Graystone Consulting

The Convergence of Investing with Impact and Institutional Consulting

PART 2: IS YOUR CONSULTANT PREPARED?

Given the growing demand by institutions for Investing with Impact, the institutional consulting landscape has become far more complex and competitive, requiring new capabilities and a distinctly new mindset. Across the industry, we are seeing a dramatic increase in investment offerings and a renewed focus on positive outcomes, including greater rigor in impact measurement. Therefore, guiding asset owners through the dual mandate of growing an endowment while also creating solutions to solve some of the world's most significant problems requires resources across manager research, reporting innovation, data and technology, partnerships, and talent.

Part 2 in this series will explore the core attributes, key challenges and necessary new capabilities required of impact consultants to navigate this evolving terrain for institutional clients. We also provide critical questions to evaluate existing and/or identify new consulting partners.

Investing with Impact

Morgan Stanley's proprietary Investing with Impact framework includes investments that aim to achieve market-rate financial returns alongside positive social and/or environmental impact. See Part 1 for a more detailed glossary. Investing with Impact includes a range of investments across public and private markets, in addition to customized portfolios, donor-advised fund impact pools and access to capital market opportunities, including green and blue bonds.

The Role of the Institutional Consultant

Institutions such as pension funds, endowments, foundations, nonprofits and religious institutions often hire consultants to help them effectively manage their assets in an increasingly complex financial world. While the most widely used consulting services continue to be general investment and capital markets research at 45%, performance attribution and measurement at 43%, and ongoing manager due diligence at 37%, we are seeing an increased need for services that provide important guidance in helping organizations make sound investment decisions. These include incorporating responsible investment criteria, and developing investment policy statements, where consulting services were used by 20% and 10% of institutions respectively.[1]

Investing with Impact approaches, including ESG integration, have the ability to add depth and nuance to portfolio asset allocation, manager selection, reporting, and ongoing portfolio rebalancing and monitoring—to better serve institutional clients. In 2019, 80% of the 195 institutions surveyed are including 'responsible investing' considerations for their endowment.[2]

- Ninety-five percent of institutional asset owners are pursuing or plan to pursue ESG integration in their investment process[3]
- In 2018 globally, $30.7 trillion was invested in sustainable and impact investing strategies, a 34% increase since 2016[4]
- Sustainable global enterprises are expected to create $10 trillion in new investment opportunities by 2050[5]

Consultant Use*

	TOTAL INSTITUTIONS	OVER $1 BILLION	OVER $500 MILLION–$1 BILLION	OVER $250 MILLION–$500 BILLION	OVER $100 MILLION–$250 MILLION	OVER $50 MILLION–$100 MILLION	OVER $25 MILLION–$50 MILLION	$25 MILLION AND UNDER
Total Institutions	**774**	**60**	**107**	**93**	**152**	**194**	**86**	**82**
Asset allocation design	22%	22%	4%	32%	20%	27%	27%	18%
Day-to-day investment management	23%	35%	1%	45%	30%	26%	15%	4%
Portfolio rebalancing	28%	38%	5%	47%	34%	32%	27%	11%
Manager selection	22%	27%	7%	32%	28%	23%	22%	16%
Ongoing manager due diligence	37%	33%	12%	43%	36%	46%	50%	30%
Investment policy statement development	10%	8%	2%	9%	13%	12%	14%	7%
Performance measurement and attribution	43%	40%	26%	47%	41%	52%	53%	37%
Responsible investing criteria	20%	23%	6%	28%	21%	23%	23%	16%
Expense / fee review	18%	15%	6%	17%	18%	21%	28%	18%
Design of spending policy	3%	3%	1%	3%	3%	4%	2%	5%
Risk management	18%	15%	7%	24%	21%	21%	20%	18%
General investment and capital markets research	45%	42%	20%	55%	44%	54%	56%	34%

* Multiple responses allowed

Source: National Association of College and University Business Officers: "Study of Endowments 2019."

