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RESPONSIBLE INVESTING BY U.S. FOUNDATIONS: PERSPECTIVES, POLICIES & PRACTICES

OXFORD METRICA

CONTENTS

THE 10 THINGS WE LEARNED

1. There are three distinct approaches to responsible investing extant in U.S. foundations: Mission related investing (MRI), Negative screening, and Positive screening.

2. There is a significant commitment to responsible investing with 64% having a deliberate engagement to some degree.

3. The extent of adoption varies widely from below 10% of assets to 100% of assets; FIGURE 1.

4. It appears that of the three approaches MRI and negative screening dominate with 44% and 40% respectively; TABLE 2.

5. Foundations tend to adopt either MRI or negative screening at their initial adoption of responsible investing.

6. Foundations tend to favour the MRI/Negative screening pairing as they increase their commitment to responsible investing. Two thirds of pairings are of this nature.

7. The most popular negative screening criteria are fossil fuels, tobacco and weapons representing 64% of all screens; FIGURE 2.

8. Alternative investments are the preferred vehicle for MRI and Private Equity is the most popular among these; FIGURE 3.

9. The key challenge that foundations face with respect to adopting responsible investing is a lack of knowledge of the subject; FIGURE 4.

10. MRI is the most likely approach for expansion in the future as foundations become more knowledgeable; FIGURE 5.

> "For this promising sector to continue to grow and mature, it needs more data, which requires a greater depth of experience and a greater measure of leadership"
>
> *Darren Walker, President, Ford Foundation*[1]

RESPONSIBLE INVESTING BY U.S. FOUNDATIONS

The aim of this white paper is to report the results of a research project that investigates the perspectives, policies and practices of U.S. foundations with respect to responsible investing. The philanthropic sector in the United States has matured into a significant actor on the financial landscape with more than 86,000 foundations and assets approaching a trillion dollars.[2] This represents an important milestone in the evolution and size of this socially important group of investors. Aside from the scale of the financial services now required by the grouping, the potential for innovations such as social impact investing is significant.

TABLE 1 presents the 10 largest U.S. private foundations by asset size, ranging from $40bn to over $7.5bn. The table highlights that the vast majority of the largest foundations in the United States are independent, however, each foundation is unique in their philanthropic approach.

Some of the largest and most prominent foundations, listed below, have been at the forefront of responsible investing. The Bill and Melinda Gates Foundation aligns its investments with the foundation's philanthropic aims in vaccine development and education. Furthermore, the Ford foundation has committed to invest $1bn of their foundation's assets to mission related investments over the next 10 years.[3]

RANK	NAME	ASSETS (2018)	TYPE
1	BILL & MELINDA GATES FOUNDATION	$40,600,000,000	INDEPENDENT
2	LILLY ENDOWMENT INC.	$15,079,716,377	INDEPENDENT
3	FORD FOUNDATION	$13,053,278,556	INDEPENDENT
4	THE ROBERT WOOD JOHNSON FOUNDATION	$11,137,377,034	INDEPENDENT
5	J. PAUL GETTY TRUST	$10,991,862,987	OPERATING
6	FOUNDATION TO PROMOTE OPEN SOCIETY	$10,358,650,756	INDEPENDENT
7	THE WILLIAM AND FLORA HEWLETT FOUNDATION	$9,761,951,364	INDEPENDENT
8	BLOOMBERG PHILANTHROPIES	$8,931,075,194*	INDEPENDENT
9	W.K KELLOGG FOUNDATION	$8,604,726,112	INDEPENDENT
10	THE DAVID AND LUCILE PACKARD FOUNDATION	$7,423,383,781	INDEPENDENT

SOURCE: Foundations' financial statements and annual reports *2017

TABLE 1. Top 10 private foundations in the United States by asset size

The survey reported herein targets the population of the largest 250 of these U.S. private foundations with a minimum asset value of $250 million at the time of the survey. The aggregate asset value of the target group was approximately $500 bn at that time.

