ENDOWMENTS & FOUNDATIONS

Investing for Purpose

A Governance Perspective on Mission-Aligned Investment Strategy

Brown ADVISORY
Thoughtful Investing.

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Increasingly, investment committee members are exploring mission-aligned investing for the organizations they serve. To be most effective, we believe that any effort to build greater alignment and/or impact should be approached holistically and in conjunction with the organization's broader investment policy. Whether an investment committee is starting from scratch or already has a mission-aligned investing program well underway, its investment policy statement (IPS) should clearly define long-term strategic goals. Importantly, investment committees should understand that it can take years to fully implement a mission-aligned strategy; together with their investment advisors, committees should include plans to periodically revisit both their goals and their criteria for success in meeting them.

DEFINING MISSION-ALIGNED INVESTING

There are many terms in use today that describe aspects of mission-aligned investing. These terms can overlap, and they are not always used consistently, which can lead to confusion.

Organizations bring many different lenses to this space, and over time, various approaches have arisen to serve the wide range of goals that mission-aligned investors express:

1. **Sustainable or environmental, social and governance (ESG) investing:** Considers ESG criteria to develop an investment strategy that generates attractive long-term returns through sustainable investment choices.
2. **Diversity, equity and inclusion (DEI) investing:** Evaluates investment managers according to criteria of diversity, equity and inclusion to ensure that historically underrepresented groups are well-represented among investment managers' workforces, including leaders in key decision-making roles that directly affect portfolio performance.
3. **Impact investing:** Seeks above all to generate positive, measurable impact in such areas of concern as social justice, environmental conservation, sustainable agriculture, animal welfare, renewable energy, economic development, and the provision of affordable and accessible basic services (housing, health care, education) to enhance human well-being.
4. **Socially responsible investing (SRI):** Seeks to invest solely in assets that align with an investor's articulated social values. This approach has historically often been favored by religious institutions.

These four approaches differ not only in their precise mission-alignment goals but also in the degree to which they prioritize financial returns. In sustainable, ESG or DEI investing, performance always remains paramount. Impact investing can target a range of returns, from at or above to below market, depending upon an organization's strategic goals for these investments. An SRI approach is typically willing to tolerate below-market returns so long as all portfolio allocations support the organization's values.

Mission-aligned investing does not have to confine itself to only one of these approaches. A DEI lens, for example, could enhance a social justice impact investment strategy. Impact investing metrics could offer a sustainable investing program specific targets to aim for in an area such as clean energy. Importantly, investment committees should focus first on expressing their specific performance and mission alignment goals as part of a sound investment policy. With those goals in hand, we believe that committees will be in a better position to develop an overall portfolio strategy that selectively draws from the four approaches mentioned above.

FIRST STEPS TOWARD MISSION ALIGNMENT

While investment committees are often eager to explore specific types of mission-aligned investing, it is important to start with a basic understanding of collective priorities. We have found that a tailored interview process with investment committee members (as a group or as individuals) can be helpful in eliciting the investment committee's financial and mission-based objectives.

For many investment committees, it helps to consider the [17 Sustainable Development Goals (SDGs)], set by the United Nations Department of Economic and Social Affairs, which constitute a formal definition of SDGs across the spectrum of sustainability concerns. The U.N.'s [2030 Agenda for Sustainable Development], which underlies the 17 SDGs, is widely recognized around the world, including in the investment industry.

An important part of the process is securing stakeholder buy-in. An organization's success in mission-aligned investing begins with effectively communicating the investment strategy, mission, and performance-related goals and progress toward realizing them. This requires thoughtful dialogue with multiple audiences—both internal and external stakeholders, including operational and program staff, board and committee leadership, and at times, outside constituencies and communities as well. With the support of key stakeholders, investment committee members should be empowered to effectively articulate the goals and objectives of a mission-aligned investment strategy through the IPS.

Lastly, it is important to consider whether a mission-aligned investment strategy will be applied to the entire portfolio or a carve-out of the whole. Some investment committees start with a carve-out in an attempt to show proof of concept, with a longer-term goal of implementing the strategy across the entire portfolio or because they are seeking to balance a below-market impact investing strategy with a broader traditional return portfolio. In any case, we believe clarifying intentions and articulating these in the IPS are critical.

TRANSITIONING THE PORTFOLIO FOR ALIGNMENT

Once the investment committee has articulated its mission-aligned investing approach through the IPS, the next step is to take stock of the organization's existing portfolio to identify any need for transitioning investments. Rarely would an entire portfolio need to be liquidated and reinvested, but in that unlikely scenario, partnering with an experienced investment advisor proves vital for ensuring a seamless transition without unnecessary market risk.

While in the past it was common for endowments and foundations to exclude investments that actually or potentially contradicted their mission, today, investors seek managers who actively support and sustain their organization's financial and mission-oriented goals. And because liquidity is usually a sensitive issue for organizations, we believe that positioning the portfolio for success will require investment strategies that can effectively balance traditional risk management against mission-aligned criteria.

When starting with a carve-out from the overall portfolio, investment committees often place a stronger emphasis on the mission of the organization and the impact from the investment of the assets. Given the combined impact and financial objectives for the carve-out, investment committees need to explicitly define the areas of focus (environment, social impact, etc.) but also the willingness and tolerance for concessionary returns. A mission-aligned carve-out can be implemented through a mix of investment vehicles and strategies from community development financial institutions to traditional asset classes and alternative investments, which range in return expectations from concessionary to market-based. This should give sufficient flexibility to an investment committee to choose the right mix for its objectives and needs.

MAINTAINING ACCOUNTABILITY

Adopting a program for mission-aligned investing inevitably requires adopting new metrics to measure and report on portfolio performance against strategic benchmarks. Like traditional investing, by defining mission-aligned performance metrics, the investment committee ensures accountability to the intention of the strategy.

In addition to traditional investment criteria, our approach to measuring success includes the following built-for-purpose tools:

- **Diverse asset manager survey:** Measures the diversity of asset managers in a portfolio, assessing representation of underrepresented groups in several areas, including overall workforce, leadership, investment teams, board, vendors, etc. Today, we leverage our partnership with Lenox Park Solutions to provide transparency into our client portfolios. Lenox Park uses technology to aggregate high-integrity data, create robust reports and score organizations using its proprietary scoring method. We believe working with an external partner provides credibility to our manager research process in this regard.
- **Sustainable investing dashboard:** Tracks the trending lines of sustainable investments on ESG metrics, including representation of the SDGs, so that alignment is periodically reevaluated.
- **Climate risk dashboard:** Evaluates the carbon emissions associated with a portfolio's underlying investments and the progress toward sustainability of carbon-intensive companies.

A common misconception of mission-aligned investing is that it is intrinsically qualitative in nature and therefore not measurable. At Brown Advisory, we have developed a disciplined, methodical process for mission-aligned investing—not a one-size-fits-all or merely reactive formula, but a flexible, data-driven approach that is custom-fitted to each client's needs. Whatever approach an organization takes, it will be important to revisit a mission-aligned investment strategy regularly, just as investment committees periodically revisit an IPS. Mission-aligned investing is often an iterative process, and a committee can expect to learn from its experience along the way.

At Brown Advisory, we fully share our clients' commitment to transparent, measurable success on the evolving and at times unpredictable path toward long-term mission alignment. We believe that we have the tools and the experience needed to support you at every step along the way.