Effective Integration Remains a Challenge

Nevertheless, it remains challenging for most consultants to serve institutional clients focused on Investing with Impact. Achieving alignment with long-term financial and impact objectives requires distinct skill and dedicated capabilities. The typical consultant likely lacks the ability to help clients structure their portfolios with mission-aligned investments, having limited tools to measure portfolio performance beyond its financials.

Investing with Impact represents a fast-evolving megatrend within the financial industry, one that is too large to be fully understood and covered by one individual or one team. Not only do these capabilities require significant investment in research, innovation, technology, partnerships and talent, but each institution's journey is different. Consultants need both a firm grasp of the impact landscape—inclusive of the opportunities and pitfalls in the sector—and a far deeper client engagement model than traditional consulting, one that is more intentional, collaborative and time-intensive, to fully understand the nuanced goals and objectives of the organization (which may evolve over time). That requires significant resource commitment to produce strong thought leadership, analytical capabilities, active coverage of existing impact products across asset classes, and the ability to innovate on solutions, tools and research where needed to evolve the industry.

There is no one-size-fits-all approach for institutional clients seeking to incorporate impact goals in their investment decisions—such as identifying objectionable issue areas, integrating ESG risks and opportunities, and positioning the portfolio to potentially benefit from sustainability themes. Impact-oriented consultants must be able to think holistically about all pools of capital that the institution is stewarding—financial, philanthropic and human—in order to leverage each to achieve the long-term financial and impact goals of the institution.

Consultants should be able to educate key stakeholders of the organization—from staff to donors and peer institutions—as well as provide resources to help attract and retain talented and diverse board members. We call this process Mission Align 360˚ and have developed a road map for instititutions of all sizes and types to leverage when evolving their approach to investments that generate positive environmental and social impact. This approach requires not only the vision to identify opportunities but also the infrastructure in place to execute a truly tailored program that suits the institution's financial and impact goals.

Mission Align 360°

Morgan Stanley defines Mission Align 360° as the process by which an organization examines itself from every vantage point—a 360-degree view. That examination requires the organization to assess its financial, philanthropic and human capital as well as how such capital is allocated in order to accomplish its mission of long-term financial stability and generating positive environmental and social impact.

Partnering With the Right Consultant

The right consultant is defined as much by ability to ask the right questions, listen and innovate, as by their distinct expertise in the impact space. Here are nine questions designed to help institutional asset owners select a consultant:

1. What is your experience working with institutions integrating Investing with Impact in their investment portfolios? Follow up with a question that focuses on a specific impact goal.

Institutional consultants should not only have a background in implementing successful portfolio strategies across asset classes and different approaches to Investing with Impact but also experience in crafting targeted thematic or mission-specific portfolios based on each institution's specific needs, mandates or missions. With a large and growing universe of investment products, it's possible to align investments with specific areas of interest, such as climate solutions, faith, animal welfare, diversity, equity and inclusion, community economic development and more.

2. How does your firm think about ways to approach Investing with Impact? What is your approach to utilizing tools such as shareholder engagement and proxy voting?

Institutions have varying definitions of impact—which may not ultimately be formalized across all key stakeholders, including the board, key staff and donors. A skilled consultant should have a keen understanding of the full spectrum of Investing with Impact approaches, from applying restriction screens to ESG integration, thematic investments, private market impact investing and direct shareholder engagement, including proxy voting and filing resolutions. This background can help facilitate an engagement with key stakeholders to develop consensus and strategy for integrating Investing with Impact over time. Some institutions may wish to develop custom engagement campaigns in-house or in partnership with their consultant.

3. What is your view on how Investing with Impact can help mitigate risks and improve positioning to achieve long-term value?