The terms sustainable investing, ESG investing and impact investing are currently widely used, often interchangeably, in the investment world and popular media. The preliminary survey reported below guided us to settle for responsible investing as the most appropriate term to use in this context. *Responsible Investing* is the term we will use throughout and which is taken to mean any proactive, deliberate investment policy that changes a foundation's asset allocations in deference to the behavior or characteristics of the underlying investee corporations with respect to any aspect of environmental, sustainable, social, ethical or governance related activities.

Active investors and index providers alike have responded to the burgeoning demand from both retail and institutional investors for responsible investment vehicles by expanding the offering of such products. The size of the responsible investment market is estimated to be over 30 trillion USD, covering most asset classes including equities, fixed income and alternatives.[4] However, it is currently believed that not all institutions have adopted a uniform response both in terms of approach and speed of adopting responsible principles of investing. Foundations are a large and important segment of the institutional investing landscape and little is known about responsible investment practice across this sector relative to more traditional asset managers or pension funds.

The purpose of this study is to provide some insight into the current responsible investing perspectives, policies and practices among major U.S. foundations. It is hoped that the foundations themselves will find this helpful for benchmarking with peers. Furthermore, it is hoped that many stakeholders in these foundations, including trustees and service providers, will find the work useful.

This survey aims to shed some light on the actual practices in foundations which may inform further discussion and progress the development of responsible investing in this important sector.

THE SURVEY

The survey primarily provided an opportunity to assess how much responsible investment is currently being undertaken by foundations, how it is being implemented and the underlying challenges and motivations.[5] This survey aims to focus entirely on investments made out of the foundations' investment portfolio, hence excluding program related investment (PRI). The survey was conducted over two phases.

PHASE 1 PRELIMINARY INTERVIEWS

A number of leading foundations were interviewed regarding all aspects of responsible investment which informed both the establishment of the appropriate terminology and the development and refinement of the survey instrument itself. In addition, the target population of 250 foundations was identified. The taxonomy developed classifies all responsible investing into three distinct approaches: Mission related investing (MRI), Negative screening (NS) and Positive screening (PS).[6]

PHASE 2 SURVEY INSTRUMENT

A 30-question survey instrument was developed and a stratified sample of 10% of the target population was surveyed which generated 25 survey respondents. Survey respondents had a range of assets sizes from $250m USD to greater than $2bn USD. Equally the foundations analyzed varied in size in terms of number of full-time staff employed, some 20% employing less than 10 and 40% employing more than 36. The large sample size and diverse nature of the respondents controls for any bias in the results. Furthermore, the stratification insures the representativeness of the sample.

CURRENT RESPONSIBLE INVESTMENT PRACTICE

The research sought to establish firstly, the extent of responsible investing, secondly, which are the main responsible investment practices being undertaken by foundations and thirdly, how these policies are being put into practice.

MEASURING THE EXTENT OF RESPONSIBLE INVESTING

It was found that there are four groups of foundations: Firstly those active in the field that are already allocating a large proportion of resources (between 40% and 100% of investable assets) to responsible investment (12%); secondly, a group that had some resources (between 10% and 40% of investable assets) allocated to responsible investing (24%) and a third group that had started experimenting with responsible investing but that had only made less significant allocations (less than 10% of investable assets) to date (28%). The rest of the respondents (36%) had not implemented any responsible investment policies. FIGURE 1 shows the extent to which responsible investing has been adopted across foundations, and highlights the estimated sum of the total asset base of the foundations falling into each category.

