Mission-Related Investments to Advance Racial Equity and Justice

Federal Actions to Encourage Private Foundation Participation

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Federal policymakers can take actions that encourage private foundation fiduciaries to invest their assets in ways that advance racial equity and justice. With two recent executive orders to advance racial equity and an unprecedented collection of large spending bills to support underserved communities, the federal government has an opportunity to encourage complementary investments from the private sector, including from private foundations. Although there are limits to how far government can push the philanthropic community, federal actions to unlock philanthropic capital, facilitate partnerships, and build a market for community benefit can help normalize mission-related investments from private foundation endowments, which can ultimately help advance racial equity and racial justice goals.

Introduction

The 84,000 private foundations that filed the Form 990-PF in the United States in 2019 held approximately $880 billion in assets and made approximately $59 billion in grants.[1] Despite having so much wealth, private foundations tend to focus on how to allocate their IRS–required annual 5 percent distribution for charitable purposes as opposed to how they can invest their assets for impact. Even in 2021, when most foundations increased their overall giving, the median payout rate remained at 5 percent.[2] Although many foundations invest their endowment assets to earn maximum returns to

increase the pool of capital from which they can make charitable grants, some foundations go beyond grantmaking to use these investments to help advance their missions.

The billions of dollars invested by private foundations each year have the potential to ameliorate society's most ingrained problems, including racial inequity. The stark racial disparities that exist across almost all dimensions of economic life, education, health, business, and housing stem from historical and contemporary practice and policy. While federal funding is the largest funding source focused on the public good, grants and investments from philanthropy can play an important role in addressing disparities and advancing racial equity and justice. Since the recent racial reckoning, a direct response to years of movement building that accelerated in the wake of George Floyd's murder in 2020,[3] foundation support to advance racial equity and justice has increased (Cyril et al. 2021; Theodos et al. 2021). For example, since 2020, nearly 80,000 grants have been earmarked for racial equity, valuing $16.8 billion,[4] and two recent executive orders signaled an ongoing commitment from the federal government to advance racial equity.[5]

Public policy that regulates private foundations can influence the investment of foundation assets. In this brief, we examine how federal policy can serve as a lever to encourage more private foundations to invest their endowments in a way that advances racial equity and racial justice.

While there are limited data on the practice of making investments from private foundation endowments to achieve a mission—known in the field as mission-related investments (MRIs)—there is an overall push to get private foundations to put more of their assets toward their missions, including advancing racial equity and justice. Accordingly, our research for this policy brief aimed to understand the following questions:

- Are there federal policy barriers that keep private foundation fiduciaries from greater MRIs usage to advance racial equity or racial justice goals?
- If so, what are federal policy actions that could encourage greater use of MRIs to advance racial equity or racial justice goals?

We report on key findings from a literature review, interviews, field consultations, a focus group, and industry conference content. In fall 2022, we conducted a series of semi-structured qualitative interviews with 11 private foundation fiduciaries and their close advisers, including charitable tax lawyers, foundation legal counsel, investment advisers, asset managers, and foundation leadership. Consultations with impact investing field leaders and researchers informed the selection of interviewees and focus group participants, as well as provided valuable background information on the landscape of the field and policy environment. We also hosted a focus group of seven foundation trustees. Content presented and discussed at Mission Investors Exchange conference sessions and meetings also informed this brief.

Background

The Internal Revenue Service (IRS) requires foundations to pay out 5 percent of the fair market value of their assets annually in grants and other eligible expenses, such as foundation operating expenses.[6] Many foundations seek to maximize the financial returns from their endowment to increase the amount they pay out each year.[7] However, some foundations go beyond the 5 percent minimum and invest their endowments to drive positive impact, including addressing race-based disparities.[8] Some do this by screening out investments they find harmful even if they generate large returns, such as those going to private prison systems,[9] firearms,[10] or fossil fuels.[11] Others go a step further and actively seek endowment investment opportunities that match or complement their grantmaking missions, a practice referred to in the foundation and impact investing fields as mission-related investing.[12] MRIs are of growing interest to private foundations, especially those that have demonstrated a commitment to advancing racial equity and justice.[13]