Extreme answers that suggest Investing with Impact "always leads" to concessionary returns or "always adds" value are overly simplistic. While risk-adjusted returns of Investing with Impact strategies can often match or even outperform traditional investments,[7] not all strategies are created equal. A skilled consultant is thoughtful and strategic in the implementation of any portfolio, seeking complementary investments across asset classes in order to achieve both impact and financial goals in a way that harnesses the full spectrum of approaches and capital pools—financial, philanthropic and human. Furthermore, it has been shown that sustainable funds (investments that have strong environmental, social and governance performance) may offer lower market risk. As found in a recent Morgan Stanley Institute for Sustainable Investing study, sustainable funds experienced a 20% smaller downside deviation, on average, than traditional funds over a period from 2004 to 2018.

4. What is your experience in developing an investment policy statement that integrates impact goals? Do you have dedicated resources conducting due diligence to identify impact opportunities across different asset classes (including public and private markets) that align with the investment policy?

The investment policy statement serves as an investment blueprint for an organization. An impact consultant should have significant experience guiding clients through a process that enables them to take inventory of existing investment policies; articulates the institution's motivation, goals and constraints; identifies the key financial and impact or mission-alignment objectives; and establishes how an approach to Investing with Impact will fit in with new governance processes. This document should be regularly revisited as part of ongoing client engagement and monitoring. Given the wide variety of financial goals and the constant evolution of impact offerings, consultants should be prepared to leverage the depth of manager research capabilities from their firm and also conduct additional, and sometimes client-specific, due diligence on investment opportunities across asset classes—from municipal or sovereign bonds funding social impact efforts, to equities of companies with leading sustainable corporate practices, to venture or private equity funds investing in the next innovators in green technology or affordable housing. This requires not only dedicated professionals with relevant experience, but also a robust pipeline of opportunities that will ultimately undergo a rigorous impact, financial and operational due diligence process to determine higher conviction strategies.

5. How do you measure impact alignment at the portfolio level? How do you help clients set targets to increase mission and impact alignment over time?

Given the absence of a universal impact reporting standard and the complexity involved with measuring impact across asset classes as well as establishing clients' custom impact goals and objectives, a consultant should be able to provide comprehensive and multidimensional reports showing impact at the portfolio and security levels. The reports should not only provide an objective picture of the alignment of each holding with respect to the client's mission, but also highlight exposure to potential issues of concern—especially issues that may serve as a reputational risk for the organization. Moreover, they should be able to tailor the impact report to the institution's specific impact goals and objectives, instead of producing a standard report or using generic "black box" scoring. Further, consultants should be able to leverage these reporting capabilities to evolve and enhance alignment with a client's mission and impact objectives over time. Morgan Stanley has solved this for our institutional clients through the launch of Morgan Stanley Impact Quotient.® This proprietary and award-winning[8] application helps institutional clients articulate the impact objectives that are integral to the organization and its mission statement, and shows how closely the portfolio and its underlying holdings align with those impact objectives. In terms of portfolio alignment over time, institutions may seek to activate a carve-out, partial portion of the portfolio or transition the entire portfolio toward their impact objectives. Setting attainable transition targets is a critical skill offered by experienced impact consultants to ensure a prudent and methodical approach to incorporating investment managers that generate positive environmental and social impact while meeting financial goals.

6. What is your approach to Diversity, Equity and Inclusion investing?

Diversity, Equity and Inclusion is a broad ranging concept covering dimensions of race, ethnicity, gender, orientation and more.

For example, gender equity investing is about identifying the ways in which achieving balance in representation, empowerment and economic opportunity is material to financial outcomes. Racial equity investing describes the effort to direct investment capital towards the advancement of economic and social equality for historically underrepresented groups, including Black, Hispanic, Asian Indian, Asian Pacific, and Native American populations.