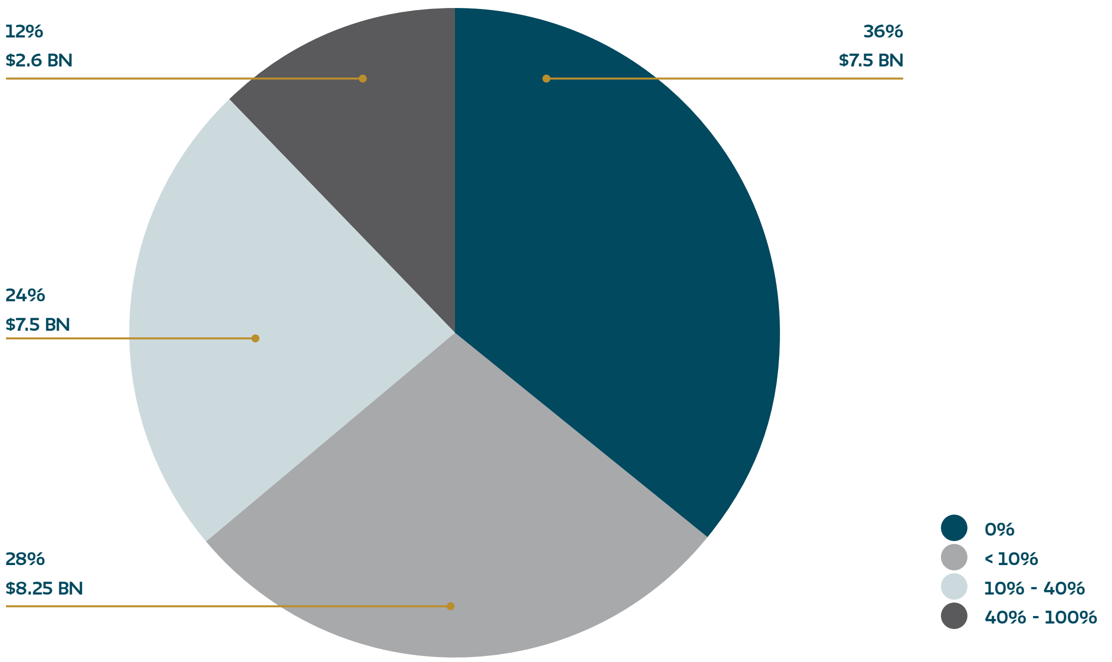


FIGURE 1. The proportion of assets devoted to responsible investing

This is an encouraging result with at least 64% of respondents actively involved in some level of responsible investment. Furthermore, of those that are not doing any responsible investing many have expressed an interest in adopting such policies in the future.

THE APPROACHES TO RESPONSIBLE INVESTING

The taxonomy developed classifies all responsible investing into three distinct approaches: Mission related investing (MRI), Negative screening (NS) and Positive screening (PS). TABLE 2 reports the extent to which the three approaches are being adopted by foundations. Clearly, MRI is the most popular with 44% practicing followed closely by negative screening practiced by 40% with positive screening the least popular with a practice rate of 24%.

However, a notable result is that the foundations which have started to incorporate responsible investing have done so mostly through direct investment. Mission related investment was found to be the most actively chosen method of implementation with 44%

SUSTAINABLE INVESTMENT PRACTICE	PERCENTAGE IMPLEMENTING	MOST USED ASSET CLASS TO IMPLEMENT
NEGATIVE SCREENING	40%	EQUITIES
POSITIVE SCREENING	24%	EQUITIES
MISSION RELATED INVESTMENT	44%	ALTERNATIVES

TABLE 2. Responsible investment practice of responding foundations

of foundations allocating capital towards responsible projects that generate social good as their primary objective and investment return a secondary consideration. Traditionally MRI by institutional investors has been a tertiary step after implementing negative and positive screening on their investments. However, the results indicate that many foundations have chosen to implement MRI in isolation or alongside negative or positive screens. Alternative investments were found to be the primary asset class for MRI investment, with private equity and real estate lending cited as alternative vehicles.

It is interesting to note that 56% of those that do practice responsible investing apply at least two of the approaches with MRI/NS being the most common pairing. It appears that foundations most commonly adopt either MRI or negative screening as the first step, thereafter, combining MRI and negative screening. Positive screening is the least favoured entry method and least common pairing with MRI.

