Insights from the

Impact Gathering

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Optimizing Capital Allocation

There is an opportunity in Canada to increase the pool of capital that is flowing into the social sector as well as more effectively allocate the capital that is available today. Our social challenges continue to persist and are scaling quicker than the capital that is made available to address these issues.

Traditional philanthropy, a source that historically powered the sector, has declined significantly in recent years. As a result, it has become increasingly important for the social sector to call upon other capital streams. One emerging opportunity is in the form of impact investing, which can increase capital that is allocated to the social sector as it offers a unique proposition: the opportunity to make a societal impact while also achieving varying levels of financial return. Other opportunities include better cultivating government funding and unlocking foundation capital that is currently being directed to traditional versus impact initiatives.

Based on the discussion from this year's LEAP Impact Gathering, this summary explores these mechanisms in greater detail as well as the role that different stakeholders will need to play.

CONTEXT:

Social challenges are scaling quicker than the capital to solve these issues

Canada has made great progress along several dimensions, but taking a closer look reveals that multiple social issues still remain. For example, while Canadians are on average better educated than ever before, education metrics such as school completion in Indigenous communities trails the Canadian average.[1] Additionally, wage growth is not benefiting everyone, and multiple health outcomes such as diabetes and obesity rate are worsening.[2] [3]

Despite these all being important challenges for Canada to tackle, the capital that is made available to address these challenges is not scaling as quickly as the problems themselves. Specifically, personal donations, one of the traditional sources of capital for the sector, has suffered:

- In the 1980s, 30% of tax filers were claiming donations. As of 2016, this number dropped to less than 20%.[4]

[1] Canada's education system failing aboriginal students: report: https://www.theglobeandmail.com/news/national/canadas-education-system-failing-aboriginal-students-report/article26246592/
[2] PressProgress: https://pressprogress.ca/new-data-shows-wages-stagnated-and-inequality-grew-even-as-the-canadian-economy-boomed-in-2017/
[3] Canada's diabetes rate worse than the US: report: https://globalnews.ca/news/2318187/canadas-diabetes-rate-worse-than-the-us-report
[4] The Giving Behaviour of Canadians: Who gives, how, and why?: https://www.cagp-acpdp.org/sites/default/files/media/rideau_hall_foundation_30years_report_eng_fnl.pdf

- We also know that households are giving less, with 0.53% of household income being donated in 2016 compared to 0.78% in 2006, a reduction of one third over 10 years.[5]
- It is Canada's older population group which is responsible for most giving in Canada. Specifically, the 55+ age group gave $6.4 billion to charity, which was almost double the $3.5 billion given by Canadians aged 25-54. The younger age group has also seen their collective donations drop by 2.8% per year, which is alarming given that there are 31% more tax-filers in this younger age group.[6]

As a result of this decrease in donations along with an uncertain future attitude towards traditional philanthropy models, it is important that the sector begin calling upon other forms and streams of capital.

THE OPPORTUNITY:

Cultivating new opportunities to drive capital

One emerging stream of capital for the social sector has come in the form of impact investing. Between 2012 to 2017, the impact investing assets under management in Canada increased from $3.8bn to $14.8bn.[7] Moreover, in a 2018 report about Canadian impact investing trends published by the Responsible Investment Association, it was noted that 98% of survey respondents stated that impact investments either met or outperformed their return expectations, highlighting the financial viability of impact investing.[8] Impact investing is a creative strategy that can help bridge the widening gap in the funding system as a result of decreasing personal philanthropy. Through impact investing, capital can be allocated to the sector in a manner that combines positive societal impact and financial returns for investors.[9]

At a high level, impact investing can be summarized through its three main pillars[10]:

- Investor intention: While the blend of social impact vs. financial return may vary depending on the type of impact investing, driving social impact is a priority for each investment decision
- Investee intention: The investees (i.e. organizations that are invested in) are designed and specifically constructed to seek both social and financial value
- Impact measurement: Investors and investees need to show how their investments are generating measurable social impact

[5] Ibid
[6] The Giving Report 2018: https://www.canadahelps.org/media/The-Giving-Report-2018.pdf
[7] 2018 Canadian Impact Investment Trends Report: https://www.riacanada.ca/content/uploads/2019/02/2018-Canadian-Impact-Investment-Trends-Report-1.pdf
[8] Ibid
[9] Impact Investing in Canada - State of the Nation: https://www.marsdd.com/wp-content/uploads/2014/09/Impact-Investing-in-Canada-State-of-the-Nation-2014-EN.pdf
[10] Ibid

Impact measurement has been one area of concern for the space, as the unavailability of standardized impact measurement tools makes it difficult to track progress towards goals. However, Upkar Arora, CEO of Rally Assets and one of the panelists at this year's Impact Gathering, shared that holding back on impact investments due to lack of standardized measures for impact is not a valid reason for the lack of adoption. Specifically, he explained that people still made financial investments despite it having taken nearly 100 years to finalize GAAP and IFRS reporting metrics. It has only been 10 years since impact investing's arrival to center stage, yet people are expecting and waiting for refined impact measurement tools before investing. Upkar shared, "It seems like there is a double standard, and this pursuit of perfection in impact investing is paralyzing many people from making a difference".

