

PROFILES OF INVESTOR SYSTEMS AND RELATED APPROACHES

MCKNIGHT FOUNDATION (MCKNIGHT)

Asset owner: Endowment * Headquarters: United States * AUM: US\$2.2 billion (2017)¹

AT A GLANCE

Originally endowed by a leader of the 3M Company, McKnight took a leadership role among foundations in launching a \$200 million Impact Investing Program in 2014. Investing through both public and private markets, this program focuses on the issues of climate change, water quality (especially relating to the Mississippi River), and community economic development in its headquarters cities of Minneapolis and St. Paul and throughout rural Minnesota.

McKnight pursues these initiatives because it believes that “ESG risks and opportunities may be material for individual businesses and are relevant for building a healthy, thriving economy that offers broad, lasting benefits to the companies that are in our portfolios” (McKnight (2016b): 6).

TOOLS OF INTENTIONALITY

- | | |
|--------------------------------------------------------|-------------------------------------------------------|
| <input type="checkbox"/> Additionality | <input type="checkbox"/> Polity |
| <input type="checkbox"/> Diversity of Approach | <input type="checkbox"/> Self-Organization |
| <input type="checkbox"/> Evaluations | <input checked="" type="checkbox"/> Solutions |
| <input checked="" type="checkbox"/> Interconnectedness | <input checked="" type="checkbox"/> Standards Setting |
| <input checked="" type="checkbox"/> Locality | <input type="checkbox"/> Utility |

ON-RAMPS

- | | |
|-------------------------------------------------------|--------------------------------------------------------------|
| <input checked="" type="checkbox"/> ESG integration | <input checked="" type="checkbox"/> Long-term value creation |
| <input checked="" type="checkbox"/> Impact investment | <input type="checkbox"/> Universal ownership |
| <input type="checkbox"/> Investment stewardship | |

ASSET CLASSES INTEGRATED INTO

- | | |
|--------------------------------------------------------------------|-----------------------------------------------------|
| <input checked="" type="checkbox"/> Fixed income | <input checked="" type="checkbox"/> Public equities |
| <input checked="" type="checkbox"/> Infrastructure and real assets | <input type="checkbox"/> Real estate |
| <input checked="" type="checkbox"/> Private equity | <input checked="" type="checkbox"/> Venture capital |
| <input type="checkbox"/> Other | |

YEARS INTEGRATING

McKnight launched its Impact Investing Program **three years** ago, in 2014. Previously, it had also engaged in Program Related Investments—that is, below-market rate loans and investments for organizations aligned with its grantmaking.

SYSTEMS & THEMES FOCUSED ON

- | |
|--------------------------------------------------------------------------|
| <input checked="" type="checkbox"/> Environmental |
| <input type="checkbox"/> Biodiversity |
| <input checked="" type="checkbox"/> Climate change |
| <input checked="" type="checkbox"/> Natural resources |
| <input type="checkbox"/> Oceans |
| <input checked="" type="checkbox"/> Renewable energy |
| <input checked="" type="checkbox"/> Sustainable land use |
| <input type="checkbox"/> Waste management and pollution |
| <input checked="" type="checkbox"/> Water |
| <input type="checkbox"/> Other |
| <input checked="" type="checkbox"/> Societal |
| <input type="checkbox"/> Consumer health and safety |
| <input type="checkbox"/> Corporate governance |
| <input type="checkbox"/> Corruption |
| <input type="checkbox"/> Employment, labor rights and working conditions |
| <input type="checkbox"/> Food production and security |
| <input type="checkbox"/> Human rights |
| <input type="checkbox"/> Income inequality and financial inclusion |
| <input checked="" type="checkbox"/> Infrastructure |
| <input checked="" type="checkbox"/> Social equality and diversity |
| <input type="checkbox"/> Other |
| <input checked="" type="checkbox"/> Financial |
| <input type="checkbox"/> Shareholder rights |
| <input type="checkbox"/> Stability |
| <input checked="" type="checkbox"/> Transparency |
| <input type="checkbox"/> Other |

TOOLS OF INTENTIONALITY: THE MCKNIGHT "TIIPING" POINT

McKnight has taken intentional steps to use the tools of **Locality**, **Interconnectedness**, **Solutions** and **Standards Setting** to address such environmental and societal issues as climate change, water quality, and community economic development.

