Creativity

### 5.4.1. Legal & regulatory hurdles

The aptly named ‘Comparative Highlights of Foundation Laws’<sup>22</sup> provides an array of legal practitioners’ views of the legal and regulatory constraints applicable to the investments made by philanthropic organisations in their respective countries and was an invaluable source of directly relevant information. Interviews, at times supplemented by reading the relevant laws or precedents, put the finishing touches to this aspect of the European landscape of philanthropic capital.

There is no shortage of rules and the divergent legislative and regulatory approaches taken by EU Member States add significant complexity to the picture. Recurring, but not common, themes are the inability for public benefit organisations to make return-generating investments made from

<sup>22</sup> Dafne & European Foundation Centre. (2021). *Comparative Highlights of Foundation Laws*. Brussels

programmatic donations, the proportion of income that must be given away (e.g. 70% in Spain), and vague references to adequate returns for the endowment.

Rules affecting asset allocation patterns, such as the German framework described earlier, do have consequences for MRI pursuits as they for example may limit the ability to allocate to illiquid equity instruments that do not produce 'ordinary' income.

On more rare occasions, more precise rules define conditions for allocations to alternative strategies or proclaim the prohibition of ill-defined speculative investments. Generally speaking, and understandably, as the recognition of an organisation's public utility and often accompanying tax benefits increase, so do constraints.

Although mention was made of ongoing engagement with regulators, there does not at this stage seem to be any framework defining or addressing, let alone regulating, mission related investments.

This regulatory vacuum is not surprising given the enduring absence of a definition for MRIs endorsed by the relevant authorities. The PRI model, which enables US foundations to make eligible investments that count towards their mandatory annual programmatic spending, works because the rules and eligibility criteria were issued by the tax authority. They did not result from a self-regulation and self-certification based framework.

This absence of MRI regulation is not helpful. Because there are no clearly defined boundaries, but rather principles that leave much to interpretation, these 'grey areas' act as inhibitors. As an academic with expertise in the field volunteered during one conversation, the imprecise prohibition of speculative investments in one EU Member State for example means that board members or decision makers stand to be accused of wrongdoing, should a foray into MRIs end badly and consequently be deemed 'speculative' after the fact. These are not circumstances likely to be conducive to experimentation.

The capital markets practitioner's approach is somewhat different. The sell-side investment equivalent of the presumption of innocence is that investments should be deemed allowed if not expressly forbidden.

A more objective guide to what is possible is however what is happening already. And the incontrovertible reality is that MRIs are made by philanthropic organisations in every one of the jurisdictions covered by the sample.

Although it has been shown that it is possible to make MRIs in each jurisdiction within each associated set of constraints, these constraints do remain relevant in several respects, even when they are not sufficient to deter the individuals presiding to the destinies of philanthropic organisations from authorising MRIs.

The resources, financial and otherwise, necessary to make MRIs work in a constrained environment may prove a limiting factor for many.

There are also potential consequences for the feasibility of initiatives seeking to mobilise philanthropic capital across organisations and borders. Workarounds may indeed exist for a specific set of constraints, but designing a vehicle capable of satisfying multiple, potentially conflicting sets may prove more challenging.

It is not within the scope of this study to discuss the potential need for reform, but it should be observed that rules that were almost certainly written without MRIs in mind have created a situation that is not helpful to their adoption. The lack of harmonisation across Member States is likely to prove an obstacle to their development. Conversely, the absence of MRI frameworks, within civil or tax law at the Member State level, or of definitional guidance at the European level, are perceived as inhibitors.

#### 5.4.2. Stock, Flow and Fungibility

The money available to philanthropic organisations does take different forms and the assets some were originally endowed with is only one of them. The income they derive from these assets is another, as is the income they may receive from other sources, for example donations from the public, businesses, other philanthropic organisations or governments.

Money is fungible and is eventually defined by the use that is made of it. Authorities however seldom embrace this point of view. The use that philanthropic organisations can make of their income is often regulated. All or a significant portion of this income must for example unsurprisingly typically be disbursed in the form of grants or spent on operations in pursuit of the philanthropic mission in some jurisdictions.

The deployment of the 'stock', or the endowment, to make MRIs is therefore the most straightforward scenario. Philanthropic organisations do however in some instances deploy from their programmatic budgets in an MRI context. This is for example done:

- To fund capacity building, whether through the funding of incubators, through contributions to the creation of fund managers or to 'laboratories', as was the case when the Callouste Gulbenkian Foundation did in 2013 support the launch of the Social Investment Laboratory (today operating as MAZE).
- To create and capitalise separate entities dedicated to MRIs, as was the case for Fondazione Sviluppo e Crescita CRT.
- To mobilise third party capital for example by taking on the outcome funder role in SIBs or DIBs. This was for example the case when Novo Nordisk Fonden and the IKEA Foundation for

a \$14 million Refugee Impact Bond coordinated by KOIS<sup>23</sup> or when La Caixa supported the ICRC's Humanitarian Impact bond, enabling CHF 26.09 million of outcome funding.

- To provide deploy grant funding alongside MRIs, thus making use of both investment capital and grant monies. The deployment of this model by FSVGDA was discussed above.
- There are also rare but interesting instances of investments being made from programmatic budgets. The one US domiciled organisation in the sample for example structured an investment in line with the PRI framework.

Philanthropic organisations do make use of grants to contribute to MRI programmes. This is at times done in conjunction with an investment. Philanthropic organisations are one of very few categories of investors to be able to use both instruments. This practice, commonplace in the development finance context, represents a unique value proposition and is worthy of further consideration.

This aspect of their activity in addition demonstrates the important role that must be played by grant funding to build capacity in the market for MRIs. Those interviewees most focussed on this end of the market called for government funding to contribute, potentially through co-granting activities.

### 5.4.3. Workarounds and Self-Motivated Actors

A key observation yielded by the study of the MRIs made by sample organisations is, in line with earlier points, the lengths to which some have gone to work around constraints.

Where public benefit organisations rules prevented investments being made, wholly owned, but at times not controlled, limited companies have been created. Where making grants to for-profit enterprises was necessary or where the risks of investing in early-stage ventures was deemed unsuitable for the endowment, separate foundations were created, revived, and sometimes even merged.

Where MRIs could be made from the endowment, carve outs were put in place outside of externally managed portfolios. Team members from both sides of the endowment / programmatic divide typically collaborate to source, select, and execute MRI transactions, and boards are often called upon to make investment decisions, a task they typically do not perform for other types of investments. The structures created or adapted to make MRIs possible often mean that the parent philanthropic organisation is not able to derive a contribution to their budgets from these portfolios.

This level of creativity is a true testimony both to the entrepreneurial skills of the teams and to the importance they attach to investments as the means of mission delivery.

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<sup>23</sup> <https://www.refugeeimpactbond.org/>

This does reinforce a key takeaway: the EU's philanthropic sector features a group of organisations, and within them individuals, that have been acting as champions for the development of the MRI concept and deploying treasures of ingenuity as well as capital in alignment with their mission. As will be discussed later, these self-motivated actors are the *sine qua non* condition of any market building process.

## 5.5. Stumbling Blocks

Interviewees were asked to share what they believed to be the main obstacles to their organisation, and by extension to the sector, making more MRIs. Because this study does not confer a representative mandate on the sample, votes were not counted, and this section does not seek to rank concerns. The following main stumbling blocks were identified:

### ***Internal debate & resulting constraints***

Whether they were already deploying MRIs or actively seeking to, interviewed individuals made it clear that a key step towards the adoption of the MRI concept is to make the case internally.

The ability to convince governance structures of the relevance of investments as a means of mission delivery, but also to reassure them about the associated risks to the perennity of the organisation's philanthropic activity, is an arduous task in an environment where there is little available data. Even where governance structures are willing to take a leap of faith, they understandably set limits which can pertain to the quantum of allocations, as a percentage of assets or as an absolute figure, or to individual asset exposure.

A specific issue identified by respondents is the often-observed association of mission investing with one specific segment of the risk spectrum, the provision of equity to small social enterprises, whether directly or through funds. Given the high perceived risk, and the low liquidity of such investments, such a simplification can understandably lead to the wholesale rejection of the concept.

### ***Risk & liquidity***

In this context, risk becomes an important factor, even if it is more linked to uncertainty than observable volatility. De-risked instruments were as a result often identified as valuable arguments in the debate around MRI adoption. Some respondents explained that it might not be necessary to target a specific level of risk, but that mobilisation could be achieved by reassuring potential investors through the provision of such a blended finance mechanism by a public institution. Other interviewees in addition mentioned that de-risked instruments would enable them to increase allocations to MRIs.

Although respondents generally professed to be comfortable with liquidity risk, the deemed difficulties experienced by private equity and venture capital funds to return capital to investors at the end of the already long life of limited partnership structures were also identified as a key concern.

### ***Legal & regulatory***

Although internal dynamics were more frequently identified as the main barrier to MRIs, there is frustration with legal frameworks and the lack of consistency in national regulators' approach was identified as counterproductive by a small but vocal number of interviewees.

These explained that the issue stemmed from the lack of recognition of MRIs as mission delivery instruments, particularly from a fiscal policy standpoint, and some expressed an interest in the development of a European equivalent to the American Programme Related Investments framework. This could both provide definitional guidance and allow for the use of income to experiment with mission investing or make investments that would otherwise be deemed inappropriate for the endowment.

The negative impact of the absence of regulation on MRIs was generally perceived to be a significant inhibitor, rather than a *carte blanche*.

### ***Certification and impact integrity***

A growing awareness of the risks associated with impact washing was identified as a key concern. Respondents argued the absence of a generally accepted taxonomy or certification framework needs to be addressed for the MRI concept to grow. There is a very clear call for public institutions to play a role. Although the difficulties of establishing a harmonised legal framework across Member States are well understood, a certification or label solution was evoked by a number of interviewees.

### ***Processing capability***

Smaller organisations and some umbrella foundations highlighted the difficulty of executing investments in complex private assets structures as a key constraint. There is understandably not always capacity to conduct the in-depth due diligence associated with private funds, nor is there budget to cover the typically high legal costs of negotiating the terms of limited partnership agreements and comparable structures.

This is an observable limiting factor in other capital mobilisation scenarios, where flawed assumptions were made about the extent to which private equity has become a feature of investment portfolios, and about the ability of institutional investors to dedicate the necessary resources to make marginal investments. The continued difficulties encountered by the use of private equity as a mobilisation instrument for private sector investment in Africa is such an example.

Larger organisations are of course less exposed to this problematic, although one mention was made of a reliance on pro-bono contributions by legal firms, which is unlikely to be a sustainable or universally available feature.

***Capacity building and pipeline***

Interviewees have already identified the lack of investible opportunities as a bottleneck for the growth of the MRI sector. There is a very clear call for public institutions to contribute to capacity building.

***Data & transparency***

The lack of publicly available data pertaining to the financial and impact performance of MRIs was also identified as a key issue stifling wider adoption and a more informed calibration of allocations. This is particularly problematic given the long investment cycles of the private funds often used for MRIs. Absent readily available third-party data, each organisation has to wait for the end of ten or twelve-year cycles to obtain the impact and financial performance data they need to calibrate allocations, benchmark the performance of their portfolio, and provide a sound basis for the often ongoing internal debate.

***Standardisation***

A number of respondents highlighted the growing need for a basis for the comparison of MRIs. This is only possible if a minimum level of standardisation is achieved.