In addition to impact investing, a number of potential other sources and tools exist to increase the pool of capital available–one of them being foundations. Currently, under Canadian law, foundations are required to only disburse 3.5% of their assets to charities each year. The implications of this are that foundations can then use the remaining 96.5% of their funds to invest in other traditional assets and securities to grow their internal capital pool, rather than using those funds to do what they were designed to do: mobilize and enable social change. In addition to this, the investment earnings that foundations could earn using 96.5% of their portfolio is not taxed, which means the wealth does not track back to driving social impact. Taxing foundations' investment earnings is a potential opportunity to explore, however, there are concerns that would first need to be addressed, such as the potential drop in the willingness to keep contributing to foundations in the future.

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>
> - Upkar Arora, CEO of Rally Assets

Bill Young, Founder and President of Social Capital Partners and a panelist at Impact Gathering 2019, said that in order to better optimize capital allocation into the social sector, "we need three things: supply of capital, a place to put it, and an enabling environment." He concluded by noting that through tools like impact investing, which create and leverage these drivers, we are moving closer towards large-scale change.

[11] Charities & Giving: https://www.canada.ca/en/revenue-agency/services/charities-giving/charities/operating-a-registered-charity/annual-spending-requirement-disbursement-quota.html

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Potential actions to catalyze change

In order to allow new approaches such as impact investing to grow further, we need public, private, and social sector participants to step up. Our panelists identified a few actionable ways where to start:

The government needs to play a role in scaling impact investing. One potential action for the government is to engage in co-investing efforts with other organizations, foundations and more. Matthew Mendelsohn, Deputy Secretary to the Cabinet in the Privy Council Office and a panelist at Impact Gathering 2019, emphasized the need to work with the government in this space. He noted that governments find it difficult to get involved in activities like impact investing on their own, due to the issues discussed earlier such as standardized impact measurement – however, adopting a co-investment strategy can help create the level of accountability and performance/impact measurement that the government needs in order to support the sector. Moreover, we know that co-investment can work, as the government at all three levels has already taken part in co-investing efforts with various organizations in Canada. As such, there is a clear appetite for it, and leveraging that at the federal, provincial and municipal levels will be important moving forward.

We will also need support from investment and financial professionals to help scale impact investing at the micro/individual level. In 2018, the Responsible Investment Association conducted a survey which showed that the 2nd largest barrier to the growth of impact investing in Canada is the lack of investment professionals with relevant skills. As such, addressing this needs to be a priority for institutions - in order for impact investing to take off, we need trained private wealth managers who are equipped with the skills to better serve their clients in a socially responsible manner. To that end, in September 2019, the Canadian Association of Gift Planners, the Knowledge Bureau, and Spire Philanthropy announced a study program that certifies individuals with a Master Financial Advisor - Philanthropy (MFA-P) designation. This designation is designed to help wealth managers think about more about the charitable sector, how philanthropy can be incorporated into their practice, and how to focus on identifying gift-planning strategies for clients.

[12] Ibid
[13] Advisors can now get an MFA-P designation: https://www.advisor.ca/news/industry-news/advisors-can-now-get-an-mfa-p-designation/

Moderator Andrea Robertson (VP Not-For-Profit Services, TD) with Bill Young (Founder and President, Social Capital Partners), Upkar Arora (CEO, Rally Assets), and Matthew Mendelsohn (Deputy Secretary to the Cabinet, Privy Council Office) during the Optimizing Capital Allocation panel at the 2019 Impact Gathering.

In order to allow new approaches such as impact investing to grow further, we need public, private, and social sector participants to step up.

However, this is only the beginning. Wealth advisors are the bottleneck in bringing their clients on board with impact investments, as they often feel their credibility will be hurt by not being fully knowledgeable about the impact investing space. As such, driving education for wealth managers through tools like the MFA-P will help make these investment opportunities more accessible for individuals. We also have a role to play in scaling education for our wealth managers – specifically, we can help accelerate this process by holding our wealth managers to a higher standard when it comes to guiding the conversation on things like impact investing and deploying capital into the social sector. As private investors, we need to avoid being paralyzed by the lack of impact measurement tools when making investment decisions. There are multiple ways out there to find investment opportunities that align with your values and we need to start somewhere.

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