# **Impact Chicago: More Responsible Investing Panel 11-14-2018**

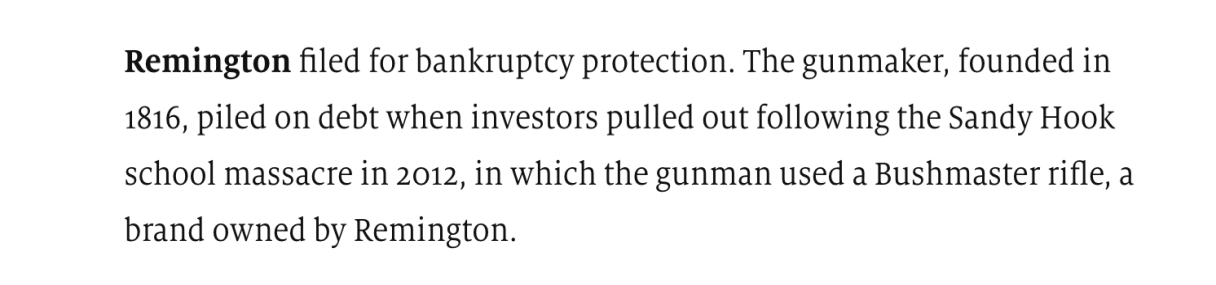
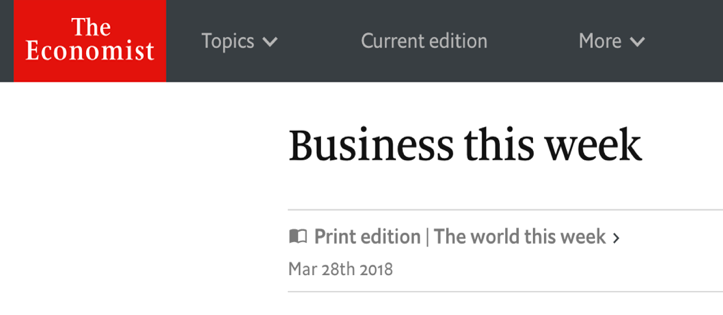
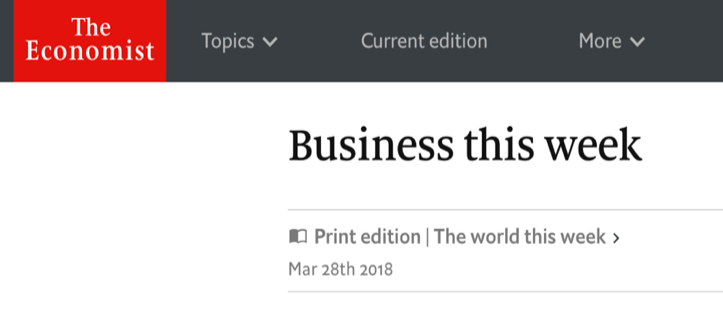
## **Q1. Can I do impact investing if I am not a Gates, Pritzker or Rockefeller?**

Khloe: For my daughter’s 9th birthday, I gave her a share of Netflix and explained owning stock means owning a piece of a company. My daughter’s response was “Now that I own Netflix, can I tell them what to do?” My answer was “Yes, you can!” and then I told her about shareholder resolutions. Everyone, regardless of how much money they have, has the power to make the world a better place.

We have power as consumers. Ivanka Trump folded her brand in July because people abandoned her line en masse. Nordstrom, Hudson Bay and QVC dropped her products due to poor sales. Sales plummeted 55% in the year up to the brand’s closing according to the Washington Post.[[1]](#footnote-1) Our purchasing power did that.

Businesses have power. When Donald Trump announced his decision to leave the Paris climate agreement in June 2017, it galvanized business leaders to take action because they know that if we do nothing the costs of doing business will be much higher in the future. In October 2018, Bill Gates announced a partnership with former UN Secretary General Ban-Ki Moon to raise money fight the effects of climate change. According to Moon, 63% of the $380 billion invested in cutting emissions in 2015-16 was from the private sector.[[2]](#footnote-2) That’s insurance companies and investment managers committing balance sheet to flight climate change. Business has tremendous power, but they don’t always have a long-term perspective. It’s up to us to hold them accountable to social and environmental goals.