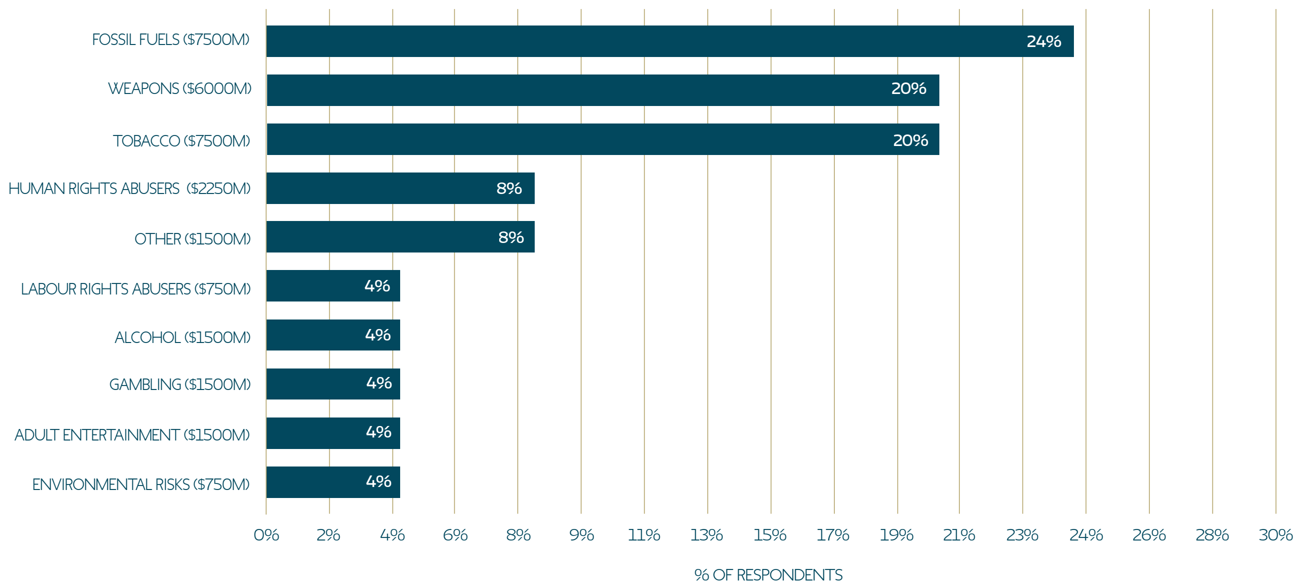
TABLE 2 also indicates that positive screening was the least popular method to implement responsible investing, with 24% of respondents citing its use. Equity investment is by far the most chosen asset class to apply with positive screening, with only 4% indicating the application of positive screens to alternative or fixed income investments.

NEGATIVE SCREENING

Negative screening, although slightly trailing MRI as the primary method, has been applied by 40% of respondents. Naturally, as with positive screening listed public equity investment is found to be the primary asset class to which negative screens are being applied, however alternatives are being applied albeit to a limited extent in both negative and positive screens.

FIGURE 2 presents the nine principal screening criteria applied with negative screening. The three most significant screens that were most actively avoided were: fossil fuels, tobacco and weapon. The leading three account for 64% of all screens being applied in aggregate. Furthermore, the figure highlights the estimated total asset base to which each screening criterion is applied.

FIGURE 2. Negative screening criteria



THE APPLICATION OF ALTERNATIVE INVESTMENTS

Alternative investments are principally the preferred vehicle in MRI and to a lesser extent in the other approaches. Overall, 36% of foundations have allocated capital to alternative investment vehicles to implement their responsible investment requirements. FIGURE 3 reports the extent to which various alternative products have been adopted by foundations. Private equity and real estate investments were both in use at 24% of foundations, closely followed by venture capital. However, hedge funds were cited as the least used product with only 4% deploying these vehicles.