- Its impact investments are in part intentionally focused on, and coordinated with, its grant making in the local concerns related to climate change and energy as they affect the Midwest, the water quality and resilience of the Mississippi River, and resilient and sustainable local economies in the Twin Cities and Minnesota.
- In developing its Climate Efficiency Strategy passive investment index in conjunction with Mellon Capital Management, McKnight created a product that sets standards related to climate-change. This product is also intended to connect other institutional investors to an investment vehicle and a model for responsible investment product development.
- McKnight has allocated \$125 million to high-impact, private-market investments that seek solutions to sustainability challenges in agriculture, energy and green technology, financial inclusion, affordable housing and small business development.

ABOUT MCKNIGHT

McKnight was endowed in 1953 by William and Maude McKnight. William McKnight had served as the President and Chairman of the Board of the 3M Company, headquartered in St. Paul, Minnesota. The foundation's primary areas of grant giving are the arts; education and learning; developing countries; Midwest climate and energy; Minnesota Initiative Foundations; Mississippi River; neuroscience; and the Twin Cities and rural Minnesota.

In 2014, McKnight created a \$200 million "carve out" from its endowment, or 10% of its \$2 billion in assets at that time, which it allocated to an **Impact Investing Program** that would "support its mission, enhance its credible influence, drive programmatic learning, and impact key philanthropic priorities (McKnight (2016b): 1). These funds were allocated to:

- Public markets (\$75 million);
- Private markets (\$75 million); and
- Program Related Investments (\$50 million).

McKnight's Impact Investment Program currently concentrates its investments and loans in three broad areas:

- Accelerating the growth of a cleaner, low-carbon economy;
- Restoring **water quality** and resilience of the Mississippi River; and
- Contributing to a thriving, sustainable Twin Cities metro area (McKnight (2017)).

APPROACHES IN PRACTICE

➤ INVESTMENT ACTIVITIES

Investment beliefs statements

McKnight's *Investment Policy Statement* states that "ESG risks and opportunities may be material for individual businesses and are relevant for building a healthy, thriving economy that offers broad, lasting benefits to the companies that are in our portfolios (McKnight (2016b): 6). McKnight believes that **climate change** "has the potential to undermine the value of the

McKnight endowment. Incorporating a **long-term** understanding of climate change—its causes and its solutions—is part of protecting the returns of the endowment (McKnight (2015)) (emphasis in original).

Security selection & portfolio construction

McKnight has invested \$100 million in a low-carbon index fund managed by Mellon Capital Management. This Carbon Efficiency Strategy excludes coal companies and overweights or underweights companies depending on their efficiency in controlling greenhouse gas emissions in operations and production processes per dollar of sales. It also has a policy of no coal-related investments for \$180 million in fixed-income strategies.

It also invests in sustainability or ESG-related funds offered by external managers.

Corporate engagements

In 2015, as a member of CDP (formerly the Carbon Disclosure Project), McKnight wrote to over 170 companies in carbon-intensive sectors to encourage improved disclosure of greenhouse gas emissions and was joined by two other foundations (Rockefeller Brothers Fund and Nathan Cummings Foundation) in a similar initiative the following year.

For proxies in accounts where it controls its voting rights, McKnight contracts with Institutional Shareholder Services (ISS) to vote according to the ISS's Socially Responsible Investment Proxy Voting Guidelines. McKnight generally favors shareholder proposals on ESG issues “to encourage long-term thinking by companies” (McKnight (2017)).

Targeted investment programs

As of 2016, McKnight had \$125 million in loans and equity investments that it categorized as high impact. These included \$75 million in private market investments and \$50 million in Program Related Investments.

- Its “aligned” investments were made with Generation Asset Management (Global Equity Fund, Climate Solutions Fund); Mellon Capital Management (Climate Efficiency Strategy, Fix-Income Portfolio); TPG (Alternative and **Renewable Energy** Technologies); and Stewart Investors (Worldwide Sustainability Strategy).
- Its “high-impact” investments were made with Midwestern BioAg (**sustainable land use** and sustainable agriculture); Generate Capital (financing for green technology); New Energy Capital (solar energy); The Conservation Fund (**natural resources**: forest and wetlands preservation); Living Cities' Catalyst Fund (**financial inclusion**); Greater Minnesota Housing Fund (**infrastructure**: affordable housing); Family Housing Fund (affordable housing); Northland Foundation (small business development in Minnesota); and Natural Capital Investment Fund (small business development in Appalachia).