We define an MRI as an investment made by a private foundation from its endowment that relates to its charitable purposes. Because a major purpose of the investment is to gain financial returns, the investment would not qualify as a program-related investment (PRI)—an investment that, according to the IRS, must have a primary purpose of accomplishing the foundation's charitable mission rather than generating income.[14] While PRIs can count toward the foundation's 5 percent payout requirement because of the primacy of its charitable purpose, MRIs, which have a goal of generating income alongside a social or environmental return, would not. MRIs are also subject to state law standards of prudent investing, although the investment's relationship to the charitable purposes of the foundation is one of many factors that can support the prudence of a MRI. Private foundation fiduciaries, entrusted with the direct oversight of a foundation's assets and sworn to act in the interest of the foundation, oversee MRIs and other investments made from the endowment. We define private foundation fiduciaries broadly to include those who influence decisions made by foundation fiduciaries, such as legal and financial advisers, not only those entrusted to oversee a foundation's assets and act in the foundation's interest.

In part because there is no IRS definition for MRI, unlike the legally codified term of PRI, there is limited research on the MRI field. In 2011, the Foundation Center (now part of Candid) published a report with aggregate information on foundations that make MRIs. It showed that 168 private, corporate, and community foundations with $119.2 billion assets under management reported making mission investments. Of the 168 foundations, 28 percent made PRIs and MRIs and 22 percent made MRIs only (Lawrence and Mukai 2011). The field lacks research on how many private foundations make MRIs on an annual basis, the amount of assets under management invested in MRIs, the types of social and environmental goals the foundations intend to advance through MRIs, and other quantifications of the MRI field. Without a legal definition of MRIs and MRI reporting requirements on the IRS Form 990, there is no central platform for the federal government to regularly collect and publish data or reference and track MRI growth. And without a legal definition, foundations can widely interpret what qualifies as a MRI, which poses challenges to documenting trends in the field.

Despite the dearth of data on their prevalence or use, MRIs remain a critical tool for activating private foundation endowment assets for positive impact, including addressing well-documented racial inequities in the United States. Racial inequities are especially evident in terms of financial and wealth disparities, which are striking when looking at rates of homeownership. In 2021, 44 percent of Black households and 49 percent of Latinx households owned their homes compared with 74 percent of white households.[15] There are stark differences across business ownership assets as well. Business survey data from 2020 revealed that Black-owned firms account for just 1 percent of classifiable business revenues, and Latinx-owned firms have only 3 percent of revenues.[16] Disparities across racial and ethnic lines are also evident in education, health, and other areas, which in turn have an impact on financial security and lead to compounding wealth gaps.

Our brief considers the role that MRIs could play in advancing racial equity and justice. Racial equity has been defined as "a process of eliminating racial disparities and improving outcomes for everyone…the intentional and continual practice of changing policies, practices, systems, and structures by prioritizing measurable change in the lives of people of color,"[17] while racial justice is defined as "a vision and transformation of society to eliminate racial hierarchies and advance collective liberation, where Black, Indigenous, Latinx, Asian Americans, Native Hawaiians, and Pacific Islanders, in particular, have the dignity, resources, power, and self-determination to fully thrive."[18]

MRIs to Advance Racial Equity and Justice

Through our interviews and research, we identified five types of MRI strategies taken by private foundations to advance racial equity and justice.

1. Investing in Fund Managers of Color

While we lack representative data, research participants indicated that most private foundations making MRIs to advance racial equity do so by investing in fund managers of color, both established and emerging. A 2022 Knight Foundation report of 35 of the 55 largest private and community foundations found that of the assets managed by US–based firms, only 18 percent go to women and racial or ethnic minority-owned investment firms—a small increase from 17 percent in 2021 (Rosevear 2022).[19]

Investing in managers of color puts decisionmaking power and wealth building in the hands of people of color, and this strategy has attracted interest from some of the largest foundations in the country. For example, in 2017, the Ford Foundation announced a $1 billion commitment to MRIs to improve society and fight injustice, including a focus on investing with diverse fund managers.[20] In 2019, the Kresge Foundation launched the "25% by '25" initiative, a commitment to invest 25 percent of the foundation's asset with firms owned by women and people of color by 2025.[21] Some foundations target investment in emerging or first-time fund managers of color and consider new approaches for completing due diligence and assessing risk for these funds. For example, one foundation interviewee has 10 investments (representing 23 percent of their portfolio) run by fund managers of color.

