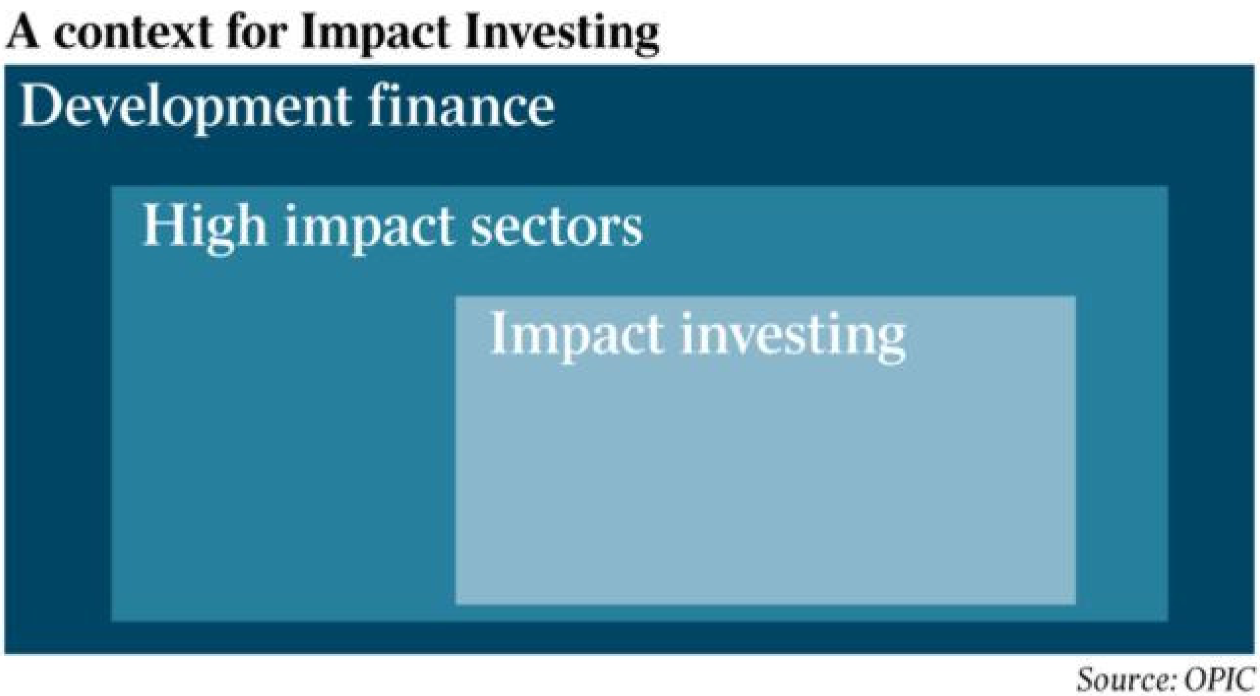
THE AUSTRALIAN

Quality control is crucial when ‘impact investing’

STIRLING LARKIN THE AUSTRALIAN OCTOBER 10, 2015 12:00AM



OPIC stresses that impact investments must have “an explicit and inherent intent at start-up to address environmental or social issues”. Source: TheAustralian

Australian ultra high-net-worth wealth faces two immediate challenges that echo the growing worries of Australian global investors more broadly.

• How best to protect investment capital, when all options now exhibit sizeable distortions?

• How to maintain a philanthropic and charitable continuum when it is becoming more difficult to identify what is philanthropy, charity and socially responsible investing?

These are not easy questions to answer, but with a higher expectation placed on both UHNW wealth advisory and the Australian philanthropic sectors since the great recession, avoiding the pressing need for this conversation is not an option.

Until the great recession and before distortions began to appear across real estate, credit, bond and equity markets — initially in the US but then in Japan and Europe — UHNW wealth had a rather dependable framework to model itself on: enhance wealth and its protection on one side of the ledger; contribute to society, humanity or any number of causes on the other.