Manager selection, directives & monitoring

McKnight uses external managers, which it evaluates and rates on their **ESG integration**. It “may attempt to influence a manager’s approach” to ESG practices (McKnight (2016b): 3). During in-person meetings with its managers it enquires about their ESG policies and practices and reports that it has recently seen an increase in the offerings of ESG products and services among these managers. It conducts a biannual review of the ESG policies and practices of these managers.

➤ OTHER ACTIVITIES

Seeds the development of climate-change related investment products

With Mellon Capital Management (MCM) and BNY Mellon and in collaboration with the impact investment division of Goldman Sachs Asset Management, McKnight helped to develop a Climate Efficiency Strategy (CES) index fund for its passive investments in public equities. This index was the result of a collaborative effort that extended over 12 months and involved several different proposed methods for constructing the CES. Among the challenges in designing the index were:

- Providing incentives for companies across all industries to reduce the intensity of their greenhouse gas emissions (i.e. emissions per unit of revenue);
- Creating **a product that could be used by other institutional investors as well**;
- Obtaining enough high quality data; and
- Keeping the tracking error and fees of the portfolio to a minimum, while reducing the portfolio's exposure to carbon emissions.

McKnight originally proposed this concept to MCM, which had managed assets for the foundation since 1987. From the outset of the discussion, it made a commitment to seed the product with a substantial investment (ultimately \$100 million) if a satisfactory product could be developed.

Publishes reports and papers on ESG issues

Along with MCM, McKnight also funded the publication of detailed case study of the product's development, *Value Chain Analysis: Partnership for a Climate Efficiency Strategy*. The Climate Efficiency Strategy is intended for use by other institutional investors and the case study can serve as a model for the development of responsible investment financial products.²

STAFFING

McKnight's Director of Impact Investing is the staff person with primary responsibility for its Impact Investing Program; the director works with an Investment Analyst and Investment Assistant.

IMPACT MONITORING & REPORTING

The Mission Investing Committee monitors and measures the impacts of the investment in its Impact Investing Program. For each of allocations it makes to the "aligned" and "high impact" funds in which it invests, as well as its Program Related Investments, McKnight publishes information on its website that outlines the:

- Rational for the investment;
- Financial performance of the investment against an appropriate benchmark; and
- Lessons learned with relation to the investment and its managers.

According to McKnight, "rather than try to create a unified, quantifiable measure of impact, we tend to look at each investment individually and assess the success based on the type of investment and data available" (McKnight 2017b).

POLICY DEVELOPMENT AND MONITORING

The foundation's Mission Investment Committee is responsible for oversight of its Impact Investing Program.

SUCSESSES AND CHALLENGES

➤ SUCCESSES:

1. Implements a high-impact investment program, finding sufficient acceptable investment opportunities.
2. Partners and collaborates with other foundations to expand the field of impact investing.
3. Increases collaboration between investment and grantmaking teams to deliver learnings on private markets.
4. Provides transparency on its impact investing portfolio and performance on the website.

➤ CHALLENGES:

1. Data availability and measurement are a challenge for impact investment.
2. Defining levels of “impact” and what should be considered impact investment vs. “strong investment management”.³

SOURCES

BNY Mellon, McKnight Foundation, Mellon Capital, pfc Social Impact Advisors, University of Oxford SAID Business school (2016. et al. Value Chain Analysis: Partnership for a Climate Efficiency Strategy. Oxford, United Kingdom: April 2016. Retrieved from https://www.bnymellon.com/_global-assets/pdf/our-thinking/partnership-for-a-carbon-efficiency-strategy.pdf.

McKnight (2014). “McKnight Announces Impact Investment Commitment of \$200 Million” Retrieved from <https://www.mcknight.org/newsroom/news-releases/mcknight-announces-impact-investment-commitment> on July 7, 2017.