***Need to scale***

There was a recognition amongst a small subset of interviewees with a longer than average track record in MRIs that there is a need for larger actors to emerge. The challenges of impact measurement, pipeline identification and wider mobilisation can only be taken on by actors with critical mass, and the continued prevalence of the 'small is beautiful' model was perceived as a risk.



The representatives of philanthropic organisations interviewed for the purpose of this study highlighted an array of obstacles confronting the growth of the MRI space. These cannot come as a surprise and should not cast doubt over the importance of their role or the value of their learnings. Philanthropic organisations are acting as pioneers in this field, and at the risk of stating the obvious, theirs is the burden of innovation. Followers do tend to encounter fewer stumbling blocks.

Some of these stumbling blocks can only be solved through a legislative process at the Member State level.

Others can be addressed through the development at the EU level of a certification or labelling framework. Others yet through catalytic interventions on the part of public institutions.

A collaborative approach, for example through the pilot group discussed in chapter 8, could leverage on the capacity of those organisations with the requisite resources, or potentially on the expertise of InvestEU Implementing Partners, to not only mitigate concerns surrounding impact integrity and to address issues linked to limited processing capability and access to pipeline, but also to progress internal debates. There is, in matters of investment, strength in numbers and respondents did highlight the value of the support of EU institutions.

Most are the recognisable difficulties associated with the early stages of market building. This is a useful observation. Market building is a well-documented process, specifically where financial instruments are concerned. The philanthropic sector can build on the learnings from similar endeavours in comparable contexts, and EU institutions are perceived to be well positioned to play a key enabling role.

## 6. Acceleration & Mobilisation

This section seeks to identify some of the instruments capable of empowering philanthropic organisations to use investments as an additional mission delivery mechanism, either by enhancing the impact of their existing programmes, or by enabling additional actors to enter the MRI space. The study of the current MRI landscape and the interviews conducted with some of the thought leaders in the space do however suggest that it is necessary to first adopt a systemic lens, before progressing to the selection of specific instruments.

### 6.1. Pause for Thoughts

The study of the landscape of philanthropic capital in the EU does strongly suggest that its potential mobilisation for MRIs significantly differs from other private capital mobilisation scenarios. As has clearly emerged from interviews, philanthropic organisations are not ‘external’ owners of capital that need to be presented with ready-made products designed to satisfy the specific demands of their investment processes.

Philanthropic organisations have played and continue to play a leading role in the nascent MRI ecosystem in the EU and should be equally central to mobilisation initiatives. The same applies to their analysis of the hurdles to its growth and wider adoption, and the concerns it yields need to be addressed.

The concerns expressed by philanthropic organisations, ranging from the lack of pipeline to the absence of data, echo the difficulties encountered in both development finance and the wider impact investing space. This section should be seen as a contribution to the ongoing search for the means to overcome these challenges and to create impact at scale, drawn from experience built and observations made in comparable situations. Should some of its recommendations be deemed useful, they would need to be adapted to the specific circumstances of the philanthropic sector.

The considerable achievements, experience, and expertise of philanthropic organisations should be leveraged upon, to ensure they have the long-lasting impact they deserve.

A core assumption is that it is desirable to work towards two objectives:

1. *Acceleration: Empower leading early adopters to enhance the impact of their existing programmes through higher volumes and efficiency*
2. *Adoption: Create the conditions for additional organisations to enter the MRI ecosystem*

Individual financial instruments can be used to work towards these goals. If the objective however goes beyond a single application, it is the ability to select and deploy them in a systemic fashion that determines how effective they eventually are. In this regard, it may be useful to have some of the fundamental principles of market building in mind when designing mobilisation initiatives.

## 6.2. Systems, markets and financial instruments

### 6.2.1. Resource allocation in a complex system

The size and the complexity of the system of actors working towards addressing societal issues in the EU means that siloed initiatives are unlikely to successfully address the stumbling blocks identified by interviewees. To manage at least some aspects of this complexity, and to facilitate the interaction between diverse actors seeking to meet a multitude of needs, market mechanisms may however provide a solution.

A market's primary role should be the efficient allocation of scarce resources. It matters not what the exact aggregate quantum of the 'good' capital available to philanthropic organisations is, it is certainly both finite and given the scale of the challenges it seeks to address, scarce. The urgency stemming from these same challenges makes the efficient allocation of these resources all the more important.

A 'good' market would allow those philanthropic organisations that wish to deploy some of the capital at their disposal towards the fulfilment of their mission, to do so in an efficient manner to maximise their impact.

Such a market would empower actors in the social economy to access the financial resources they need to deliver impact on the ground. Such a market would empower philanthropic organisations to identify, select and support those projects best positioned to help fulfil their mission.

Because there exists a multitude of needs, and because a correspondingly diverse universe of actors is needed to meet them, it is necessary to create the conditions for additional actors to participate. A market where one side of the equation is dependent on a few, large actors is unlikely to be successful, even if these theoretically hold sufficient capital to meet the sum of the funding needs.

A crucial, if difficult to illustrate, impact of a functioning marketplace is its ability to address the pipeline issue identified by interviewees as a key stumbling block. When making life-changing decisions, entrepreneurs – social or otherwise - need to assess the demand for what they plan to create, one aspect of which is the availability, suitability, and accessibility of the capital they need. In a mainstream business environment, they can easily observe market trends, access information pertaining to the relevant sources of capital and their terms of engagement. They derive confidence from the successes of others and learn from their failures. All of this happens without any bank, fund manager, investor or service provider reaching out to them.

Building an observable, diverse, and transparent marketplace has the potential to grow the social economy landscape beyond what single initiatives can. Rather than focus on individual financial instruments, it can be argued that the most effective way to address the concerns emerging from the interviews is to build a market that will empower a growing number of philanthropic organisations to effectively identify, engage and meet the funding needs of the creators of mission aligned projects and enterprises.

### 6.2.2. Principles of market building

While fully recognising both the specificities of the philanthropic sector, some of the basic principles of financial instruments market building may prove useful to guide initiatives aimed at the sustainable development of MRIs as instruments of philanthropic mission delivery. The building blocks derived from these are illustrated in figure 13 and briefly discussed below.

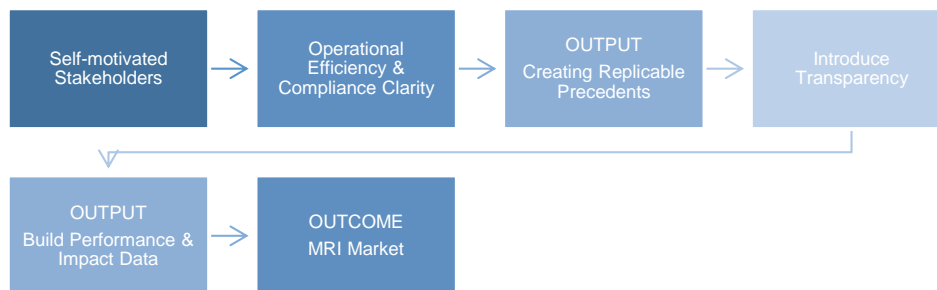


Figure 13: Market building principles

#### ***Self-motivated Stakeholders:***

The study established that the *sine qua non* pre-condition for any market building endeavour is in the case of philanthropic capital fulfilled: a core constituency of self-motivated stakeholders.

Philanthropic organisations across the sample have deployed significant resources, demonstrated high levels of creativity, and in places a willingness to push the limits of their legal and governance frameworks to make mission related investments a reality. They have in some instances created new, separate entities and in others revived or repurposed existing ones. They have allocated scarce human resources and embarked on steep learning curves to do things they were often under no obligation to do. Their motivation cannot be doubted.

This resolute adoption of the MRI concept is of course not universal, but the core group identified through the Philanthropic Capital Study is large enough, both in terms of the number of institutions and of the combined size of their assets. There is little doubt that the necessarily limiting nature of the sampling process means that many more could make a meaningful contribution.

### ***Operational efficiency:***

The second key principle of market creation is that it should strive to deliver the highest possible level of operational efficiency. The lightest operational framework possible must be aimed for, using the lowest common denominator for relevant stakeholders.

Interviews have confirmed the need for such an approach in this context, as excessive operational complexity will make it difficult or impossible for resource constrained teams at all but the largest organisations to sustainably participate. This is at least equally relevant for early-stage social entrepreneurs and small-scale intermediaries on the investee side. Higher levels of complexity and flexibility should ideally be introduced once the marketplace is established, not at the outset.

### ***Compliance Clarity:***

As is invariably the case in the creation of a market for financial instruments, there exists a high level of regulatory uncertainty. Key decision makers at each institution must be convinced that any new use of capital does not fall foul of their legal, regulatory and governance frameworks.

It is self-evident that given mission related investments were not a feature when rules applicable to the capital of philanthropic organisations were written, no clear-cut text can in most cases be pointed at. In the absence of clarity, the status quo is most likely to prevail.

A key role for public institutions should therefore be to empower the champions of MRI by equipping them with the content they need to make a clear case for the compatibility of the proposed instruments with legal and regulatory frameworks.

### ***Creating replicable precedents:***

Financial markets primarily achieve scale through replication, not innovation. Where innovation is necessary, it should be achieved with replicability in mind. Standardisation drives down processing costs and timelines for both sides of the investment equation.

### ***Introduce Transparency***

For this to be possible however, it is crucial that all market actors should be able to learn from the precedent thus established.

Transparency is therefore a key concept:

- Legal documents should be made readily available.
- Financial performance, including all fees, should be the subject of standardised, publicly available reporting.
- Impact measurement and reporting should be conducted according to a single collectively accepted framework.

Markets will not grow where data is not readily accessible. Interviewees explained that the first track records for MRIs are often in the process of being built. If the data is not adequately recorded, or if confidentiality clauses have been agreed to, this might however be lost.

### **Build Performance and Impact Data**

The combination of the creation of precedents and the introduction of transparency should result in the gradual building of centrally maintained, publicly available data pertaining to the financial performance and the impact delivered. This will as the number of observable instruments grows allow market participants to 'benchmark' as part of their investment process and will introduce comparability as a key market building accelerant. In the same way that the lack of standards and norms are counter-productive, the absence of a reference point inhibits investment.

The study suggests that the EU's philanthropic organisations already have the key ingredient of market building: a core constituency of self-motivated actors. Other requirements, ranging from operational efficiency and replicability to the transparency needed to build performance and impact data are well documented, and precedents across financial markets can be leveraged upon.

### **6.2.3. The role of public grants**

Grants, whether they be from EU sectoral programmes or national governments, or indeed from philanthropic organisations, can play a decisive role in this context.

Capacity Building	<ul style="list-style-type: none"> <li>– Support the setup and operations of accelerators, intermediaries and service providers, for example in the field of impact measurement.</li> </ul>
Market Building Research Work	<ul style="list-style-type: none"> <li>– The market building role played by investment banks through intermediation and product development is in the MRI context neither played by these institutions nor systematically funded.</li> <li>– The work conducted by industry bodies (Philea, EVPA, GSG NABs, national associations), academic networks (ERNOP) should be supported, as should the advent of thinktanks akin to those at work in the development field (CGD, ODI, CDFS).</li> </ul>
De-risking	<ul style="list-style-type: none"> <li>– Where possible, grants can be used as blended finance instruments, sharing the risk of creating precedents with philanthropic organisations.</li> <li>– Beyond mitigating investment risk, they can also help de-risk the launch of vehicles, for example through underwriting non-recoverable launch costs.</li> </ul>
Central data maintenance	<ul style="list-style-type: none"> <li>– Providing transparent access to professionally maintained data carries a cost.</li> </ul>

	<ul style="list-style-type: none"> <li>– Absent the commercial motivations of data accumulation and ownership observed at play in capital markets, there is a need to create and maintain a central repository of financial and impact performance data pertaining to MRIs.</li> </ul>
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Table 2: Use of grants for market building

Where philanthropic organisations or public institutions can derive value from the development of MRIs, there is a range of interventions that could be funded by grants. These are aligned with the market building principles listed above, whether it be through research leading to the design of standards or through the maintenance of publicly available data. Though philanthropic actors can deploy this type of funding, several interviewees suggested additional public support is needed.