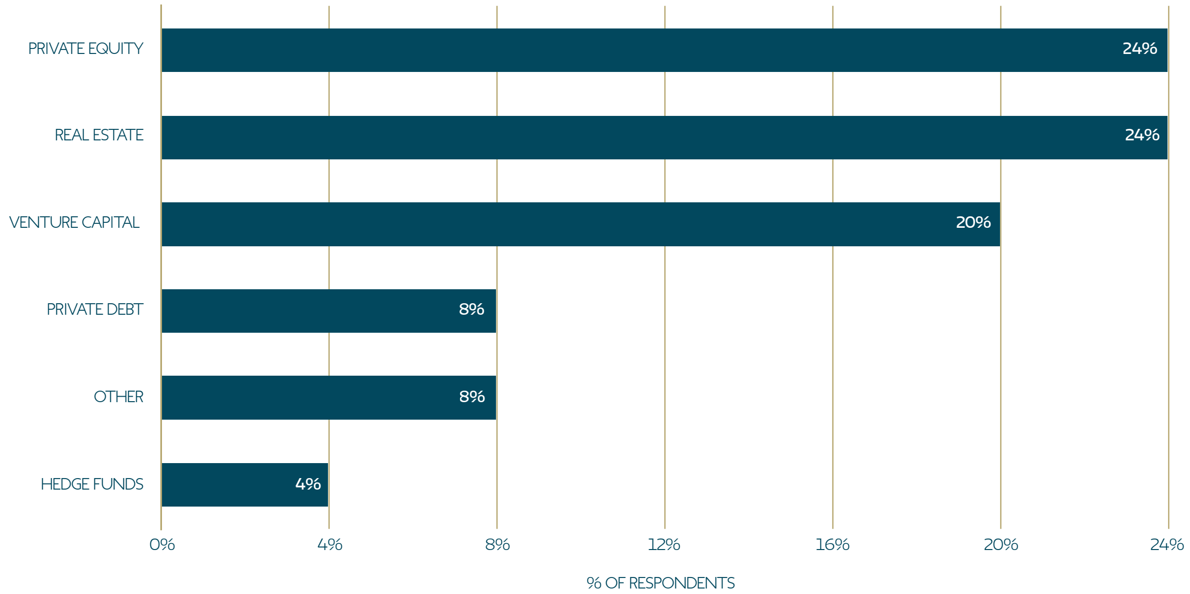


FIGURE 3. Alternative investment vehicles

Other areas of responsible investing emerging in importance to foundations are: *shareholder activism* and *responsible investment frameworks*. The majority of foundations participating in this study are yet to participate in shareholder activism on ESG topics, compared to more active engagement and proxy voting analysis practiced by other types of investors such as public pension plans, which highlights this as an area for future development. However, a few foundations indicated the use of voting proxies (3) on ESG matters and some have used outside bodies or coalitions (2). Similarly, the application of a standardized responsible framework in investment decisions, monitoring or accounting is not yet widely applied by foundations. In fact, only 4% use the UN responsible investment goals, which across other institutional investors and corporations is one of the most widely adopted frameworks.[7] However, others did indicate that they were developing a framework internally.

> "Ultimately, The Nathan Cummings Foundation's decision to go all-in on impact investing was motivated by two core beliefs. First, we believe it is possible to invest in a way that creates positive mission impact while meeting our financial goals. Second, we believe the challenges facing society today cannot be solved through grant-making alone"

Bob Bancroft, VP Finance, The Nathan Cummings Foundation

THE WAY FORWARD: IMPEDIMENTS & INTENTIONS

The rapid development of responsible investing into mainstream investing will inevitably influence the investment philosophies, policies and practices within the foundation world over the next five years. This preliminary survey provides an encouraging picture reflecting the positive perspectives of many foundations. In order to enhance our understanding of the likely development of this activity within foundations we focussed on the impediments to implementation and the positive intentions of the leaders in this sector.

Firstly, understanding the challenges that foundations face in developing or even initiating a responsible investment practice may help provide a roadmap for foundations and external parties on which areas to focus and allocate resources. Respondents were asked to rank 6 possible challenges in terms of importance, therefore enabling the creation of a weighted average score for each challenge, with the highest score signifying the most important challenge. The highest possible score for a particular challenge would be 6, which would signify each respondent ranking a particular challenge as most important. Likewise, the lowest possible score would be 1, with all respondents ranking a certain challenge as least important.

FIGURE 4 presents the weighted score for each challenge and indicates that the two leading challenges were *lack of knowledge or resources* and *lack of investment opportunities.* The lack of knowledge and resources may help explain why the majority of respondents have yet to undertake shareholder activism in the space and implement sustainable investment frameworks. Furthermore, currently the *risk and return* dynamic of the responsible investment opportunities does not justify a holding in the view of many.