Shareholders have power. Divestment, pulling money out of companies not on board with a pro-social future, works. I want you to take a moment to read this from The Economist in March 2018:



We have power. We can boycott products, vote our shares, encourage more companies to ‘take a knee’. How are you going to use your power?

## **Sylvia: What’s thought of as “sexy” impact investing (renewable energy, green infrastructure and technology) is higher risk, which is why the Priztker/Buffet types can invest in it and why green entrepreneurs pursue their money. Based on the current financial system, it’s easier to pursue millions of dollars from a handful of investors and institutions. It’s not easy to create an easily-traded, pooled set of high impact investments for a million $100 investors. Largely, the government restrictions were designed to protect small investors, because possibly losing 50% of $100K is very different than losing 50% on $100M. Hard to live on $50K for very long, but not so hard to live on $50M left over…theoretically. However, there are socially-conscious investors and entrepreneurs who want to ‘democratize’ access to smaller investors and have tried for more innovative finance. The trend has been growing slowly, but surely. Community development finance banks and credit unions have expanded to green CDs; the JOBS Act made crowdfunding investment platforms possible; some states allow for limited small investors into equity issued at the state-level offerings when you are a resident there; also “locavesting” is a growing movement to look at local-level ways to invest back into your community.**

Matt: Absolutely. While the strategies available to an investor will depend to some degree on the amount of capital that they have available to them, anyone can be a responsible investor. There are many mutual funds and ETFs available to investors of all sizes that focus on various social and environmental issues and/or analyze ESG criteria when making investments. It is also quite simple for anyone to go to a local community bank and open a savings account or purchase a CD in order to provide investment capital for impactful local investment. Benefit Chicago, as I mentioned earlier, is another way for investors to invest in direct impact on a local level. Investors can invest in Benefit Chicago with as little as $20.

## **Q2.** What is responsible investing 101 ? (SRI, ESG, etc. | Define landscape and basic terms )

Khloe: Asking ‘What is Socially Responsible Investing?’ is like asking ‘What is art?’ What is ‘socially responsible’ depends on each person’s values. I grew up in the South which is thick in gun culture and my brother would say, “It would be socially irresponsible to take my guns away.” One person’s ‘good’ is someone else’s evil.

It might be easier to describe what responsible investing is not. It is no longer hippies helping hippies or investing simply in what feels good. Socially Responsible Investing or Sustainable Investing is investing with a dual-mandate also called “double bottom line” – investing for financial return and specific social goals. ESG which stands for environmental social governance is a disciplined investment analysis process that evaluates the long-term social and environmental implications of a company’s leadership and culture. Impact investing aims to generate specific social or environmental benefits in addition to financial returns.[[3]](#footnote-3)

Impact investing funds in Chicago you should know:

Benefit Chicago: <https://benefitchicago.org/>

Impact Engine: <https://www.theimpactengine.com/>

Sylvia: Right. Essentially, ESG is a passive approach to comparing and filtering publicly traded companies against each other. Impact investing is a more proactive approach to investments with a mandate for social and environmental impact. Would you agree, Matt?

Matt: Responsible investing is a subjective term. It all depends on what is important to each individual. Some investors are very focused on encouraging development of renewable energy sources, for example, and therefore want nothing to do with fossil fuels. For other investors, their focus is on gender equality or violence reduction or sustainable agriculture. The definition of “responsible” simply depends on the values of the investor.

It’s important to differentiate “responsible investing” from ESG investing. The terms are often used interchangeably or in conjunction, but they are different. While responsible investing is a general term used to describe strategies that focus on values alignment, ESG is more of a means to an end. E, S, and G stand for “Environmental, Social, and Governance,” and refer to fundamental investment criteria that investors can analyze in order to better understand the risks and opportunities that companies face. These might include regulatory risks, reputational risks, or new business opportunities based on social trends. ESG criteria help investors get a clearer picture of these non-financial factors and how management teams are addressing them. Investors who are focused on sustainable or responsible investing will often rely on ESG criteria to better understand whether or not companies align with their values, but ESG factors themselves are independent of investors’ values and stand alone as points of analysis that investors can use to better understand the merits of an investment.