## 6.3. Market Building Instruments

### 6.3.1. Guiding principles: golden rules and silver bullets

Of the many quotable elements of feedback drawn from interviews, one stands out for its relevance to mobilisation dynamics: ‘instruments divide’.

Although it is possible to identify a single financial instrument to solve a specific investment equation, and even perhaps to identify a set of instruments worthy of considerations for a specific sector, an often-observed mistake in mobilisation scenarios is an ill-guided focus on the tools rather than on the job. There is usually no ‘silver bullet’ instrument.

Instruments do however have their importance as they, alongside taxonomy, regulations and performance standards, form part of the common language of any investment ecosystem. It is important to first define the characteristics that would make specific financial instruments fit for purpose in the wider context of the system they are meant to serve.

The discussion of individual instruments that follows is meant to illustrate the realm of the possible, not to advocate for one solution over another. The examples were selected on the basis of their compatibility with private equity portfolios. Not only have these been identified as one the main MRI instruments, but they are also the most difficult to structure around. Debt based vehicles are much easier to deal with. *‘Qui peut le plus peut le moins.’*

#### 6.3.1.1. Replicability

As briefly discussed above, a key guiding principle to the creation of a mobilisation instrument is that it should be replicable. This is particularly true of nascent fields where the amounts that can be deployed remain relatively modest.

Not only can scalability only be achieved through the replication of successful precedents, but replication through the use of the same instrument and legal structure is the only way in which mobilisation can be efficient in terms of cost, of time and of human resources. The initial pain and expense of setting up a blueprint must be ‘amortised’ through repeated subsequent use.

This is specifically relevant in a space where individual philanthropic organisations do not uniformly possess the resources to engage in long and costly investment processes.

This in turn means that co-creation needs to be approached in a spirit of compromise. Private assets models and practices have created counter-productive habits whereby each investor sees it not just as their right but too often as their responsibility to make separate and additional demands, leading to longer investment cycles, higher legal fees, and jeopardising the benefits of standardisation.

#### 6.3.1.2. Simplicity

There is a high level of divergence across the sample of interviewed philanthropic organisations in terms of their technical ability to invest in relatively complex financial instruments.

While those without the necessary know-how would be excluded from any mobilisation drive relying on complex instruments, those that have the capability might be reluctant to repeatedly allocate scarce resources to protracted negotiations for non-core, experimental products.

Efforts aimed at mobilising private capital on the part of development financial institutions too often relied on the flawed assumption that because – some – institutional investors made allocations to complex financial vehicles, they would gladly consider doing so to invest in developing countries they had little or no prior exposure to. On the contrary, it turned out that the common sensical principle that when asking investors to do something that lies beyond their comfort zone, one should do so through instruments that minimise the effort required, was correct.

Here it is important to contrast the nature of investments and their structure. Financial institutions know how to structure products that bridge the gap between the nature of underlying investments to the needs of specific investor audiences. Where it is necessary to use complex instruments as underlying building blocks, the structuring capacity of financial intermediaries should be brought to bear to deliver simplicity at the mobilisation instrument level.

Whilst there are limits to how wide the bridge can be, the aim should be to empower those who wish to deploy some of the capital of their philanthropic organisations to deliver on their mission by presenting them with the simplest possible solution without compromising the ability of the tool to deliver.

Any mobilisation instrument should be as simple as possible and as complex as necessary.



### 6.3.2. **Pari-passu investment**

Pari-passu investment was the basic building block of the original theory of change of private capital mobilisation in the development finance sector. By deploying significant amounts of investment capital, public institutions would simultaneously create an ecosystem of professionalised intermediaries, fund private businesses in target geographies and economic sectors, and pave the way for private institutional investors by using investment vehicles they were assumed to be comfortable with.

This last outcome has not yet been satisfactorily achieved, but there is no doubt that this approach was at least successful in both deploying otherwise unavailable capital on the ground and in creating a group of institutional grade financial intermediaries. The private equity industry in Africa would arguably not exist in anything like its current form without the relentless support it received from development finance institutions.

Pari passu investment on the part of catalytic actors is therefore an effective strategy for capacity building. It is also of course appropriate where the objective is predominantly to deploy more capital to address an issue. When the aim is to build a market or to create momentum by enticing additional investors into a space, it can deliver value through shared due diligence and operational capacity, as well as through the implied endorsement of specific themes or products.

There is however a growing realisation across the fields where investment has been identified as a legitimate additional tool to address societal or environmental issues, that the incumbent supply of capital that can meet the corresponding needs, be it public or philanthropic, is available in insufficient quantities. It has for some time been deemed necessary for catalytic actors to stimulate the ‘movement’ of capital from additional sources, which may be subject to different mandates. This realisation resulted in the development of the blended finance concept. There is, characteristically, no shortage of definitions for blended finance. Convergence, an organisation dedicated to the advancement of the concept defines it as ‘the use of catalytic capital from public or philanthropic sources to increase private sector investment in sustainable development.’<sup>24</sup>

### 6.3.3. **Acceleration Tools**

Acceleration tools refer to catalytic interventions applied to the structures already used by philanthropic organisations to enhance the impact of their existing MRI programmes. They can, through de-risking mechanisms, help existing actors to increase their ticket sizes. They can also be used to facilitate the mobilisation of actors who already have the technical know-how to support these structures but who deem the perceived risk to exceed their risk tolerance, or who are not comfortable with the lack of historical data. As will be discussed later, these instruments should preferably be used to allow actors to become familiar with the underlying risk through a de-risked

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<sup>24</sup> <https://www.convergence.finance/blended-finance>

structure that will not always be available rather than to subsidise an investment that is not likely to eventually be appropriate on its own. They presuppose the availability of catalytic capital.

### 6.3.3.1. Waterfalls

Private equity vehicles, whether structured according to the original ‘limited partnership’ model or its various adaptations, typically share a common if cumbersome feature: a waterfall. Poetic though the term might be, the underlying concept is anything but. It refers to the order in which money is distributed as the fund self-liquidates over the course of its life. At the risk of over-simplification, the first order of business is to return the capital invested by each party, and then to distribute any profits. The waterfall describes the order in which each investor - leaving the fund manager aside – receives distributions, which has significant implications for the amount of risk linked to their initial investment and their investment return.

#### 6.3.3.1.1. First loss, share classes, and waterfalls

The most popular blended finance mechanism applied to private assets vehicles is based on the granting of different rights to different groups of investors. For the sake of clarity, they can be referred to as *protecting* and *protected*. The basic idea is that the capital of the junior or *protecting* investors will act as a buffer between losses and the senior or *protected* investors.

In practical terms, this can be built into the waterfall arrangements. As, towards the end of its life, the fund starts selling positions and returning cash to investors, all, or a comparatively higher proportion of cash payments go to *protected* investors until such time as they have recouped their initial investment amount. Only then do *protecting* investors start getting their money back.

In July 2021, the European Investment Bank (‘EIB’) for example announced that its Luxembourg-EIB Climate Finance Platform (‘LCPF’)<sup>25</sup> would make a €15 million investment in the junior tranche of Allianz Global Investors’ Emerging Market Climate Action Fund (‘EMCAF’)<sup>26</sup>. Allianz Global Investors explains that:

*‘the Fund’s waterfall structure prioritises the repayments of the senior tranche. This provides initial downside protection for private investors, and balances the risk-return profile of the strategy to make it suitable for institutional investors.’<sup>27</sup>*

These arrangements are built into the contractual documents underpinning the fund. The contracting process for private funds is often long, arduous, and costly, but the additional cost of such provisions

<sup>25</sup> <https://www.eib.org/en/products/mandates-partnerships/donor-partnerships/trust-funds/luxembourg-climate-finance-platform#:~:text=The%20Luxembourg%20EIB%20Climate%20Finance,%2C%20high%20impact%20finance%20solutions.>

<sup>26</sup> <https://www.eib.org/en/projects/pipelines/all/20210191>

<sup>27</sup> [https://academy.allianzgi.com/learning/modules/EMCAF/#/lessons/\\_SVIHWfmdmMzSZBqVyJVTkP8le0fBpRW](https://academy.allianzgi.com/learning/modules/EMCAF/#/lessons/_SVIHWfmdmMzSZBqVyJVTkP8le0fBpRW)

is relatively marginal, assuming all participants are willing. As an acceleration tool, they combine operational simplicity and replicability.

*Protecting* investors have historically been government backed entities or indeed philanthropic organisations - sometimes through the deployment of grants - seeking to entice and protect 'commercial' investors. There is however no technical reason why the roles cannot be re-distributed.

### **6.3.3.1.2. Danish Waterfall: Preferred returns for pension funds**

Pension funds have long been the most sought-after source of capital for development finance mobilisation initiatives.

The Danish Climate Fund ('KIF') is one of the more successful attempts to date. With a mandate to make equity and mezzanine investments in climate mitigation and adaptation assets, it raised DKK 1.4 billion when it launched in 2012, 60% of which came from four of the country's largest pension funds (PensionDanmark, PKA, PBU, Dansk Vaekstscapital), and the Aage V. Jensen Charity Foundation. The rest came from the Danish government and its development finance institution, IFU. The KIF is also the precursor to the larger SDG Fund, which attracted a couple more pension funds, but importantly much larger tickets.

There are two particularly interesting aspects to this initiative:

- It is not just a rare success in pension fund mobilisation in the development finance case, it is also an even rarer case of co-creation. The Danish government was able to leverage on its relationship with pension funds to ensure they were involved in the product's design from the word go, and remained engaged, for example through the presence of PensionDanmark's and PKA's CEOs on the fund's investment committee. This caused blended finance specialist organisation Convergence to remark that 'a collaborative design process is critical to understanding investors' requirements and ensuring the capital structure is catalytic'<sup>28</sup>.
- At a time where blended finance was squarely focussed on first loss tranches to bring risk down to an acceptable level, this initiative allowed IFU to learn that what its target investors actually wanted was an improved return profile. The waterfall was accordingly designed so as to first return invested amounts to all parties, but then direct all distributions to the private investors until such time as they realise a preferred return of 6%. Only then would the Danish government be allowed to 'catch up'.

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<sup>28</sup><https://www.convergence.finance/resource/4RSEwoMnRCQsWOWo2QWGsQ/view>

Private equity funds are some of the most frequently used instruments for the delivery of MRIs. Pari-passu investments are effective to amplify investments on the part of currently active mission investors. There do in addition exist tried and tested waterfall-based blended finance practices that can alter the risk/return profile of these funds to incentivise different type of investors to enter the market for MRIs.