The goal is to use race and ethnicity as an investment consideration across asset classes to advance equitable opportunities—and institutional consultants can help to provide access to these strategies. A study by Knight Foundation and Harvard found that fewer than 4% of publicly traded funds are run by people of color and, due to bias in manager selection, firms owned by women and minorities combined manage just 1.3% of assets in the $69 trillion asset management industry.[9] As institutional investors seek to utilize capital to take action in advocating for racial equity we expect investment opportunities to continue to accelerate.

7. Can you provide access to emerging and diverse managers?

Emerging, women and minority-owned firms represent a small fraction of the asset management industry, despite data showing these managers can perform in line with peers.[10] Impact consultants should have access to a variety of emerging managers—defined as managers with fewer assets under management or shorter track records, and/or owned and operated by women and minorities.

Measuring the Impact on the Issues That Matter Most

Morgan Stanley Impact Quotient® application enables a customized approach to helping clients understand the environmental and social impact of their investments:

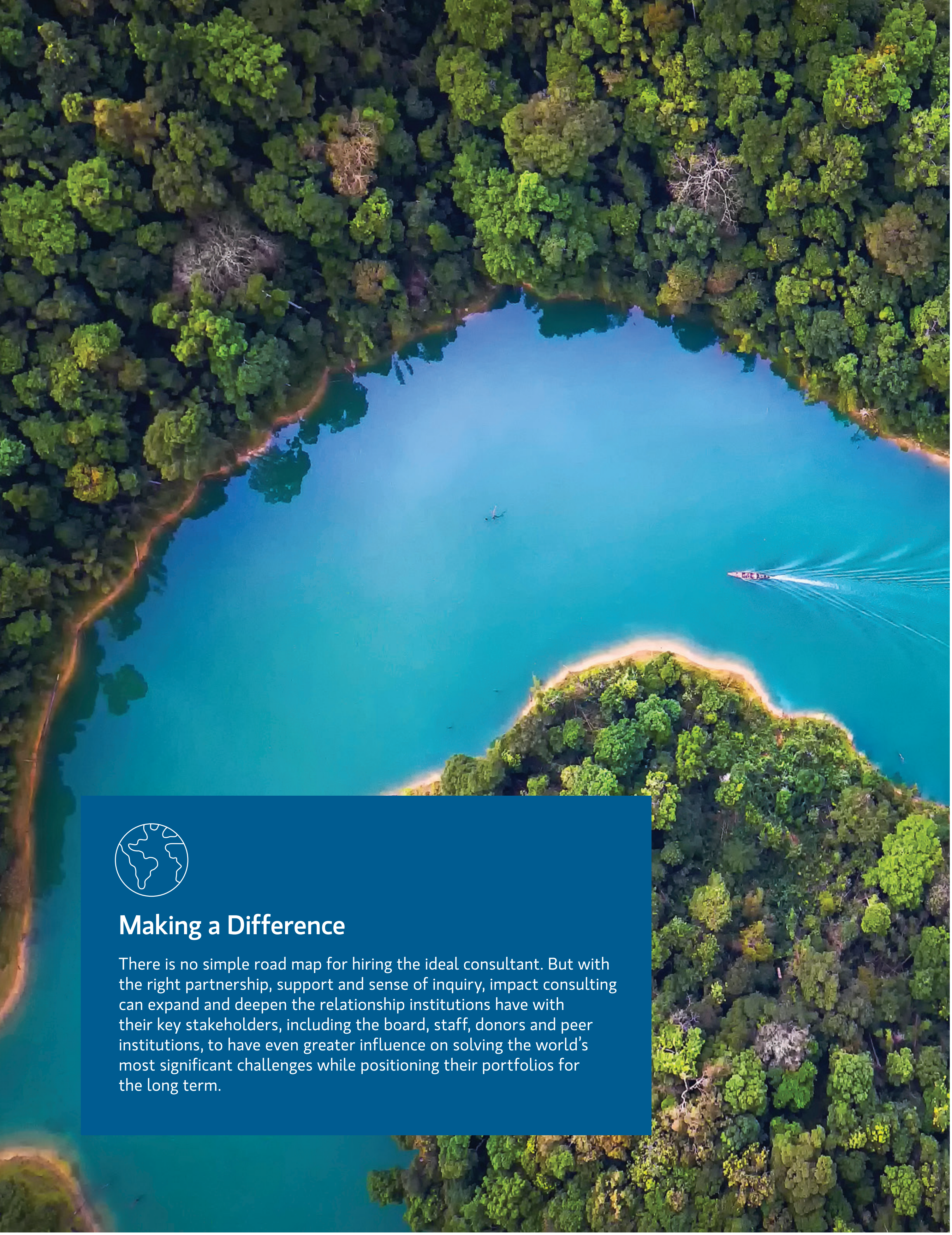
1. Discover and articulate the values and impact objectives of the institution
2. Assess and visualize a portfolio's current alignment with the identified unique impact objectives
3. In partnership with an institutional consultant, better align the investment portfolio to selected impact objectives over time