## **Q3. What is the spectrum of it (from saving with community banks/ credit unions, to community notes, to passive and active securities, retirement vs, non-retirement, etc.)**

Khloe: New products are being introduced all the time with various themes, such the environment, gender equality or labor. When doing sustainable, start with your values. What is your vision of the future? What are the big problems that threaten our communities and the planet?

Then look for mutual funds or ETFs that have those goals in their prospectus which can be found on their website.

Sustainable Investing-ESG may use some of following investment strategies[[4]](#footnote-4) in addition to traditional tools such as fundamental analysis.

* Exclusionary screening: Avoiding investments in companies or industries on the basis of moral values and standards (i.e., tobacco), and social norms (i.e., human rights), historically referred to as SRI
* Best-in-class selection: Selecting securities based upon strong or improving ESG-factor performance relative to the company’s industry peers
* Active ownership: Entering into a dialogue with the management teams of the portfolio holdings on ESG issues, and exercising ownership rights (i.e., voting proxies, submitting shareholding proposals) to promote change
* Thematic investing: Focusing investments on specific environmental or social themes, such as clean energy, water, education, or healthcare
* Impact investing: Selecting securities to promote social and environmental benefits in addition to earning a financial return
* ESG integration: Systematically integrating ESG considerations, where material, into investment due diligence and financial analysis

Sylvia: For example, Fossil Fuel Free has been a huge trend the past few years, to the point where we developed FFF portfolio models for clients who wanted to absolutely avoid any investments in oil, coal, or gas. This is an extra layer over the ESG approach that we require of all investments for a client. (Well, our clients come to us because we only want to manage assets in a socially responsible manner as a firm. It’s a mutual choice.) A month ago we saw a Vegan ETF launched. There are guns-free indices available. Now, not every product is appropriate for every client. A good advisor will look at the details of the product and the details of your life (age, income, expenses, etc.), then make a recommendation.

Matt: Sustainable, Responsible, and Impact Investing can cover a broad spectrum of investment strategies across different asset classes. We think of it as comprising three primary buckets. First, there are public market strategies. This is where investors buy publicly-traded stocks or bonds in companies that meet their criteria for sustainability or responsibility. The strategies may include negative screening, positive screening, best-in-class selection, thematic investing, or others. Public markets are highly accessible, and there are many SRI and ESG focused products in the market with more going live every day.

Next you have community investing, which is where investors provide capital to community banks or community investment funds like Benefit Chicago, which in turn invest that capital in communities that are often starved of investment capital. This is another highly accessible form of responsible investing. Anyone can open a bank account at a community bank, and the minimum investment in Benefit Chicago is only $20.

The last bucket is alternative investing. This includes things like private equity, venture capital, or hedge funds that are focused on making direct impact with their capital. An example here would be Impact Engine, which invests directly in private start-up firms with explicit social or environmental missions. There are a lot of new strategies coming to market in this space, but it can be a bit harder to get involved in some of these, as many strategies require that an investor be accredited. However, this is changing somewhat, due to recent SEC rule changes around equity crowdfunding for start-ups. The rule changes are making it easier for non-accredited investors to access some of these really interesting private impact investment opportunities, and I think this will pick up steam going forward.

One other point that I’ll mention in relation to public market investing is something called shareholder advocacy. This is where investors who own shares in companies can actually engage with the management teams of the companies that they own, through conversations or the shareholder resolution process to push for change within the company. This is a powerful shareholder right that many people don’t know exists, but it is a core part of the strategy of many SRI investors, including my firm. If anyone would like to hear more about the work that we’re doing in this area, I’m happy to share some stories about companies we’ve worked with to help push them toward being more responsible corporate citizens.