### 6.3.4. Adoption Tools

Adoption tools refer to solutions that alter the structure, but not the nature, of investments to make them accessible to a wider array of philanthropic organisations. Even absent 'de-risking' capital, some of these instruments can help clear risk-linked hurdles through dilution or by structurally addressing specific risks, for example liquidity risk.

#### 6.3.4.1. Danish Venture Capital and American Certificates of Participation

In 2011, the Danish state helped launch Dansk Vækstkapital, a national level fund of funds programme initially designed to - here again - mobilise pension funds to invest in Danish 'small-cap, mid-cap, venture, and mezzanine funds'<sup>29</sup>. Pension funds indeed contributed one quarter of the equity of the first €700 million fund, Dansk Vækstkapital I. The other three quarters were also raised from pension funds, but through guarantee-based debt instruments issued by the Danish National Promotional Institution (NPI) Vækstfonden, paying an interest composed of the Danish government bond rate plus an illiquidity premium. Vækstfonden in turn invests equity into Dansk Vækstkapital I.

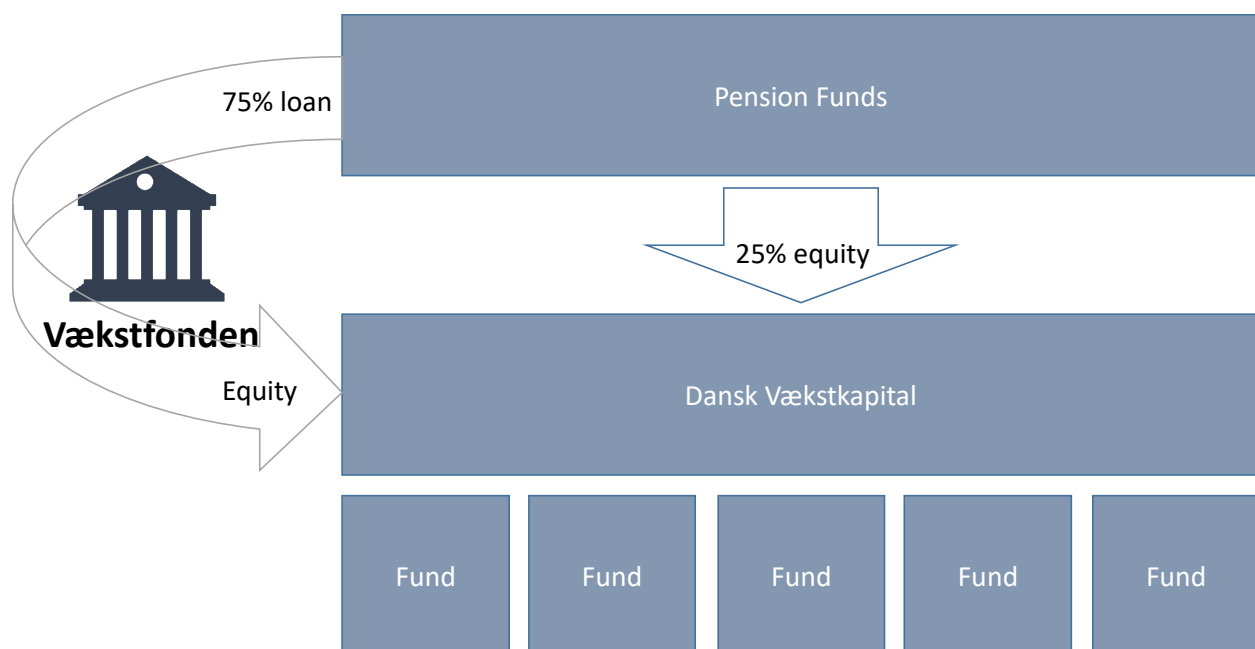


Figure 13: Dansk Vækstkapital, Source: Vækstfonden presentation, 12/09/2011

<sup>29</sup> <https://www.oecd-ilibrary.org/sites/9630c7d1-en/index.html?itemId=/content/component/9630c7d1-en>

As a result, the Danish government mobilised €525 million by providing a guarantee and, through its NPI, 'turned debt into equity' and was exposed to the difference between the performance of the fund of funds and the repayment of the debt instruments, which could of course be positive. Pension funds got to contribute to the financing of the SME sector through a low-risk debt instrument.

Further afield, one of the most interesting private capital mobilization schemes in development finance finds its roots in the fact that until recently the United States' DFC (Development Finance Corporation, formerly OPIC) did not have a mandate to make equity investments. Given private equity funds are one of the main tools used by DFIs, there was a need to adopt a creative approach.

The DFC made contributions to private equity funds by offering them senior secured loans, essentially resulting in a leveraged debt structure.

In addition, and due to further intricacies in the way the DFC operates, these loans were not funded from its balance sheet, but with private capital raised through the issuance of Certificate of Participation ('COPs') on debt capital markets.

Although the loan agreement was between the DFC and the borrower, the proceeds from the COPs issuance were directly transferred from the placing agent to the borrower. Only US investors were eligible, and the COPs were backed by the full faith and credit of the U.S. Government. COPs paid investors an interest rate composed of a relevant US treasury securities rate plus a premium.

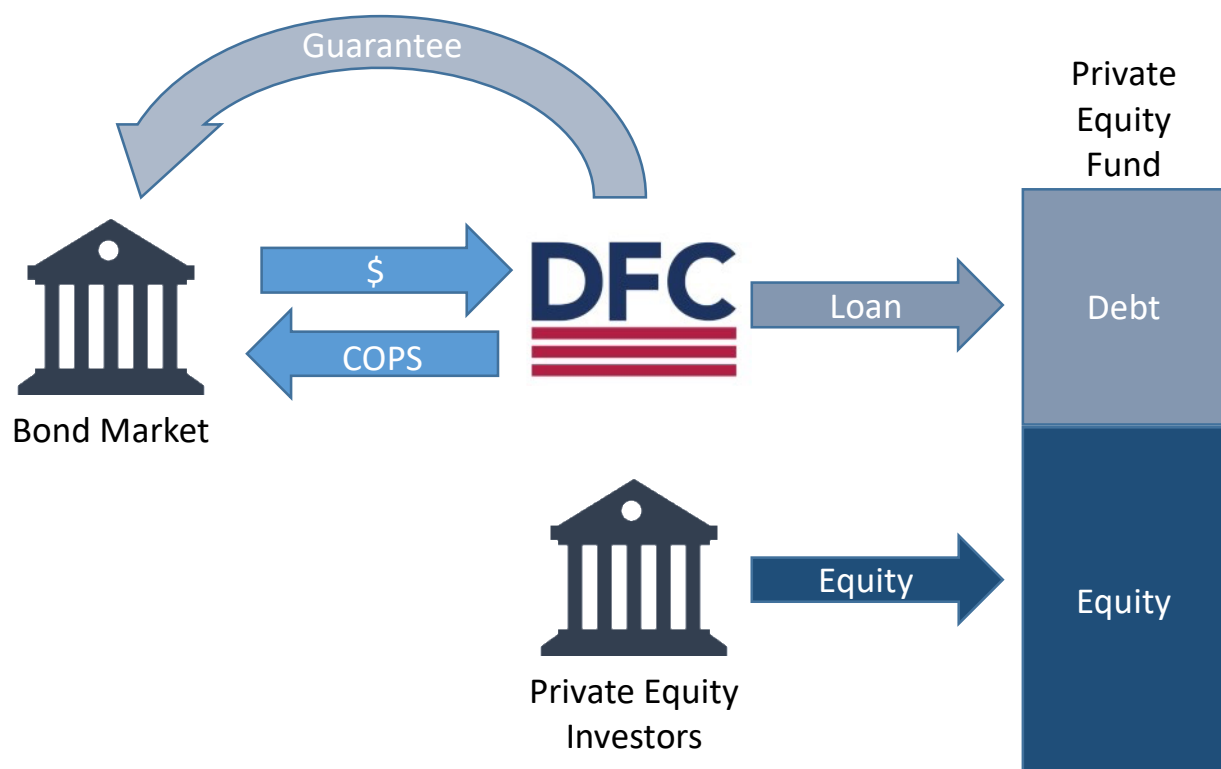


Figure 14: COPS

Although issues were typically relatively small (\$30-50million), COPs are held by pension funds, insurance companies and mutual funds, and they allowed the DFC to support private equity funds with billions of US dollars of loans. DFC's total COPs-related debt portfolio recently amounted to over \$10 billion, roughly 10% of which is supporting commitments to investment funds. COPs therefore demonstrated both replicability and scalability.

The application of debt leverage to a private equity investment does of course have implications for the risk carried by equity investors in the vehicle. Where such equity investors are however publicly funded institutions with a catalytic mandate or indeed philanthropic organisations desirous of leveraging the impact delivered by their investment, this could be justified. In the event that this is not the case, the Rockefeller Foundation and Axa XL Caitlin found a workaround to address tail-end performance risk, allowing the DFC to make a significant commitment to LeapFrog's third fund while protecting equity investors. The foundation made a 'commitment in the form of an insurance deductible, backstopping a broader insurance policy that benefits the fund's equity investors'<sup>30</sup>.

It is also theoretically possible to structure certificates as equity instruments, offering a scenario where only the capital is protected, but where the capital is invested *pari-passu* with equity investors, and returns are in line with the underlying private equity fund.

The Dansk Vækstkapital programme and COPs are good examples of how, through the use of guarantees, investors can, through simple instruments, support complex investments. In the context of the philanthropic sector, such mechanisms could provide new entrants in the market for MRIs with a very simple, low-risk debt instrument allowing for their capital to be protected. For the supporting public institution, it entails the use of a budgetary guarantee, which is core to the offer of the InvestEU programme.

#### 6.3.4.2. 90/10 Funds and the French 'Investissement Solidaire' Model

Many philanthropic organisations, whether it be due to limited resources, or to structural constraints simply will not for the foreseeable future be in a position to create MRI programmes and invest directly into a private fund, let alone a portfolio thereof or individual companies. This study has for example observed the recourse to traditional collective investment schemes, often with 'balanced' equity/fixed income mandates, by some components of umbrella foundations.

To empower those organisations willing to deploy some of their endowment capital into MRIs, but unable to do so under current circumstances, it may be useful to draw inspiration from the French 'Investissement Solidaire' model and the 90/10 'solidarity-based' funds it has been using to mobilise

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<sup>30</sup> <https://www.rockefellerfoundation.org/blog/zero-gap-fund-supports-leapfrogs-growth-and-scaling-of-impact-investing-market/>

savings for just over twenty years. In its 2019 ‘Study on 90/10 funds’<sup>31</sup>, Finansol provides a helpful definition:

*Created by the ‘Fabius’ law of 19/02/2001, solidarity-based funds, known as ‘90/10’ funds, are required to invest between 5 and 10% of their assets in accredited ‘solidarity-based enterprises of social utility’ (entreprises solidaires d’utilité sociale – ESUS) organisations.*

According to FAIR’s data, these 90/10 funds held assets worth €13.7 billion in 2021.

Essentially, the 90/10 funds offer a dilution-based access mechanism to savers wishing to allocate some of their assets to solidarity-based investments. Whilst the bulk (90%+) of the assets are deployed into ‘traditional’ liquid securities, the solidarity-based allocation is dedicated to illiquid, accredited investments they would otherwise be unable to support.

It is important to note that the landscape of 90/10 funds is dominated by some of France’s largest asset managers, including Natixis Mirova, BNP Paribas IP and Amundi. As assets under management grew, and to bring operational efficiency to the management of the solidarity-based allocation, they created ‘FCPR (venture capital mutual funds) or FPS (specialist occupational funds) that pool solidarity-based investments into a single financial vehicle’.