Researchers have found that high-performing fund managers of color may encounter barriers to capital raising due to racial bias in the investment decisions of asset allocators and systemic disparities in how investors evaluate funds. Additionally, even managers of color who outperform their white counterparts still face barriers to capital raising because of structural racial biases (Lyons-Padilla et al. 2019). Some interviewees revealed that they do not want to set expectations for fund managers of color to invest only in entrepreneurs of color because they see this as limiting and adding to the bias-related challenges fund managers of color already face. Yet some criticize MRI investment strategies that focus solely on investing in fund managers of color and not on the underlying investments, noting that this approach might benefit already well-off fund managers of color instead of increasing capital in underserved communities.

2. Investing in Businesses Led by or Serving Communities of Color

Research participants also indicated that some private foundation fiduciaries advance racial equity goals by investing in businesses owned by or directly serving communities of color. Research has documented the success of companies with diverse business leadership.[22] For example, across all asset classes, the adviser Veris Wealth Partners—which serves individuals, families, and private foundations—looks for people of color and women on the board, in management, and in the workplace; entrepreneurs and owners who are women and people of color; or products and services for women and people of color. Additionally, they target community wealth-building impacts in areas such as quality jobs, education, health and wellness, and access to fair and affordable capital (Veris Wealth Partners 2022), indicating that they also look at how these businesses serve communities of color.

Our research also revealed how private foundations combine different MRI approaches. For example, one interviewee noted that they invest in a fund owned by people of color where at least 50 percent of investments must go to Black-, Latinx-, or Indigenous-led companies, demonstrating that investing in fund managers of color does not preclude a second layer of wealth building in communities of color. Additionally, the Mary Reynolds Babcock Foundation made an investment from its endowment in the Impact America Fund,[23] founded by a Black immigrant woman, which invests in "companies built for and by people in marginalized communities."[24] These examples combine the first approach of investing in managers of color with the second: investing in businesses led by or serving communities of color.

In some cases, a focus on investing in business owners of color could benefit owners who are already well-resourced and connected at the expense of business owners of color who do not have the same level of resources. Businesses that cannot provide the returns targeted in foundations' investment strategies may be overlooked, or business owners without much wealth might agree to investment terms that are not ultimately in their best long-term interest.

3. Investing in Public Companies with Racial Equity Commitments

Private foundations also work with mission-driven financial advisers and investors that evaluate public companies' commitments to racial equity. For example, an adviser interviewee shared that they assess

whether a company has an authentic commitment to racial issues internally by asking questions about B corporation status, a third-party designation signifying that the company has high standards related to their social and environmental performance, governance accountability, and performance transparency[25]; whether they have pay equity policies; and intentionality around how the company handles issues of race internally.

Beyond due diligence, some private foundation advisers also lead shareholder advocacy campaigns to promote company policies that could improve outcomes for communities and workers of color. For example, one private foundation investment adviser shared that after getting a Fortune 500 company to agree to conduct a racial equity audit, they continued working with them to ensure that the audit included contract workers, who were expected to have a different racial makeup than full-time employees. In one instance, shareholder engagement with Discover led the bank to publish a diversity, equity, and inclusion transparency report and, subsequently, set goals to increase Black and Latinx representation at all management levels. Discover also established indicators to advance equity through recruiting, retention, internal mobility, and support of diverse suppliers (Veris Wealth Partners 2022).

While shareholder advocacy can be an effective approach to get public companies to change practices, different levels of commitment to implementing these policies can lead to uneven results in terms of addressing racial inequity and injustice.

4. Investment in Entities with Racial Equity Missions

Another option for private foundations seeking to advance racial equity goals through MRIs is investing in intermediaries, such as financial institutions and funds, that have racial equity missions and provide loans to entrepreneurs of color or invest in businesses located in communities of color.

Supported by their members, including private foundations, Living Cities' Blended Catalyst Fund offers loans, credit, and below-market-rate equity investments to funds[26] such as Founders First Capital Partners and 1863 Venture Fund I, LP (Living Cities 2022). Founders First is a San Diego–based accelerator and investment firm, co-founded and led by a Black woman, that offers a revenue-based financing product developed to serve founders of color without many assets who have faced and continue to face barriers to accumulating generational wealth.[27] 1863 Venture Fund I invests in portfolio companies that are all owned by Black or African American entrepreneurs (Living Cities 2022).