McKnight (2015). “The Road through Paris: Building a Low-Carbon with Investing and Philanthropy” Retrieved from https://www.mcknight.org/resource-library/impact-investing/the-road-through-paris?with_layout=1 on July 7, 2017

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McKnight (2017a). “Impact Investment Strategic Investment” webpage. Accessed from <https://www.mcknight.org/about-us/strategic-framework> on July 7, 2017.

McKnight (2017b). Responses to TIIP’s 2017 Survey of Investors that Integrate Environmental, Societal, and Financial Systems Considerations Into Their Investment Practices. Returned to TIIP on August 2, 2017.

Wolford, Kate and Ted Staryk. “Looking beyond Impact Investing to Support Climate Solutions” Stanford Social Innovations Review November 30, 2015.

NOTES

¹ McKnight 2017b.

² BNY Mellon et al (2016).

³ Successes and challenges are as reported in McKnight (2017b).

Profile developed in: July 2017

Profile developed by: The Investment Integration Project (TIIP). TIIP helps institutional investors understand the big picture, or “systems-level,” context of their portfolio-level decisions. “Systems-level” events, such as economic crises, ecosystems under stress, and societies in turmoil can disrupt the best-laid plans of investors and cost them dearly. Even seemingly “local” issues are now having much greater impact than they once did as the world becomes increasingly interconnected.

TERM DEFINITIONS

What are "Tools of Intentionality"?

Tools of intentionality are specific pathways through which investors can bridge the gap between daily portfolio management decision-making and systems-level investing. Investors use these tools intentionally because the portfolio-level discipline of efficiency alone does not naturally lead them to systems-level considerations. Investors can use these tools to manage risks and rewards at systems levels and facilitate impact in a variety of ways.

What are "On-Ramps"?

On-ramps are investment approaches that represent logical extensions of the concept that investment has impact on the world at large—and on its component environmental, societal and financial systems—and that that impact can be managed to maximize these systems' wealth-creating potential in society.

What are "Asset Classes Integrated Into"?

Into which asset classes does the investor incorporate a systems-related approach?

What are "Years Integrating"?

The number of years since investor initiated systems-related approaches.

What is the "Tipping Point"?

Description of investor's primary approaches to adopting/executing system-related considerations.

What is "About"?

General description of the investor and their approach to systems-related investing.

What are "Approaches in Practice"?

How does the investor's systems-related approach manifest itself? We examine five key investment activities as well as other intentional systems-related undertakings. We also look at staffing and impact monitoring and reporting.

What are "Investment Beliefs Statements"?

Inclusion of observations about environmental, societal or governance considerations in the investor's formal investment belief statements or in more general statements of beliefs about the relevance of these considerations at portfolio or systems levels.

What are "Security Selection & Portfolio Construction"?

The incorporation of environmental, social and governance factors into individual security valuation and portfolio construction.

What are "Targeted Investment Programs"?

Creation of specialized sector or theme-based funds with an explicit environmental or social focus and the stated purpose of serving sustainable or responsible investors.

What are "Corporate Engagements"?

Communication on environmental, social and governance issues with corporations indirectly through proxy voting, or directly through individual or collaborative dialogue, the filing of shareholder resolutions, or other means in order to promote improvements in practice.

What are "Manager Selection, Directives and Monitoring"?

Incorporation of systems-related or on-ramp themes into the selection and monitoring of external managers.

What are "Other Activities"?

Additional investment policies and practices beyond those captured in key investment activities. Those intentional policies and practices that seek to achieve systems-goals are highlighted. They vary considerably across investors.

What is "Staffing"?

When information is available, this section describes investor contracting with external entities to execute systems-related approaches; internal personnel whose responsibilities exclusively or primarily include developing, executing or overseeing investor systems-related approaches; committees/groups with systems-related responsibilities; training provided to staff.

What is "Policy Development and Monitoring"?

When information is available, describes the processes undertaken by the investor to develop systems-related approaches.

What is "Impact Monitoring and Reporting"?

Discusses whether and how the investor measures and reports on the non-financial outputs, outcomes or impacts (effectiveness) of its systems-related approaches, or has plans to do so. Also whether and how the investor reports on the content of its systems-related activities.

What are "Successes and Challenges"?

Discusses the main successes and challenges reported by the investor about its systems-related approaches. This includes successes and challenges reported on a TIIP survey or in an interview, or statements describing successes and challenges in publicly available materials.