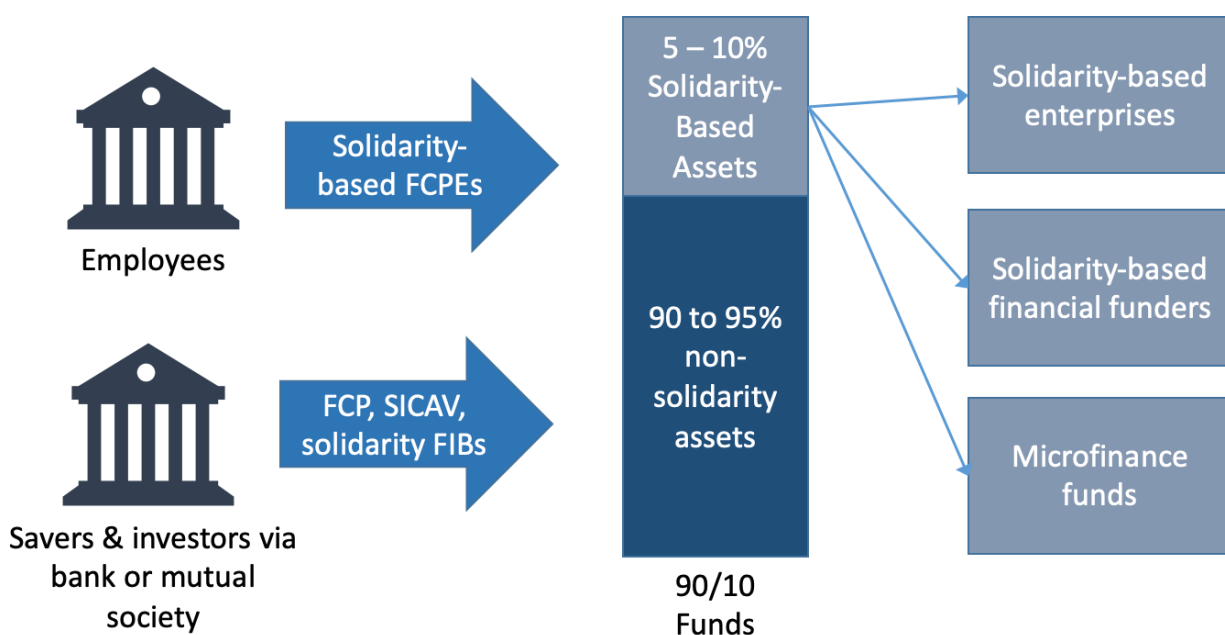


Figure 15: 90/10 solidarity based funds, Source: Finansol, Study on 90/10 funds, 2019

<sup>31</sup> <https://www.finance-fair.org/sites/default/files/2022-05/FAIR-study-on-9010-2019.pdf>

In its March 2022 paper<sup>32</sup>, FAIR provided an analysis of solidarity-based 90/10 funds, based on Morningstar's ratings system. This suggests that the performance of solidarity-based 90/10 funds is either in line with or better than the average performance of the relevant universe of funds in 79% of the cases, with a lower risk profile in 100% of the cases.

French 90/10 solidarity-based funds are, rather understandably, focused on the French social economy. The model should however be eminently capable of replication across EU jurisdictions. 90/10 funds were in fact covered under the UCITS III framework, although they for reasons unclear, were omitted from the successor UCITS IV dispensation. It has in fact for example attracted interest from the Spanish NAB (National Advisory Board for impact investing).

90/10 solidarity-based funds provide a time-tested proof of concept for a relatively straightforward, replicable model that leverages off the resources of some of Europe's largest asset management groups to provide investors with a non-disruptive opportunity to allocate some of their assets to solidarity-based investments they could not access directly.

Whilst there is no suggestion that this model is relevant to the largest, most sophisticated philanthropic organisations, they represent a potential collective mobilisation tool for a wider set of participants. Importantly the 'solidarity-based' allocation, if structured as a stand-alone vehicle as is now the case in France with FPS/FCPR funds, would make it possible for those institutions that do not require a dilution-based adoption vehicle, to co-invest directly into these pockets.

#### 6.3.4.3. Taking MRI Public: Listed Funds

If one peeps across the Channel for inspiration, the public markets listed and traded funds sector too has passed the test of time. The first London Stock Exchange('LSE') listed 'investment trust' dates back to 1868.

The principle is simple. Instead of having an open-ended structure where investors get in and out through subscriptions and redemptions that affect the size of the fund, or a private equity fund limited partnership structure where there is no robust mechanism to exit until underlying investments are sold and proceeds distributed, LSE listed 'Closed-End Investment Companies' ('CEIC') function like other listed stocks.

Once such a vehicle is launched, investors can invest or disinvest by buying or selling its shares on the stock exchange. In very much the same way that Tesla does not sell any assets when an investor decides to exit its position in the fêted electric car manufacturer, the size, and the portfolio of a CEIC is unaffected by transactions in its shares.

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<sup>32</sup> '90/10 Funds: A French proof of concept for social investment funds, FAIR, March 2022



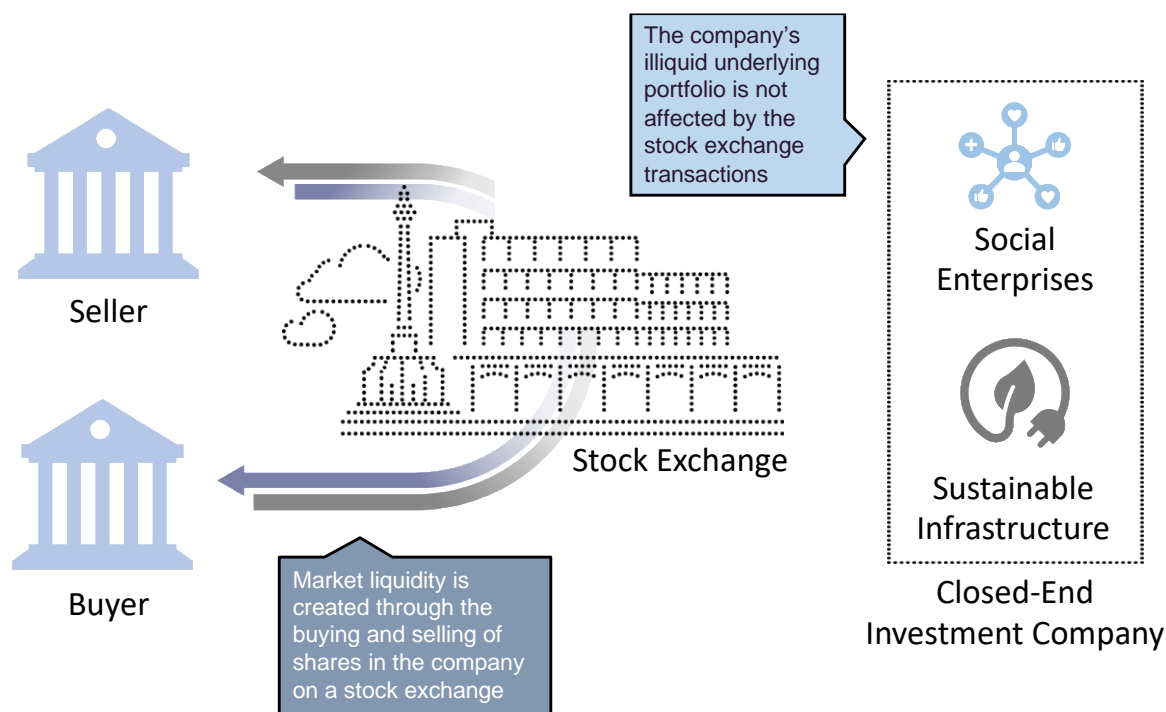


Figure 16: Publicly listed CEICs, Source: Eighteen East Capital

The liquidity available to investors is disconnected from the liquidity profile of the portfolio, allowing fund managers to take a very long-term view. This is particularly relevant to the context of MRIs, given the long-identified importance of patient capital. Whilst a debate of the additionality or lack thereof of a 'secondary' investment is beyond the scope of this study, it should suffice to point out that there is full additionality at the 'primary market' stage when the CEIC completes its initial public offering ('IPO').

Equally, the fact that the shares are traded and therefore have a price, which means it is exposed to more observable volatility than is the case for a private vehicle that has no price should not be ignored but is not significant in the context of a diversified portfolio.

The LSE is home to 'over 450 listed investment funds that total over \$320bn in market capitalisation invest in more than 70 subsectors, providing access to a range of asset classes and geographies'<sup>33</sup>. Beyond the test of time, CEICs therefore tick both the replicability and the scalability boxes. As for simplicity, all types of investors can and do buy shares in these funds, from retail investors through online platforms to pension funds and of course, charities.

The renewables sector makes for a particularly striking case study. The first CEIC in the sector was listed in 2013 with the support of a GBP 50 million cornerstone investment from the UK government.

<sup>33</sup> <https://www.londonstockexchange.com/raise-finance/investment-funds>

It has since grown into a GBP 16 billion sector with a wide variety of individual vehicles, all trading at a premium to NAV, signalling the existence of further market appetite.

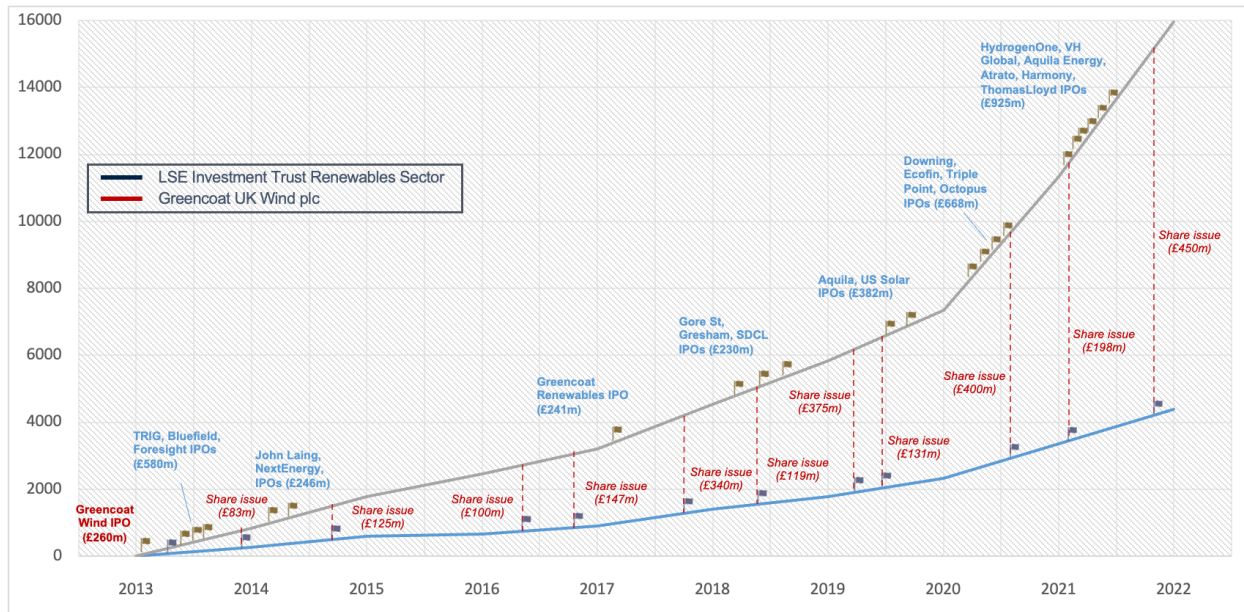


Figure 17: The LSE Investment Trust Renewables Sector, Source: Eighteen East Capital

This was of course achieved against a backdrop of generally strong demand for exposure to the sector, and one could argue that renewable energy has graduated to ‘mainstream’ status. It does however provide a powerful demonstration of what happens when assets that investors want to gain exposure to but cannot access are eventually made available to them through appropriate instruments.