## **Q4. Why should I consider it?**

Khloe: First, in order to fund major life goals such as college education and retirement, you need to invest. And you need to get a long-run average annual return of like 6% to 8%. You can’t get returns without risk. It makes sense that anyone with long-term goals should be thinking about long-term risks and ESG is all about long-term risk. Some financial advisors will tell you that sustainable investing has lower returns than conventional portfolios, but the data doesn’t support that. Patrick Geddes of Aperio Group and University of Chicago Booth School of Business MBA has analyzed decades of data and found no performance penalty.[[5]](#footnote-5) Good returns come from companies with good management teams.

Second, problems like climate change demand everyone do something. It is up to our generation to stop global warming. Corporations tend to have a quarter by quarter income statement focus and handle externalities very badly.[[6]](#footnote-6) This concept of capitalism which is basically profit-maximization and to hell with everything else, is woefully outdated. We need a modern concept of capitalism which is sustainable to our planet and the human race. We can change corporations and one way to do that is through shares.

Sylvia: Exactly. Great points. For the left-brained data driven people in the audience, we have a Performance page on our website which we update annually with some of the latest research on SRI coming out of business schools, financial institutions, and consulting groups. 30+ years of research over SRI screened investments hasn’t shown this approach to hurt your bottom line. US SIF is also a good resource with research on the topic. For the right-brained intuitives, it’s also a no-brainer – knowing that your investments are avoiding (or trying to avoid) the worst of exploitative business practices while also seeking those with best practices, (if not also encouraging better through shareholder advocacy and resolution filings at annual meetings) lessens the anxiety of wondering how your money is contributing to the world.

Also, I have a question for the group - who here has a checking account? Who here has a savings account? As Matt mentioned earlier, having your banking accounts at a certified community development finance institution is a very powerful way to have your dollars working for public good automatically. Banks use the money sitting in your accounts as collateral, in a simplified way of describing it, to make investments and for lending purposes. Certified CDFIs are mandated that 80% of that activity must be to low-to-mid income communities in their area, so small business loans, mortgages, auto loans, etc. Regular banks don’t. They could be funding the Dakota Access Pipeline or oil drilling in Russia. Transferring to a CDFI can feel like a pain in the caboose, especially if rent and bills are on auto-pay, but for the truly impact minded, it’s worth it. These are normal banks (mobile apps, online banking, FDIC insured) but with an impact.

Matt: First, in my opinion, investors who do not consider ESG factors are doing themselves a disservice by failing to get a full picture of the investments they are considering. Analyzing ESG criteria can improve investment performance over time by avoiding risky companies and investing in forward-thinking companies with innovative management teams. Beyond this, research has shown that investors who are focused not only on their financial returns but also the social and environmental impacts of their investments tend to outperform investors who only care about financial returns. This is because values-based investors are typically “stickier” investors, meaning that they are less inclined to abandon an investment or strategy when markets get turbulent. And of course, investing according to one’s values can help lead markets toward a more sustainable future, whether that is through simply affecting a company’s cost of capital or through direct involvement in the form of shareholder advocacy or private impact investment. Money is a powerful force, and it can be used for good or bad. Directing your capital toward more responsible and sustainable companies sends a powerful message to management teams and the market as a whole that the old way of doing things simply won’t cut it anymore.

## Q6. How do I get started?

Khloe: Start with your values, then account type and how much money to invest. This will determine the products available to you. If you are just getting started and thinking of doing sustainable investing in your IRA or brokerage account, look for products with low investment minimums such as mutual funds or ETFs. Impact Investing funds typically are marketed to the high net worth (accredited investors), but mutual funds such as Calvert Social Equity or Neuberger Berman’s Sustainable Equity can be found in larger 401(k) plans.

If you are not working with a financial advisor like Sylvia or me, first, determine how much risk you want to take, second, design your asset allocation (which is the mixture of stocks, bonds, US, and foreign companies of different sizes), and then research the products available for each asset class and don’t take shortcuts. I advise people against using fund screeners such as Morningstar because their data isn’t robust enough at this time.