Local financial institutions such as community development financial institutions (CDFIs) are another type of intermediary that aggregates and facilitates the equitable flow of capital to communities. The W.K. Kellogg Foundation, which has been working to align a portion of its endowment investing with the foundation's commitment to racial equity, has deployed $152 million in investments from their MRI portfolio over the last decade, including into CDFIs, as of 2019. For example, recognizing that students of color tend to have more debt than their white counterparts and are also more likely to default, Kellogg invested in Sixup Lending LLC—a certified CDFI with a mission to provide fair, responsible financing to underbanked, underfunded students.[28]

Research has found disparities in funding to CDFIs based on the race of their leadership. For example, from 2014 to 2017, the assets of CDFIs led by people of color grew by $682.5 million compared with a $21.8 billion growth in assets for CDFIs with white leadership.[29] Some funds, such as the Black Renaissance Fund, have sought to address this gap by making direct investments to Black-led CDFIs working in Black communities.[30] While CDFIs can play a critical role in providing more flexible lending solutions, communities will need to ensure that they are getting favorable terms, whether from a CDFI or a Wall Street bank.

5. Investing for Community Benefit

Finally, MRIs can advance racial equity through direct investments in the assets of communities of color to promote positive outcomes for long-time community members or community-serving institutions. Without representative data, it is difficult to determine how common this type of investing is. Interviewees suggested that this type of mission-related investing is not the norm but indicated interest in growing this field.

For example, an investment for community benefit could look like a foundation making place-based MRIs as anchor investors in properties that give communities an ownership stake in developments. This could help incentivize developers to structure the financing of their projects in ways that create windows for local small-dollar investment (Theodos and Edmonds 2020). Alternately, foundations could invest in anchor institutions, such as health centers that serve the local population. One such example is a private foundation MRI made in a joint venture with a DC–based health center that was looking to expand its health services in Ward 8, where people of color represent more than 95 percent of the population[31] (Theodos, Marx, and Nunna 2023).

Other foundations approach investment for community benefit by investing in affordable housing funds. For example, the Weingart Foundation invested $5 million of its $936 million endowment in SDS Capital Group's Supportive Housing Fund.[32] When investing in efforts to help vulnerable people, there is a growing call to listen to the perspectives of people with lived experiences, along with seeking to address some of the underlying causes, such as structural racism, that contribute to the need for these solutions in the first place.[33]

Public Policy Environment for MRIs

In seeking to understand what federal policy actions could help advance private foundation MRIs, we explore public policies that private foundations might view as affecting their ability to make MRIs. As noted above, the federal government does not have a legal definition for mission-related investing. Because of this, no policies explicitly promote or prohibit MRIs. However, there are policies at the federal and state levels that may influence how private foundations make investment decisions.

Jeopardizing Investments

Absent a legal definition of mission-related investing, private foundations can look to IRS prohibitions on making jeopardizing investments to understand permissible endowment investing practices. The IRS notes that "[j]eopardizing investments generally are investments that show a lack of reasonable business care and prudence in providing for the long- and short-term financial needs of the foundation for it to carry out its exempt function. No single factor determines a jeopardizing investment."[34]

Section 4944(a)(1) of the IRS tax code imposes an excise tax on a private foundation that invests "any amount in such a manner as to jeopardize the carrying out of any of its exempt purposes," while Internal Revenue Code Section 4944(a)(2) imposes an excise tax on the participation of any foundation manager in the making of such an investment, knowing that the investment will jeopardize the carrying out of any of the foundation's exempt purposes.[35]

Foundation managers can be held personally liable and taxed up to a maximum of $10,000, or 10 percent of the jeopardizing investment, if they "knowingly, willfully, and without reasonable cause" participated in making the investment.[36] Therefore, private foundation managers must pay close attention to high-risk activities noted by the IRS, such as trading securities on margin, trading in commodities futures, and short selling. Investments that advance a foundation's mission for potentially less-than-maximum returns, however, are not explicitly cited as examples of jeopardizing investments.