Another advantage of the model is that it can accommodate almost any underlying asset class or theme, and it is important to note that a social economy precedent now exists, further to the December 2020 IPO of the GBP 90 million Schroder BSC Social Impact Trust, born out the collaboration between large asset manager Schroder and the UK’s impact investing ‘wholesaler’ Big Society Capital. The trust is for example mentioned in the Impact Investing Institute’s ‘Investing with impact in the endowment’<sup>34</sup> report recently showcased by EVPA. Social housing, a prominent feature of MRIs made by the sample, can also be accessed through listed vehicles.

	Total Assets (GBP Million)	Dividend Yield (%)
Civitas Social Housing	947.72	4.7
Home REIT	254.28	2.2
Residential Secure Income	345.28	4.7
Triple Point Social Housing	421.98	5

Table 3: LSE listed social housing investment trusts, Source: AIC/Morningstar as at 12 July 2021

<sup>34</sup><https://www.impactinvest.org.uk/wp-content/uploads/2022/02/Investing-with-Impact-in-the-Endowment.pdf>

Listing a vehicle is no mean feat, and the challenges of reaching both critical mass and a suitably diversified shareholder base should not be underestimated. Addressing these challenges is an important aspect of the raison d'être for the UK Government FCDO's MOBILIST programme, which seeks to leverage public capital markets for sustainable development<sup>35</sup>.

Exchange listed CEICs do present several advantages in the MRI context. They can provide philanthropic organisations with an adoption route that is:

**Liquid**, as opposed to the long term 'locked up' private markets equivalent, shares in CEICs can be sold every day on the stock exchange, albeit as a function of the volumes.

**Regulated**, as the market regulator needs to vet the prospectus of the vehicle before it can list

**Truly long-term**, as there is no need, under normal circumstances, for the fund manager to liquidate position to accommodate fixed investment horizons

**Transparent**, as public markets governance mandates that all investors must have access to the same information and defines reporting standards.

Apart from a lack of a tradition in their use, there is no reason why this model could not be imported to EU Member States. After all, shares in CEICs look, act and trade just like stocks.

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<sup>35</sup> <https://mobilistglobal.com/>

## 7. InvestEU & Philanthropy: Common Missions

### 7.1. InvestEU, a – brief – introduction

It is of course not the purpose here to provide a detailed depiction of the InvestEU Programme, but rather to highlight how it is both an illustration of the significant alignment of values and objectives of the European Union and European philanthropic organisations, and the potential means to turn this alignment into tangible cooperation.

As the successor to the Investment Plan for Europe programme implemented by the EIB Group until 2020, InvestEU will until 2027 seek to make access to EU funding both simpler and more effective by turning a wide array of instruments, including the European Fund for Strategic Investments (EFSI) into one facility.

The InvestEU Programme is organised into three building blocks:



Figure 18: InvestEU Building Blocks, Source: ECFIN, 2021<sup>36</sup>

All three are relevant to the matter at hand. It is important to note that the InvestEU Fund component consists of a €26.2 billion budgetary guarantee tasked with the mobilisation of €372 billion of additional investments across Europe for the support of key EU thematic objectives. The guarantee itself is allocated across four policy windows that will be discussed below.

### 7.2. Mission alignment

InvestEU' four policy windows are defined in article 8 of the regulation establishing the programme<sup>37</sup>. It is in such matters prudent to quote verbatim.

<sup>36</sup> [https://economy-finance.ec.europa.eu/events/launch-investeu-programme-opportunities-start-here-2021-03-18\\_en](https://economy-finance.ec.europa.eu/events/launch-investeu-programme-opportunities-start-here-2021-03-18_en)

<sup>37</sup> <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32021R0523&from=EN>

**REGULATION (EU) 2021/523 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL**

Article 8: Policy windows

The InvestEU Fund shall operate through the following four policy windows that shall address market failures or suboptimal investment situations within their specific scope:

- (a) a sustainable infrastructure policy window which comprises sustainable investment in the areas of transport, including multimodal transport, road safety, including in accordance with the Union objective of eliminating fatal road accidents and serious injuries by 2050, the renewal and maintenance of rail and road infrastructure, energy, in particular renewable energy, energy efficiency in accordance with the 2030 energy framework, buildings renovation projects focused on energy savings and the integration of buildings into a connected energy, storage, digital and transport systems, improving interconnection levels, digital connectivity and access, including in rural areas, supply and processing of raw materials, space, oceans, water, including inland waterways, waste management in accordance with the waste hierarchy and the circular economy, nature and other environment infrastructure, cultural heritage, tourism, equipment, mobile assets and the deployment of innovative technologies that contribute to the environmental or climate resilience or social sustainability objectives of the Union and that meet the environmental or social sustainability standards of the Union;
- (b) a research, innovation and digitisation policy window which comprises research, product development and innovation activities, the transfer of technologies and research results to the market to support market enablers and cooperation between enterprises, the demonstration and deployment of innovative solutions and support for the scaling up of innovative companies, as well as digitisation of Union industry;
- (c) an SME policy window which comprises access to and the availability of finance primarily for SMEs, including for innovative SMEs and SMEs operating in the cultural and creative sectors, as well as for small mid-cap companies;
- (d) a social investment and skills policy window, which comprises microfinance, social enterprise finance, social economy and measures to promote gender equality, skills, education, training and related services, social infrastructure, including health and educational infrastructure and social and student housing, social innovation, health and long-term care, inclusion and accessibility, cultural and creative activities with a social goal, and the integration of vulnerable people, including third country nationals.

As discussed above, allocating MRIs through any specific categorisation system is a less than exact science. It is however clear that there is a significant degree of alignment. Just over 80% of MRIs made by the sample can be allocated to one of the four policy windows and are in the EU. The policy areas linked to the Social Investment & Skills window account for approximately half of the InvestEU aligned MRIs in the sample.

There is therefore *prima facie* evidence of the relevance of MRIs and by extension philanthropic capital to the InvestEU programme.

Beyond those areas of common purpose more directly aligned with philanthropic missions, it should be mentioned that there is also the potential for philanthropic organisations to engage with InvestEU around investments that, though not internally categorised as MRIs, are at the intersection of either

or both of their wider set of values or their corporate pursuits and of policy windows. Investments into sustainable infrastructure or biotech venture capital are examples of such areas.

There is observable alignment between the sectors in receipt of MRIs as identified through the study and the policy windows of the InvestEU programme. The budgetary guarantee that can be brought to bear through InvestEU implementing partners could play a significant catalytic role at this early stage of a market building exercise.

### 7.3. Mechanics

The budgetary guarantee at the core of the InvestEU programme is applied to financing delivered through Implementing Partners, which at the time of writing are the European Investment Bank ('EIB') and the European Investment Fund ('EIF'). These two institutions will remain the main Implementing Partners covering at least 75% of the programme. These will be joined in due course by additional Pillar-Assessed Implementing Partners including International Financial Intermediaries and National Development Banks and Institutions, selected further to a 2021 call for expressions of interest.

As illustrated in Figure 19, the guarantee is provided to the InvestEU's implementing partners, who in turn deploy financing and investment operations towards beneficiaries, either directly or indirectly through financial intermediaries, including investment funds.

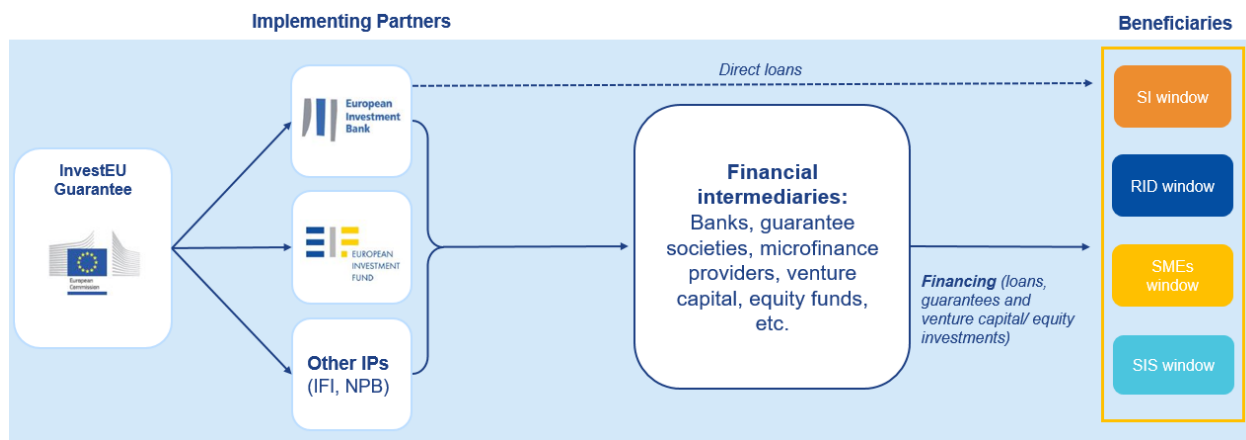


Figure 19: InvestEU Implementation model, Source: DG ECFIN, 2021<sup>38</sup>

Beyond investment, financing and de-risking tools however, there is a need for advice and capacity building support, which the programme's implementing and advisory partners can deliver. The InvestEU Advisory Hub, which is a successor of the European Investment Advisory Hub (EIAH), is also directly relevant. EIB Group is the main Advisory Partner within the InvestEU Advisory Hub.

<sup>38</sup> [https://economy-finance.ec.europa.eu/events/launch-investeu-programme-opportunities-start-here-2021-03-18\\_en](https://economy-finance.ec.europa.eu/events/launch-investeu-programme-opportunities-start-here-2021-03-18_en)

## 7.4. Instruments

The conditions of the application of InvestEU guarantees, including policy prioritisation and eligibility criteria and targeted financial recipients are defined in the Guarantee Agreement signed by the European Union with each implementing partner.

The two currently active implementing partners, the EIB and the EIF signed a joint guarantee agreement on the 7<sup>th</sup> of March, for an aggregate guarantee amount of €19.65 billion<sup>39</sup>. Each agreement in addition lists the instruments relevant to each implementing partner and to each window.

The EIB has products linked to the Sustainable Infrastructure ('SIW'), Research, Innovation and Digitisation ('RIDW') and Social Investment & Skills ('SISW') windows, and the EIF has products linked to all four, including the SME ('SMEW') window.