8. What do you see as the main challenges and opportunities within Investing with Impact?

Given the proliferation of investment strategies in this category in recent years, assessing asset managers on their Investing with Impact capabilities requires a higher degree of discernment, thoughtfulness, critical thinking and resources. Further, consultants should ideally be able to offer a nuanced outlook on timely market trends like climate change, diversity, equity and inclusion as well as access to data and impact measurement to drive thoughtful processes. At Morgan Stanley institutional clients have access to an open-architecture manager platform and seek to provide customized portfolio exposure with compelling financial and impact results.

9. What led you to develop a practice in Investing with Impact? How is your firm helping to build capacity for the industry broadly?

It's important to gain a holistic sense of the culture of the firm—how is the consultant's practice "walking the walk" around positively influencing the world, from specific actions to building infrastructure by playing a leading role in industry organizations. A consultant who shares the investor's impact goals and has a genuine commitment to sustainable investing is more likely to invest in developing the expertise to help clients achieve their financial and impact goals. At a minimum, an interesting story would indicate the consultant's curiosity, interest and motivation to deliver results in this fast-evolving area of investment management.



Making a Difference

There is no simple road map for hiring the ideal consultant. But with the right partnership, support and sense of inquiry, impact consulting can expand and deepen the relationship institutions have with their key stakeholders, including the board, staff, donors and peer institutions, to have even greater influence on solving the world's most significant challenges while positioning their portfolios for the long term.

Graystone Consulting: Leading the Impact Charge

Graystone Consulting, a business of Morgan Stanley, is one of the country's largest and oldest institutional consulting practices of its kind, with more than 40 years of experience advising clients as an investment advisory fiduciary. Our consulting approach is structured to provide unbiased, objective advice and guidance—delivered in a cost-effective manner that helps our clients potentially drive greater performance to support their goals. We provide sophisticated institutional investors with the best of both worlds: A highly engaged boutique consulting client experience, backed by the deep resources of a global financial services provider, with what we believe is superior access to the industry's best managers and investment solutions.

We are among the leaders in Investing with Impact, with a business model that focuses on understanding the nuances of each institution, whether it's a foundation, endowment, nonprofit, retirement portfolio or other mission-aligned institution.

Assets Under Management Summary (as of December 31, 2019)

Client Type	$ in millions	%
Corporations	165,782	49%
Taft-Hartley	70,070	21%
Nonprofit Organizations	28,513	8%
Public Funds	27,014	8%
High Net Worth	16,467	5%
Hospitals and Health Care	15,993	5%
Educational Institutions	9,212	3%
Insurance Companies	3,125	1%
Sovereign Nations	360	0%
Other	198	0%

Client Pools Summary (as of December 31, 2019)

Client Type	#	%
Corporations	2,850	51%
Nonprofit Organizations	737	13%
Taft-Hartley	672	12%
Public Funds	425	8%
Hospitals and Health Care	365	7%
High Net Worth	391	7%
Educational Institutions	185	3%
Insurance Companies	83	1%
Sovereign Nations	8	0%
Other	129	2%

Source: Consulting Group Data Analytics, 2020.