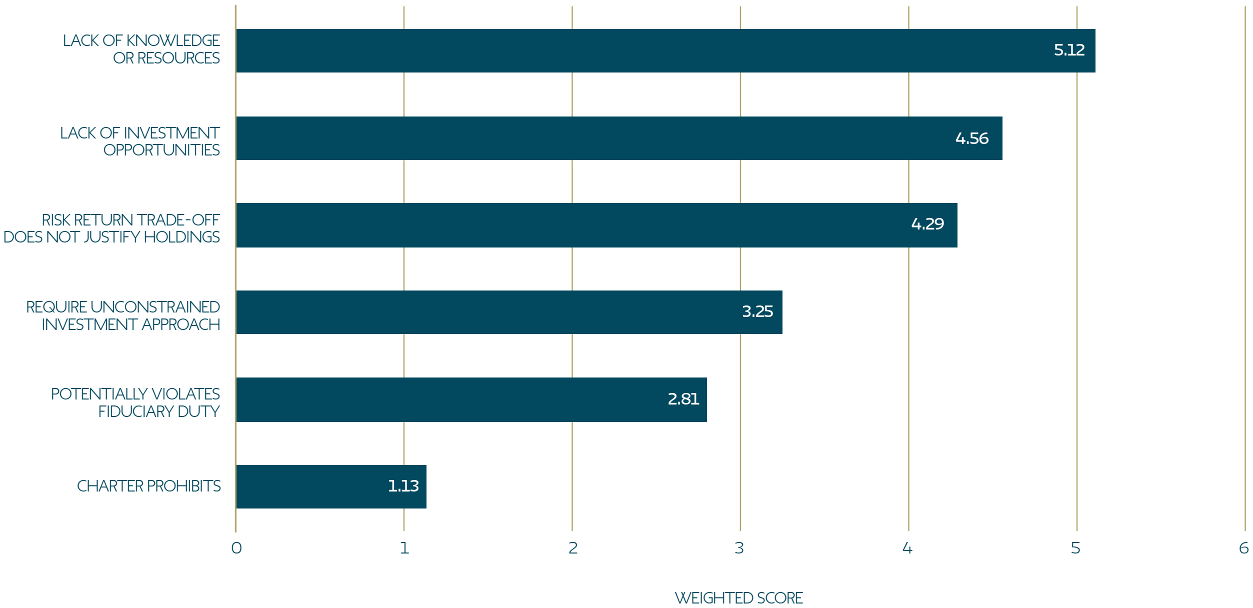


FIGURE 4. Challenges to responsible investment implementation

In regard to aspirations for future development, there are two clear approaches that foundations aim to build: Mission related investing and positive screens. FIGURE 5 presents the areas of further development that were most frequently cited. As highlighted earlier in the paper, MRI is currently the most actively employed approach to responsible investing. Unsurprisingly it seems that most aspire to follow this trend in the future. This means an increasing demand for alternative investment vehicles.