	<i>SIW</i>	<i>RIDW</i>	<i>SMEW</i>	<i>SISW</i>
<b>EIB</b>	<ul style="list-style-type: none"> <li>- General Debt</li> <li>- Thematic: Green Transition</li> <li>- <i>Thematic: PF4EE (not yet available)</i></li> </ul>	<ul style="list-style-type: none"> <li>- General Debt</li> <li>- Thematic: Green Transition</li> <li>- Thematic: Thematic Innovation</li> </ul>		<ul style="list-style-type: none"> <li>- General Debt</li> <li>- Public Sector</li> </ul>
<b>EIF</b>	<ul style="list-style-type: none"> <li>- Sustainability Guarantee</li> <li>- Climate &amp; Infrastructure Funds Product</li> </ul>	<ul style="list-style-type: none"> <li>- Joint Equity Product</li> </ul>	<ul style="list-style-type: none"> <li>- Sustainability Guarantee</li> <li>- SME Competitiveness Guarantee</li> <li>- Innovation &amp; Digitalisation Guarantee</li> <li>- Cultural and Creative Sector Guarantee</li> <li>- Joint Equity Product</li> </ul>	<ul style="list-style-type: none"> <li>- Microfinance &amp; Social Guarantee</li> <li>- Skills &amp; Education Guarantee</li> <li>- Social Impact Equity Product</li> <li>- Climate &amp; Infrastructure Funds Product</li> <li>- Capacity Building Investment Product</li> </ul>

Table 4: EIB Group Invest EU products, Source: ECFIN The InvestEU Programme, Prague 2022

EIB General Debt products may take different forms, including mostly direct loans, guarantees, securities and standby facilities, of various levels of seniority, and convertibility into equity is allowed. In particular under RIDW, financing by the EIB takes predominantly the form of venture debt. In addition, two 'thematic' – high policy added value and high risk - products, respectively focussed on

<sup>39</sup> [https://ec.europa.eu/commission/presscorner/detail/en/ip\\_22\\_1548](https://ec.europa.eu/commission/presscorner/detail/en/ip_22_1548)

the green transition and on thematic innovation in R&D are available under SIW and RIDW. Financing under these thematic products will take riskier forms of venture debt. Finally, the Private Finance for Energy Efficiency (PF4EE) initiative, currently not yet available to the market, aims to offer a capped portfolio guarantee to financial intermediaries.

The EIB can either intervene directly in scenarios that are broadly in line with its bankability criteria, but with an enhanced level of flexibility in the context of InvestEU, or indirectly through risk sharing with financial intermediaries. The latter approach makes it possible to reach smaller financial recipients. The EIB does finance climate action and environmental sustainability through a range of adapted financial products, and should also be well positioned to support a wide range of MRIs, in areas including infrastructure, innovation or digitalisation.

The EIF range of InvestEU products is wider and more directly relevant to those MRI programmes focussed on SMEs, social or impact-driven enterprises. It is focussed on intermediated models, articulated around two main products, portfolio guarantees and investments in infrastructure, venture capital and private equity funds, and therefore most readily applicable to funds-based initiatives. EIF is one of the largest investors in private equity and venture capital in Europe.

The EIF portfolio guarantee products are designed to be deployed through a wide range of intermediaries (banks, microfinance and social finance providers, alternative lenders, etc.), selected further to successfully concluding a rigorous due diligence assessment. Although it is not useful to go into a detailed account of the parameters of each of the five EIF InvestEU guarantee products, the key takeaway is that they are targeting sectors identified as directly relevant to MRIs, and that they are designed to allow for the small-scale investments typical of early-stage market building.

It is also useful to note that there exist precedents for the provision by the EIF of a guarantee to a philanthropic organisation, under InvestEU predecessor instruments.

For instance, under the EFSI Skills & Education Guarantee Pilot, the EIF provided Fundação José Neves with guarantee backing an innovative income sharing agreements ('ISAs') programme. This ability to apply a guarantee tool to a non-standard lending model jointly with a philanthropic organisation acting as financial intermediary indicates the EIF has the capacity to support bespoke MRI solutions adapted to the needs of philanthropic organisations.

Another option within the InvestEU Programme is to deploy InvestEU equity products. Similarly to the portfolio guarantees, there are precedents of collaborations between EIF and philanthropic organisations in the equity space but these remain limited. The observable parameters of the three InvestEU equity products suggest that the InvestEU programme is well positioned to co-invest with philanthropic organisations in pooled MRI vehicles. The framework does allow for long investment terms and for flexibility to support first-time funds and vehicles supporting early-stage SMEs. EIF is typically acting as a cornerstone investor, particularly in funds with a high policy value-added, supporting their establishment with structuring input.



Under InvestEU the EIF is investing pari-passu with other investors. One exception is linked to the application of the ESCALAR<sup>40</sup> mechanism, which does share some characteristics with the Danish waterfall model described earlier and is therefore presumably once again available under InvestEU.

In the context of philanthropic organisations, one potential opportunity to de-risk their investment may be to intervene in a subordinated position. The provision of equity capital subordinated to other investors would however require the granting of a policy exception.

As was the case under EFSI, InvestEU makes provisions for the creation of investment platforms, based on the observation that the former's 'experience shows that the use of Investment Platforms is an efficient way to operate in incipient and less mature markets, to address areas of high policy priorities and to ensure broader geographical coverage'<sup>41</sup>. These 'can be set up under all appropriate financial products offered by Implementing Partners and under all policy windows of InvestEU' and could theoretically provide a suitable framework for the co-creation of a facility by one implementing partner and a group of philanthropic organisations.

The InvestEU programme, through its two main implementing partners, EIB and EIF, already offers an array of instruments with a high degree of potential applicability to the MRI space. It is particularly well positioned to enhance the impact of philanthropic MRI programmes where credit risk mitigation can be brought to bear.

The built-in flexibility of its funds-based equity products and the observable evidence of the innovative application of its guarantee products to non-standard credit risk suggest there is sufficient scope to develop innovative and dedicated blended-finance mobilisation solutions to support the building of EU's MRI ecosystems. Where philanthropic organisations opt to provide debt financing to relevant final recipients, they may in addition stand to benefit indirectly from InvestEU guarantees.

Beyond the financial instruments, the InvestEU Advisory Hub, equipped with a €270 million budget dedicated to the provision of 'market development, developing skills and project level advisory services' across the four policy windows could in addition make a significant contribution towards the growth of the philanthropic MRI space.

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<sup>40</sup> <https://www.eif.org/attachments/escalar-annex-ii-investment-guidelines.pdf>

<sup>41</sup> InvestEU Steering Board – Rules applicable to the operations with investment platform under InvestEU, June 2022

## 8. Creating a catalytic precedent

### 8.1. Catalytic capital: where to apply?

Blended finance and catalytic capital are relatively recent concepts. The methodology for determining how to allocate catalytic capital, optimally size its deployment or set the level of protection it affords is still very much work in progress. The ‘Catalytic Capital Consortium’<sup>42</sup> launched by the MacArthur Foundation, Rockefeller Foundation, and the Omidyar network is seeking to document evidence-based learnings to contribute to its development.

When asked what the optimal use of catalytic capital from public institutions would be in the MRI context, the Philanthropic Capital Study interviewees volunteered two main avenues:

- Use it to facilitate the adoption of MRIs by new philanthropic organisations
- Use it to allow existing MRI investors to increase ticket sizes or support initiatives beyond their risk appetite.

One interviewee suggested it would be more productive to ‘empower the convinced’ than to seek to convince the doubters. More insisted that wider adoption should be the main focus. There are presumably three categories of organisations at this stage of market building:

- Organisations that are both convinced and able to invest
- Organisations that are convinced but currently unable to invest
- Organisations that are not convinced, and whose ability to invest is therefore at least temporarily irrelevant.

The options therefore seem to be to either empower the first two groups, or just the first one. If catalytic capital is deployed to attract new entrants, for example by limiting downside risk, it should also make the underlying investment more attractive to existing actors, enabling them to increase exposure, even if it might not be the most efficient use of this capital. Different share classes could in addition help address this inefficiency. There is no need for these options to be mutually exclusive however, and it is worth highlighting that models such as the Dansk Vækstkapital illustrated above have the potential to address both.

When designing initiatives aimed at driving the growth of the MRI market, it may be necessary to decide whether the main objective is to accelerate investments made by actors already active in the space, or to make it possible for additional actors to adopt the MRI concept. This determination belongs to philanthropic organisations and to the providers of said catalytic capital.

### 8.2. Who should catalyse whom?

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<sup>42</sup> <https://www.macfound.org/programs/catalytic-capital-consortium/>

Philanthropic organisations have played an important role in the advent of blended finance, typically as the providers of de-risking mechanisms, either through subordinated investments or through the application of grants to investment vehicles. Public institutions including DFIs have in fact at times been among the beneficiaries of philanthropic catalytic interventions.

It should be remembered that, where they take the form of an investment by a US foundation such interventions often come from PRI programmes that need to be compliant with IRS rules. Easily observable ‘concessionality’ is a helpful feature in this context. There are fewer examples of such investments being made from endowments. The MRIs analysed for the purpose of this study are generally not structured as ‘junior’ to other investors.

Philanthropic capital is scarce, as is taxpayer money. There are many precedents for either or both being deployed as catalytic capital to mobilise ‘commercial’ private investors. This was for example the case for the Global Health Investment Fund where the Bill & Melinda Gates Foundation and the Swedish government’s SIDA jointly provided a partial guarantee to mobilise investors<sup>43</sup>. Few examples of one solely seeking to mobilise the other do spring to mind in an investment context. On the grants front however, the European Social Catalyst Fund<sup>44</sup> may provide a useful precedent.

There is no harmonised tax treatment for philanthropic organisations across Member States, but those organisations who have a preferential status already receive support from public coffers. Whether additional help should be forthcoming is a legitimate question.

Where public money has however already been earmarked to catalyse private investment towards mission areas or policy windows, the concept of catalytic efficiency can provide elements of answer. Where a category of investors, for example philanthropic organisations are ‘naturally’ aligned with the missions public actors seek to mobilise towards, then the cost of mobilising their capital should be lower than would be the case with purely commercial investors. In other words, it should be cheaper to incentivise an investor that is in principle already willing to invest towards a specific mission than it would be to do so where the investor is mission agnostic.

Where they are granted preferential tax treatments, philanthropic organisations are already benefiting from public support. Although there do exist precedents for public grants mobilising grant funding from the philanthropic sector, questions can be asked of the applicability of the principle to an investment context. Where initiatives designed to use public funds to mobilise private sector investment pre-exist, it can however be argued that incentivising institutions that share common goals should be more efficient.

### 8.3. Time limited offers to use in moderation

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<sup>43</sup> [https://www.dcvmn.org/IMG/pdf/egertonwarburton\\_dcvmn\\_28\\_oct14.pdf](https://www.dcvmn.org/IMG/pdf/egertonwarburton_dcvmn_28_oct14.pdf)

<sup>44</sup> <https://www.euscf.eu/>

The scarcity of catalytic capital, and the uncertainty of its availability over time does suggest that it should be seen as a temporary feature. It should therefore ideally seek to deliver momentum, ensuring its mobilisation effect endures when it is no longer applied. A good illustration of this principle is the work conducted by Guarantco, part of the Private Infrastructure Development Group ('PIDG') on African infrastructure bond markets. Guarantco provided a 100% guarantee to the first such issue, thereafter gradually reducing the protection covering additional issues leading to bonds eventually being successfully issued without a guarantee once investors became familiar and comfortable with the associated risks<sup>45</sup>.

This concept was endorsed by participants in the Philanthropy Focus Group convened by DG ECFIN in February 2021. Whilst there was an acceptance of the risk of a 'temporary overshoot', in other words of the provision of too much de-risking, participants suggested that this could be gradually scaled back and eventually removed once sufficient track records have been built.

