A Role for the Feds? The Opportunities and Challenges in a Federal Government Role in Measuring and Defining Social Impact in the Impact Investing Field

Sameera Fazili
U.S. Department of the Treasury

The impact investing field has made notable strides in recent years in developing metrics for measuring and evaluating the social impact of its investments. This includes the launch of the Global Impact Investment Rating System (GIIRS), which offers a third-party social and environmental impact assessment of companies and funds resulting in a rating that institutional investors and investment intermediaries can rely on in making investment decisions. It also includes the development of the CDFI Assessment and Rating System (CARS™), which offers both a financial and social performance rating for Community Development Financial Institutions (CDFIs). Both are examples of social performance metrics that have been developed by a coalition of impact investors and impact oriented companies.

However nonfinancial returns are notoriously difficult to quantify, measure, and compare across the many asset classes in which an impact investor may seek to deploy capital. For example, a fund manager may be choosing between investments in an affordable housing fund or a charter school facility. How do they compare the returns from the housing fund to the charter school? Even more difficult, how does the manager make a comparison between two housing investment funds? Purely in terms of the number of units built? On whether they target the poorest? On targeting cities with the highest rental prices? Once an impact investor decides what information to collect, they still must find a way to collect the information. How do investors and their fund managers collect this information in a manner that is cost effective to investors and investees?

This question is especially timely in light of the economic downturn. With shrinking public budgets at the federal, state, and local level, public dollars available to support social services, non-profits and economic development are dwindling. With the economic downturn impacting foundation balance sheets, the grant dollars that traditionally financed these activities are no longer available. More effective measurement of social impact could lead to new investors entering this marketplace and expand the financing of socially beneficial or socially oriented enterprises. It could also help fuel new forms of entrepreneurship and new business models that seek to both make a profit and have a social benefit, a movement that goes by many names including social enterprise, "double bottom line" enterprises, and benefit corporations.

While the impact investing industry continues to tackle these questions of impact measurement, the question naturally arises regarding role the federal government can play in helping support, encourage, or facilitate impact measurement. Some want to look to the federal government as a source of the actual impact measurements. A harmonization of impact measurements is, however, unlikely to come from the Federal government. While the current administration has considered ways for Federal agencies to report publically their performance, starting with the Recovery Act's Recovery Accountability and Transparency Board charged with providing the public with transparency on Recovery Act spending and job creation and continuing with the Office of Management and Budget's High Priority Performance Goals, it is unlikely that the impact investing industry can directly rely on the social performance measures government agencies generate. While the government in some sense acts as an impact investor when it dispenses competitive grants, it is unlikely that the Federal government agencies can harmonize all impact measurements across the agencies. There is variation across and within agencies due to different statutory mandates, regulations, and oversight bodies that drives the performance measures used at each agency and for each program. For example, a financing program run by USDA will attempt to measure geography of the investments to demonstrate rural outreach, while a similar facility run by SBA may focus more on the sector of the investment.

Nonetheless the federal government can still play a constructive role in supporting the impact investing industry's search for social impact metrics.

The impact investing industry can look to the federal government to establish the investment areas that have "impact." The federal government's establishment of policy priorities in particular areas can help impact investors select their at-need populations or the social goals of their interventions. The investors can adopt the targeting criteria used by federal agencies or specific federal programs. The CDFI Fund defines certain population groups or geographic areas as categorically lacking access to capital, offering the impact investor a characteristic to track when investing in CDFIs. The SBA sets thresholds per sector for defining small business, allowing a small business minded impact investor to carefully select investees or measure the ultimate targets of the investment. The federal banking agencies, through the Community Reinvestment Act regulations, define community development. Impact investors can look to government standards as a marker for whether an investment has impact, and provide activities or other markers for investors to track even if the investor still must quantify precisely how much impact the target investment has.

The federal government can serve as an information source. The federal government is a producer and aggregator of large amount of information. The impact investing community could identify key data points that could be collected at the federal level that would help facilitate the measurement of their investments. The data could be used pre-investment, to compare different investment options, or post-investment, to compare the performance of investments. For example, EPA data on environmental violations or Department of Transportation data on carbon emissions can be used to assess a company's green performance.

Government certifications or labels as quality assurance seals. Government can also provide a quality seal to organizations through certifications. This can give the impact investor some assurance that an institution has a mission impact or is achieving a mission goal. A few examples include Treasury's Community Development Financial Institution (CDFI) certification, the Department of Housing and Urban Development's certified counseling agency, and Department of Energy's Clean Cities. This helps decrease the due diligence required pre-investment and may offer some markers for the investor to track, because the investee may already be tracking these markers for government compliance purposes. As the impact investment industry matures, it may consider developing new certifications for federal agencies to administer, and must weigh the costs and benefits of an industry led certification as opposed to a government led one.

The government's role in supporting impact measurement can be more indirect, as well. The voice of the federal government can be a powerful tool to galvanize and spur the private sector into action on issues of concern. In these instances, the federal government does not lead industry by establishing standards or definitions but instead invites the private sector to work further in a particular area. The First Lady's Let's Move! initiative to combat childhood obesity offers an example, helping to encourage the creation of the private sector led Partnership for a Healthier America which will spur action across the private sector to achieve the First Lady's childhood obesity reduction goals.

In the end, the impact investing industry should consider the best way to leverage the federal government into the impact measurement arena. For example, is the industry best supported in its current stage by the federal government promoting impact investing or providing financial incentives to impact investors? Or, conversely, is the industry still in a nascent stage and therefore would prefer more indirect forms of government support, such as use of the federal bully pulpit powers to simply draw attention to the field.

Impact investing is still an emerging sector; accordingly clear definitional parameters have not yet been firmly established, although the excellent work highlighted in this volume indicates that progress to this end has been made. The industry still needs to settle uncertainty surrounding what distinguishes impact investing from the simple measurement of the positive externalities of a business. For example, should the impact investing label be narrowly defined as investments in enterprises that focus on solving a social problem – such as a business that focuses on providing workforce training opportunities to low income individuals – or more broadly defined as businesses that employ good social practice that are incidental to the business – such as a carbon neutral policy that places the company in energy efficient real estate or leads to purchasing of carbon offsets. Or instead, should the definition not focus on the businesses and instead focus on the investor. For example, is an investment in the carbon neutral business an impact investment because the investor was motivated to invest based on that impact?

The federal government offers a diverse array of tools upon which impact investors can already rely to select measurements for impact or to find sources of data on potential investees. There is always the risk that government intervening too early or prematurely will set the standard at a place investors are not comfortable and will not actually enhance capital flows to the sector. Therefore, as the industry matures, it should continue to look for ways federal policy could enhance the efficiencies in the impact investing marketplace, and educate the federal family on the industry's new growth and expanding infrastructure.

Sameera Fazili *is a senior policy analyst in the Treasury Department's Office of Financial Institutions where she focuses on development finance and community development. Prior to that she taught at Yale Law School, where she served as the Ludwig Community Development fellow and a clinical lecturer of law for the Community and Economic Development Clinic and the Community Development Financial Institutions Clinic. Her past work on development issues includes international microfinance, financial inclusion, banking, small business finance, social enterprise, human rights, and public health. She is a graduate of Yale Law School and Harvard College.*