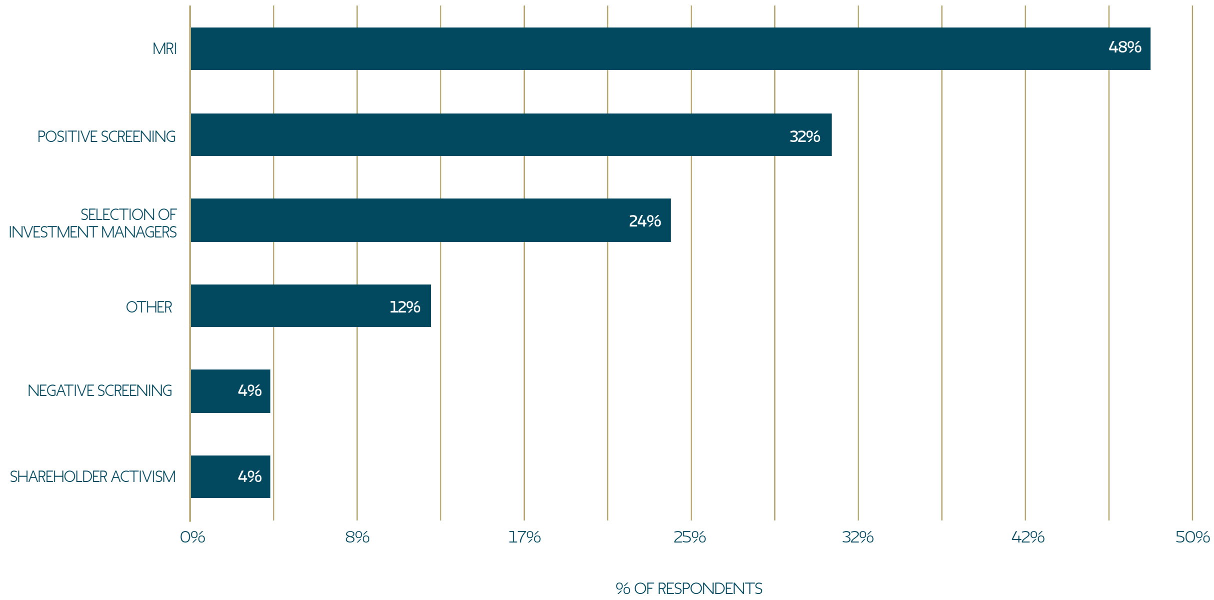


FIGURE 5. Areas of future development

Surprisingly, positive screening, currently the least popular approach, was cited as the second most popular area to enhance. It seems foundations are keen to enhance an area that is falling behind, perhaps because of a lack of knowledge according to many. Overall, the results clearly suggest an increasing emphasis on responsible investing by foundations, trending toward a more active approach rather than passively applying screening.

Foundations in the main are clearly indicating a keen interest to develop more extensive responsible investment policies and practices. However, there are a number of impediments, the most significant being the ability to obtain the necessary training and knowledge in the field. This suggests itself as an area to be addressed by foundations and their advisors. The benefits are recognized and as the activity develops further, we expect to see an increasing demand for a new set of services and products from the investment industry.

The survey provided a snapshot of the foundations' activity at a particular point in time, however, foundations are constantly evolving in their responsible investment engagement. In fact, the recent market volatility due to the Covid-19 outbreak, has accelerated the engagement of foundations in responsible investment. Furthermore, there has been an increased focus on sustainable investment products, from the wider investment community, that can tackle the resulting economic and health challenges. In combination, responsible investing among foundations will continue to grow at a rapid rate.

We hope that this paper will provide insights that might help particular foundations benchmark themselves and excite further interest in this important activity.

> "As fast as the market for responsible investing has been growing, a lack of knowledge or resources is the biggest challenge facing foundations who might otherwise increase their responsible investment programs. This finding suggests that additional education and investment support could accelerate the investments available to focus on areas of positive change."
>
> *Frances Barney CFA, Head of Global Risk Solutions, BNY Mellon*

GLOSSARY

Mission related investment (MRI): Investment from the investment portfolio that have near market returns expectations but have a social return as the primary objective and investment return secondary.

Negative screening: The exclusion of investments that are socially or morally disagreeable

Positive screening: The active inclusion of investments that score highly on ESG factors.

Program Related Investment(PRI): Investments that provide capital mainly from grants and often have reduced return expectations.

Responsible investment practice: General term that captures negative screens, positive screens and MRI.

FOOTNOTES

1. Unleashing the Power of Endowments: The Next Great Challenge Philanthropy, Darren Walker, 2017.

2. Global Philanthropy Report, Harvard Kennedy School, The Hauser Institute for Civil Society, 2018.

3. Transformative Capital: How mission-related investing can deepen foundations' impact, Ford Foundation.

4. Global sustainable investment review 2018, Global sustainable Investment Alliance.

5. See appendix for the definition for terms used throughout the survey.

6. ESG integration was not included in the survey terminology, as the foundations focused on screening and MRI.

7. UN Principles for Responsible Investment, 2019.

NOTES

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BNY Mellon is a global financial services company dedicated to helping its clients manage and service their financial assets across the investment lifecycle and in over 110 markets. Whether providing safe-keeping and administration or investment management solutions to institutions, not-for-profits, corporations or individual investors, we embrace the challenges and goals that foundations face. Our solutions include multi-dimensional and comprehensive services that help clients manage and monitor ESG and other important sustainability considerations across their portfolio, helping them make more informed investment decisions

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