On a whole, this model, which was founded in the US, worked spectacularly well since the formation of modern philanthropic foundations by former American "robber barons" at the turn of the 19th century.

The model not only tolerated, but in many respects also entrenched, a moral prerogative to maintain a separation between UHNW wealth and giving, while, importantly, for the first time, delineating between charity and philanthropy.

Whereas charity was intended to alleviate suffering, philanthropy — which refers to a longer term, deeper commitment to public benefit — sought to redress the roots of social problems and now, by extension, environmental challenges as well.

The success of philanthropy throughout the 20th century could be credited directly to this delineation and the imperative placed on separating altruistic initiatives from potentially corrupting financial endeavours, which UHNW investors naturally pursued on the other side of their ledgers.

But as wealth management has evolved and the ways in which philanthropy have been redefined, the line between the two, for better or worse, in many instances, no longer exists.

The best exemplar of this is the contemporary concept of "impact investing", which only really became "kitsch" in these most recent years following the great recession.

Unlike other new financial concepts such as "smart beta" or "liquid alternatives", the definition of impact investing remains opaque and is, most alarmingly, misappropriated in both the UHNW and other investment community settings.

This should not be surprising given that Philanthropy 2.0 — which in short sees wealth and giving merge — has been in existence since only about 2009.

Why this matters to both Australian investors and philanthropists is that it remains little or no secret that government will be retreating from the not-for-profit and domestic charitable sectors leading up to 2018-20 and it then becomes the moral imperative of Australian Philanthropy 2.0 to step up.

But rather than succumbing to the confusion and, in so doing, inadvertently investing in unethical "white labelled" funds feigning as philanthropic, the global investor can thankfully now seek clarity and clear definitions of what should satisfy altruistic thresholds.

On the merits of impact investing for the Australian experience, Michael Gonski, council member of Philanthropy Australia, says that he is supportive of the concept and believes it is great if investors take the social impact of their investments into account when making a decision.

He cautions that "the quality of the investment needs to be looked at first and foremost as part of the decision-making process to avoid poor investments being dressed up as 'social enterprises'."

Gonski adds: "As with everything, if these quality investments become part of a balanced portfolio, it would be hard to argue why impact investing is not a good thing."

In helping us identify quality, the Overseas Private Investment Corporation — the US government's development finance arm — recently undertook a detailed segmentation and as the table illustrates, its categorisations assist us to better ascertain which are stand-alone impact investments and which should be deemed development finance or high impact sectors focused alternatives.

To qualify as an impact investment, OPIC stresses that the investment must have "an explicit and inherent intent at start-up to address environmental or social issues, as well as a business model with a structure dedicated to achieving both impact and financial returns".

More than simply semantics, this internationally recognised and respected definition becomes controversial in Australia, primarily because many Australian-originated impact investments are not by any measure originated with an impact intent.

For instance, several mature Australian real estate projects have refurbished their premises by improving their “star” efficiency ratings and these may be sustainability enhancements to high-impact sectors but are by no means qualifying as impact investments — for which many are so labelled.

Without having to state the obvious, the most important thing is that these investments have targeted impact. If we do accept the delineation between wealth and giving, it becomes incumbent upon us to enthusiastically ensure that what we are doing in this space is as meaningful and altruistic as professed.

This is not yet another thing to be regulated.

The incorrect regulation of Australian philanthropic formations — such as private ancillary funds — is already a blight against our sector and that in itself needs to be corrected.

As aired in this column previously, the fact Australian private ancillary funds cannot distribute in non-Australian dollar currencies, and by so doing fail to assist worthy global causes which require US dollar or euro funding, is both arcane and, in some respects, cruel. As higher expectations are placed on UHNW wealth and delineations dissipate, our aspirations to seek an altruistic line must never be blurred.

Larkin Group is a Wholesale Wealth Adviser focusing on high yielding global investments.

www.larkingroup.com.au *(http://www.larkingroup.com.au)*