Investments Made for Charitable Purposes: IRS Notice 2015-62

To clarify whether investing for financial and charitable returns constitutes a jeopardizing investment, the Treasury Department issued guidance in 2015 on how private foundations can avoid jeopardizing investments when making "investments for a charitable purpose,"[37] the term used in place of what practitioners refer to as MRIs. IRS Notice 2015-62 (box 1) provides guidance to the Internal Revenue Code (IRC) Section 4944 for private foundations that make "investments for charitable purposes" (box 2) but are not program-related investments (PRIs). The guidance also cited standards of exercising "ordinary business care and prudence" to align with investment standards under state laws.[38]

BOX 1

IRS Notice 2015-62

IRS Notice 2015-62 states:

> When exercising ordinary business care and prudence in deciding whether to make an investment, foundation managers may consider all relevant facts and circumstances, including the relationship between a particular investment and the foundation's charitable purposes. Foundation managers are not required to select only investments that offer the highest rates of return, the lowest risks, or the greatest liquidity so long as the foundation managers exercise the requisite ordinary business care and prudence under the facts and circumstances prevailing at the time of the investment in making investment decisions that support, and do not jeopardize, the furtherance of the private foundation's charitable purposes. For example, a private foundation will not be subject to tax under section 4944 if foundation managers who have exercised ordinary business care and prudence make an investment that furthers the foundation's charitable purposes at an expected rate of return that is less than what the foundation might obtain from an investment that is unrelated to its charitable purposes.

The notice also states, "Further, the determination of whether an investment jeopardizes the carrying out of the foundation's exempt purposes is made on an investment-by-investment basis, in each case taking into account the foundation's entire portfolio."

Many saw the 2015 guidance as a clear step forward in bringing attention to the idea that foundation investments can exist not solely to sustain and grow a foundation's endowment but also to advance a charitable mission. The guidance makes clear that a private foundation is "not subject to jeopardizing investment excise tax if investment that furthers charitable purpose has a lower return,"[39] and it deconstructed "silos between mission and investment functions" (Buteau 2016). Furthermore, the US Impact Investing Alliance highlighted that the guidance "recognizes that foundations can reasonably accept some level of financial trade-off when making MRIs." The Alliance noted that the guidance asks private foundations to consider individual investments in the context of the institution's whole portfolio and charitable purpose, in alignment with state regulations. It also provides comfort to boards and investment committees approving MRI strategies (US Impact Investing Alliance 2022).

BOX 2

IRS Definition of Charitable Purpose

The Treasury first defined the term “charitable purpose” in a 1943 regulation stating, “Corporations organized and operated exclusively for charitable purposes comprise, in general, organizations for the relief of the poor” (Internal Revenue Service 1980, p. 3). A 1959 Treasury regulation updated the definition to “relief of the poor and distressed or of the underprivileged; advancement of religion; advancement of education or science; erection or maintenance of public buildings, monuments, or works; lessening of the burdens of government; and promotion of social welfare by organization designed to accomplish any of the above purposes, or (i) to lessen neighborhood tensions; (ii) to eliminate prejudice and discrimination; (iii) to defend human and civil rights secured by law; or (iv) to combat community deterioration and juvenile delinquency” (Internal Revenue Service 1980, p. 4). The Treasury still uses this definition of charitable purpose today.

Although the definition of charitable purpose has not changed since 1959, revenue rulings have shaped the concept of charity over time. For example, 1968 revenue rulings indicated that “promoting lessening of racial and religious prejudice in the fields of housing and public accommodations” and “promoting racial integration in neighborhoods” were charitable purposes as the promotion of social welfare (Internal Revenue Service 1980, p. 17).

Uniform Prudent Management of Institutional Funds

Cited in the 2015 IRS guidance, state standards on the prudent investment of institutional funds play a critical role in determining whether a private foundation has properly managed and invested its assets.[40] At the state level, private foundation fiduciaries—those entrusted with the direct oversight of a foundation’s assets and sworn to act in the interest of the foundation—are governed by state trust and nonprofits corporation law, namely through the Uniform Prudent Management of Institutional Funds Act (UPMIFA) and the Uniform Prudent Investor Act (UPIA) (box 3). UPMIFA requires that fiduciaries make investment decisions by looking at the institution’s overall investments and considering the risk and return in relation to the overall needs of the full portfolio and investment strategy.[41]

BOX 3

Uniform Prudent Management of Institutional Funds Act and Uniform Prudent Investor Act

At the state level, the Uniform Prudent Management of Institutional Funds Act (UPMIFA), which governs charitable corporations, and the Uniform Prudent Investor Act (UPIA), which governs charitable trusts, enshrine the legal duties of trustees: duty of care, duty of loyalty, and for some states, duty of obedience. Duty of care refers to the steps a trustee would take to stay informed and act in good faith like "an ordinarily prudent person." Duty of loyalty requires that a trustee act in the best interest of the organization. And duty of obedience involves following what the institution's organizational documents state as their purpose.[42]