One of the interviews conducted for the study highlighted that any subsidisation exercise, and asymmetric risk sharing on the part of public institutions is exactly that, is also likely to have side-effects. These side-effects can include market distortion as a small number of beneficiaries necessarily gain a competitive advantage, or the creation of an ecosystem that cannot survive without sustained subsidisation. The impact of these can be magnified in an early stage, fragmented market, where the net growth in the market size brought about by an intervention is a significant percentage of the pre-existing market size. A cautious approach should therefore be adopted.

The scarcity of catalytic capital, combined with the risk of market distortion, suggest that it is the responsibility of all parties to ensure that any catalytic blended finance deployment is as efficient as possible, delivers true additionality, and does not unnecessarily enhance the position of investors who do not need it.

## 8.4. Potential role for InvestEU stakeholders

Interviews have made it clear that many in the sector would welcome tangible political and practical support from European Institutions.

The European Commission and InvestEU, through its implementing partners and its Advisory Hub could support the market building process through:

- **Convening**, bringing together early adopters to foster the growth of MRIs, including in the context of InvestEU;
- **Advisory** work, to raise market awareness, accelerate investment readiness and encourage internal champions to take the case to their governance structures;

<sup>45</sup> <https://guarantco.com/blended-knowledge/delivering-the-next-generation-of-onshore-local-currency-bonds/>

- **Structuring** to ensure best market practice, temporarily taking on the role played by financial intermediaries in a mature market;
- **Co-investments and blended finance** tools, to share in the risk of trailblazing, of building observable financial and impact performance track records.

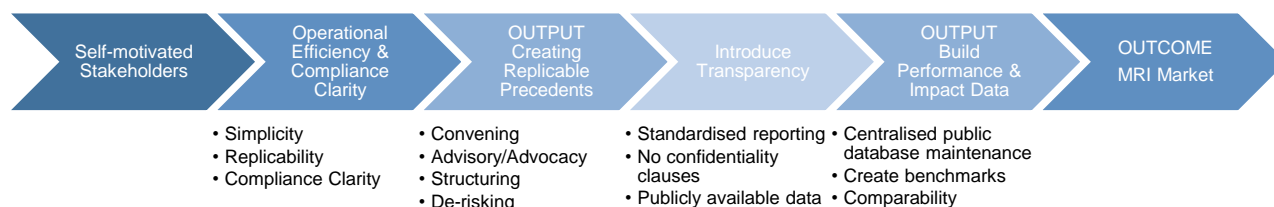


Figure 20: Market building principles, potential role for InvestEU stakeholders

There is in addition considerable value built into the EIF's capacity to source, select and conduct due diligence on fund managers and other financial intermediaries. Investment initiatives have the potential to leverage off the EIF's expertise and capacity to deliver operational efficiency to the philanthropic sector. Intermediation on the part of public institutions with recognised expertise has demonstrably been well received by investors, as is for example the case of the IFC's B-loans<sup>46</sup> or its MCPP platform<sup>47</sup>, where the IFC originates investments, contracts in its own name and thereafter passes on all or part of the resulting risk exposure to private sector investors.

InvestEU does present an opportunity to accelerate the market building process by helping philanthropic organisations to create de-risked, replicable, observable precedents. This potential goes beyond the deployment of capital, and should leverage off its stakeholders' capacity to convene, set standards and disseminate knowledge.

## 8.5. One possible path to co-creation

The key principle underpinning this section is that philanthropic organisations are thought leaders in their respective mission areas and in the MRI market and should therefore play a corresponding role. In line with above remarks, to be of optimal value to the market building process, the objective should be to build a structure that can and will be replicated, and that sets standards in terms of structural features, transparency, impact measurement and reporting. Beyond the 'content', the investment

<sup>46</sup> [https://www.ifc.org/wps/wcm/connect/topics\\_ext\\_content/ifc\\_external\\_corporate\\_site/syndications/sa-product/b-loans/b-loans](https://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/syndications/sa-product/b-loans/b-loans)

<sup>47</sup> [https://www.ifc.org/wps/wcm/connect/topics\\_ext\\_content/ifc\\_external\\_corporate\\_site/syndications/sa-product/portfolio-syndications/mcpp](https://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/syndications/sa-product/portfolio-syndications/mcpp)

that it will result in, the value of the exercise is in creating a 'box', a standard instrument that can be used by others.

Co-creation is not a traditional mechanism in investment matters and can only be more delicate in an early-stage scenario. Inspiration can thankfully be drawn from initiatives such as the *Fondo de Fundaciones de Impacto*<sup>48</sup> initiative driven by Spain's Open Value Foundation and Fundación Anesvad and designed to facilitate the entry of additional philanthropic organisations in the MRI space. Although this was based on a co-learning process and to date done at a relatively small scale, it does demonstrate the mobilisation potential of convening, resource sharing and co-creation.

Lessons learnt from these, in combination with the interviews conducted for this study do suggest that the starting point for an EU investment facility should be the mission itself. It should nevertheless take into account the parameters under which InvestEU operates to ensure such a facility is be compatible with the EU budget.

Through a series of working groups, the European Commission did in the last year explore the opportunity to work with philanthropic organisations towards the creation of a facility that would focus on one or more of the following themes:

- (i) Equality and inclusion (including integration and inclusion, education, and housing and homelessness);
- (ii) Media, culture and democracy; and
- (iii) Green transition and related societal transformation.

Perhaps unsurprisingly, both desktop research and interviews do suggest that these mission areas are relevant to a significant subset of the sample. They will be used as the basis for this theoretical exercise to outline a path to the co-creation of a framework of cooperation designed to catalyse the growth of MRIs in Europe. A potential facility should ideally embed the right level of flexibility to enable a wider range of philanthropic organisations to engage by potentially covering other InvestEU supported areas that are aligned to other philanthropic organisations' missions.

A **first step** could be for the European Commission to convene and chair a pilot group of philanthropic organisations, motivated to work together towards making an investment in one or more of these mission areas, or other areas compatible to InvestEU.

The terms of engagement should provide potential participants with clarity pertaining to:

- **The objectives:** to work towards one or more of the mission areas which can serve as a starting point for blueprint, with envisioned subsequent replication and scaling up for other missions. Whilst it is of course not suggested that it is possible to pre-approve any deployment of capital, there should be genuine intentionality.

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<sup>48</sup> <https://www.openvaluefoundation.org/es/fondo-de-fundaciones-para-el-impacto>

- **The means:** the nature and the quantum of the support European institutions are in principle both willing to contribute and capable of contributing.
- **The process:** who the actors will be, what the timelines are, and a proposed methodology.

As a **second step** this pilot group would, in consultation with the European Commission and the relevant implementing partner(s), select a mobilisation model (e.g. acceleration for existing actors, adoption by new entrants) and identify current market opportunities (e.g via market research or market testing).

Alternatively, or in addition, the participating philanthropic organisations could volunteer their own knowledge of relevant opportunities.

The **third step** would, further to a transparent process, see the universe of investible opportunities narrowed down, first to a manageable number of candidates that participating organisations would support, and then, potentially based on discussions within the group, including - in the context of InvestEU - with the relevant implementing partner, to single out an underlying investment opportunity.

As a **fourth step**, the work on structuring and setting up the facility would continue with the implementing partner selected, while the European Commission would be kept informed of the progress in the context of the policy dialogue between the European Commission and implementing partner(s).

This would be done according to:

- The characteristics of the selected investment opportunity
- The implementation criteria of the relevant InvestEU product or of the provider of catalytic capital
- The mobilisation model selected by the pilot group

It is at this stage that elements of standardisation should be introduced:

- The identification of a legal structure and a domiciliation jurisdiction for the vehicle (if applicable)
- The selection of an impact measurement and reporting framework
- The inclusion of transparency standards to ensure the legal documents underpinning structure and data pertaining to the financial and impact performance can be made publicly available

Where the use of a de-risking mechanism is deemed appropriate, the structure should be designed to ensure it is serviceable without such a feature in future iterations.

The **fifth step** would include the appointment of one or more fund managers and involve conducting due diligence and commercial negotiations.

The final and **sixth step**, towards execution, could involve seeking to offer additional philanthropic organisations the opportunity to invest, particularly if adoption is a key objective.

It should be clear that the role of pilots is not to prioritise one mission area over another, but to enshrine the principle that by working together market actors can gradually create a market that will allow all missions to benefit from the resulting efficient allocation of capital.



## 9. Concluding Remarks

The landscape of the EU's philanthropic capital painted through this study, imperfect as it is, yields some important observations. European philanthropic organisations, though they might not display the uniformity of structure nor for the nonce enjoy the luxury of a single legal, fiscal and regulatory framework, collectively have the financial capacity, the expertise, and perhaps most important of all the will to go further towards the achievement of their philanthropic goals by harnessing the potential of their capital through mission related investments.

The long-term nature of philanthropic capital means it is well positioned to unlock the potential of mission investing. This must however be balanced against the responsibility philanthropic organisations have willingly assumed to, year after year, make a substantial and much needed contribution to addressing societal issues. In this context, committing resources to the uncharted waters of mission related investments is not a decision taken lightly, particularly since the widely held assumption continues to be that their financial performance will be 'below market'.

Institutional investors across the board are under increasing pressure from society to demonstrate that the deployment of their capital is aligned with their stakeholders' values. This pressure is arguably higher for those philanthropic organisations endowed with investment portfolios. MRIs may provide an element of response to the questions asked of the sector.

If the measure of a philanthropic organisation's performance is its ability to deliver mission related impact, and if the volume of its grants is only one component of this, then it can be argued that the real question is whether any hypothetical financial performance opportunity cost of allocating endowment funds to mission related impact investments is adequately compensated by the creation of a financially self-sustainable, mission related impact generating asset.

In other words, will the grants capacity generated by €1 invested in traditional investments over a given period of time deliver more or less impact aligned with the organisation's mission than €1 deployed through mission related investments?

The answer to this question should prove an important input in this debate. To obtain it, it is necessary to create a universe of transparent, observable precedents, to measure their impact, and to assess their financial performance. The InvestEU programme is well positioned to share the risk of this crucial learning process with pioneering actors.

Instruments capable of aligning the structure of an investment to the needs of investors without affecting its nature do exist. Some were listed here but only as an illustration of what is possible, not as an attempt to interfere with a process that should be focused on the mission. Instruments and vehicles are the means and must never be the end.

Though individual initiatives will of course have an impact, creating the system-wide conditions for the emergence of a 'good market' can leverage the already considerable achievements of the philanthropic sector.

There is ample evidence of a high level of alignment between the objectives philanthropic organisations seek to achieve, as expressed through their current MRI programmes, and the policy windows of InvestEU, itself an expression of some of the core values and priorities for the European Union.

Putting a number against the potential and the ambitions of a mission aligned collaboration between the European Union and its rich and diverse community of philanthropic organisations would be presumptuous. Whilst numbers do serve a purpose when used to inspire, precedents suggest that, if core principles are abided by to allow all willing participants to contribute, ideas whose time has come far exceed the most optimistic of back-of-the-envelope extrapolations.

The concurrent advent of mission investing and implementation of InvestEU do provide Europe's philanthropic sector and the European Union's institutions with an opportunity to demonstrate that capital is a human invention, and that for all its pitfalls, it is capable of being Good.

## 10. Credits

The Philanthropic Capital Study is, to a large extent, built on the knowledge of others, to whom a debt of gratitude is owed.

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