Investing with Impact

Morgan Stanley Wealth Management launched Investing with Impact in 2012 at the U.S. State Department's inaugural Global Impact Economy Forum. Investing with Impact provides our wealth management clients, including institutions, with a suite of investment strategies, portfolios, tools and analysis to deliver solutions that can generate both market-rate financial returns and measurable positive environmental and social impact. Investing with Impact is designed to be flexible enough to service the varied needs of individual investors, families, institutions, religious organizations, corporations, charitable trusts, foundations, nonprofits, donor-advised funds and more. With more than 150 investment strategies across asset classes and additional customizable opportunities across a range of approaches, institutions can advance broad sustainability solutions as well as mitigate climate change, support diversity, equity and inclusion, and promote economic development through their investment portfolios.

To learn more, visit:
www.morganstanley.com/ impactinvesting

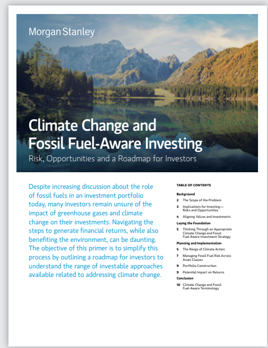
The Morgan Stanley Institute for Sustainable Investing

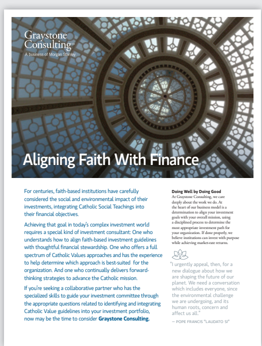
In 2013, Morgan Stanley launched the Institute for Sustainable Investing to accelerate the adoption of sustainable investing, produce informative insights and develop the next generation of sustainable finance leaders. The Institute combines the firm's history of excellence in client service with cutting-edge approaches to sustainable investing.

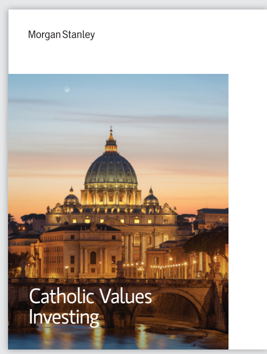
To learn more about these efforts and read the latest insights, visit: www.morganstanley.com/sustainableinvesting

Investing with Impact Publication Examples

We have developed an extensive library of materials to assist institutions in their efforts to better align their investments and organizational structures with their financial and impact goals.







[1] National Association of College and University Business Officers: "Study of Endowments 2019."

[2] Ibid.

[3] Morgan Stanley Institute for Sustainable Investing and Morgan Stanley Investment Management. "Sustainable Signals: Asset Owners See Sustainability as Core to the Future of Investing." May 2020.

[4] Global Sustainable Investment Alliance. "2018 Global Sustainable Investment Review." 2018.

[5] Ibid.

[6] Hale, Jon. "Sustainable Fund Flows in 2019 Smash Previous Records." Morningstar. January 10, 2020. https://www.morningstar.com/articles/961765/sustainable-fund-flows-in-2019-smash-previous-records.

[7] Morgan Stanley Institute for Sustainable Investing. "Sustainable Reality: Sustainable Investing Without Sacrificing Returns." July 2019.

[8] Winner of Money Management Institute and Barron's 2019 Industry Award for Sustainable Investing Solutions. The award honors investment advisory solutions that support awareness and adoption of sustainable and ESG investing.

[9] Lerner, Josh. Bella Research Group, 2019, Diversifying Investments, A Study of Ownership Diversity and Performance in the Asset Management Industry, knightfoundation.org/reports/diversifying-investments-a-study-ofownership-diversity-and-performance-in-the-asset-management-industry/

[10] ibid.

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