I released a whitepaper earlier this year with two of my colleagues at Natural Investments looking at the Morningstar Sustainability Rating®. It had been around for 2 years, but we had heard various complaints from other SRI investors in the industry, so we took a deep dive ourselves. We have run our SRI rating system for mutual funds since 1992, so we felt we could assess it’s quality. What we found is that it’s methodology is incredibly flawed. The Morningstar rating doesn’t give extra points to funds with an SRI mandate (point out Ariel Investment’s example) and it should maintain a set of minimum standards for achieving 4 and 5-Globe status, [Invesco Energy Fund eg] The current approach dilutes the rigor of its overall structure, even rendering it meaningless in some cases. Out of the couple hundred funds we rate, Appleseed Fund earned full 5 points but Morningstar gives it a 1, based on what we determined to be several flawed and inflexible technicalities. Morningstar has a relatively good tool for rating mutual funds based on financial performance. However, it’s SRI rating is “bunk”, unfortunately. For a real do-it-yourself-er, you’re going to have to use a combination of Morningstar for financial, and our Heart Rating or US SIF Mutual Fund performance chart for SRI impact evaluation.

It is hard to design a retirement account that will get someone to retirement in 20 years with only one theme, such as gender equality. The average investor is going to pick a mutual fund based on 1, 5 and 10 year returns which is the wrong approach. Think about the impact you want to make and consider choosing products based on which causes need your money the most. For example, can anyone think of a time housing markets in the US were equitable and fair? Does anyone believe the housing market on its own will create affordable housing? I didn’t think so. That’s one of the problems managers like Access Capital is trying to solve.

Matt: There are a few ways to get started. First, you can seek out an advisor, such as the three of us, who focus on helping investors direct their capital in this way. My firm helps clients develop custom portfolios that align with their specific values while also helping them meet their financial goals. We do this as part of a very focused and individualized financial planning process. If you are just looking for specific investments and don’t want broader financial advice, then you can put together a portfolio on your own using mutual funds and ETFs that are designed to meet certain investor values. If all of your investment capital is in a company-sponsored plan, then you may have a more difficult time directing those assets in such a way, depending upon the options made available to you by your plan provider. Fortunately some providers are realizing the importance of including more responsible investments in their fund lineups, but we are still in the early stages of this.

**A person posing for the camera

Description generated with very high confidence**Khloé U. Karova is a CERTIFIED FINANCIAL PLANNER™, an independent financial advisor, and founder of Modern Capital Concepts, one of Illinois’ first benefit corporation in financial advisory. Khloé earned an MBA with Honors from the University of Chicago and BA from Northwestern University. She started her career in financial services in 1998 working on the first fully electronic stock exchange which became the technology platform for the New York Stock Exchange. She is investment advisor to 168 households globally and has impacted hundreds more through her free Chicago Public Library seminars and workplace financial wellness programs. Her motto is: “Everyone deserves high-quality objective financial advice.”

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. Investing involves risk including loss of principal.

1. https://www.washingtonpost.com/business/2018/07/24/ivanka-trump-shuts-down-her-namesake-clothing-brand/?noredirect=on&utm\_term=.b08e8ddb94df [↑](#footnote-ref-1)
2. https://www.theguardian.com/environment/2018/oct/16/leaders-move-past-trump-to-protect-world-from-climate-change [↑](#footnote-ref-2)
3. <https://www.upstartco-lab.org/wp-content/uploads/2018/10/Hiding-in-Plain-Sight-Imp-Inv-in-the-Creative-Economy.pdf>, page 25 [↑](#footnote-ref-3)
4. <https://lplfinancial.lpl.com/content/dam/lpl-www/documents/sustainable_investing.pdf> [↑](#footnote-ref-4)
5. <https://www.aperiogroup.com/resource/141/node/download> [↑](#footnote-ref-5)
6. <https://www.advisorperspectives.com/articles/2018/06/28/jeremy-grantham-we-are-not-equipped-to-deal-with-climate-change> [↑](#footnote-ref-6)