UPMIFA helps ensure charitable corporations spend their endowment funds prudently through the duties listed above and enumerates standards for spending policies. The key factors include (1) the relationship between the asset and the organization's mission[43]; (2) whether the endowment fund intends to exist in perpetuity or for a limited life span; (3) what the institution intends to achieve with its endowment; (4) the economic conditions of the time period at hand; (5) considerations of how an environment of inflation or deflation could affect spending; (6) the long-term effects on the total return of the endowment and what this means for long-term spending; (7) what additional resources beyond endowed funds the organization might have; and (8) the asset allocation outlined in the investment policy.[44]

UPIA helps charitable trusts "act in good faith to manage investments with the care that an ordinary prudent person in a similar position would exercise under similar circumstances, but not as a mindless copycat."[45]

UPMIFA allows fiduciaries to factor in the ways an investment might help advance the institution's mission as opposed to only considering financial outcomes.[46] This means that, among other duties such as complying with tax requirements and incurring only reasonable and appropriate costs, fiduciaries could consider how an asset relates to the institution's charitable purpose. In fact, the prudent investor standard encourages fiduciaries to take new risk management information into consideration, such as research showing the benefits of making investment decisions using environmental, social, and governance (ESG) factors.[47] This flexibility makes it possible for private foundation fiduciaries to engage in more mission-related investing.

For private foundations looking for additional reassurance, according to an interviewee, a private foundation may sometimes use its donor agreement to relax UPMIFA restrictions by stating the donor's intent. For example, a donor may write in their gift agreement that they would like the foundation to make investments related to their mission. The foundation can then fulfill the donor's intent without violating UPMIFA restrictions because the gift agreement supersedes any perceived UPMIFA restrictions.[48] However, using this approach to clarify intentions for funds is challenging for older, larger foundations where the authorizing party of the donor agreement is deceased. Therefore, auditors recommend working with living donors to create explicit agreements when possible.[49]

Private Pension Fund Investments

While the previous three policies provide specific guidance on private foundation investment practices, this section examines the volatility around guidelines for private pension fund investments, which are regulated by the US Department of Labor. Although these regulations have no direct bearing on private foundations, the perceived permissibility of private pension investing for impact can play somewhat of a role in influencing private foundation investment decisions. Since the US Department of Labor under President Bill Clinton issued an interpretative bulletin in 1994 on the permissibility of private pension funds making "economically targeted investments," or investments that generate economic benefits alongside investment return,[50] each subsequent presidential administration to date has rescinded, reinstated, or updated guidance on this topic on party lines. While Democratic administrations have upheld the permissibility of this type of investing,[51] Republican administrations have challenged the prudence of these investments.[52] In the nearly three decades since the first interpretive bulletin, the language has moved from a focus on "economically targeted investments" to the practice of "considering environmental, social, governance factors in plan investments."[53]

A recent Market Watch article notes, "To date, relatively few 401(k) plans offer ESG investments, in part because of regulatory swings from one administration to the next."[54] Much of the debate has centered on whether private pension fiduciaries can maximize financial returns while also taking ESG factors into consideration. Many argue that private pension funds can achieve portfolio optimization while investing with a purpose (Schor 2020; Woll 2021). And in November 2022, the Department of Labor finalized a rule explicitly permitting retirement plan fiduciaries to consider climate change and other ESG factors in their investment decisionmaking.

Although all fiduciaries are expected to uphold certain standards of prudence when investing funds, there are key differences between prudence rules governing private pension funds—the focus of recent guidance—and private foundations. While pension plan trustees are not permitted to sacrifice financial return,[55] the federal guidance and state laws, which have not changed from one administration to another, have made clear that private foundations can take nonfinancial considerations into account.

This distinction is important because ESG investing in pension plans has drawn some controversy. Some criticize ESG for making investments that are not actually environmentally and socially friendly,[56] while others have criticized it as part of a broader pushback against environmental and social efforts to limit investment in certain industries, such as fossil fuels and firearms. [57]

Anti-Discrimination Law

The outcomes of anti-discrimination cases that did not yield favorable rulings, as well as uncertainty around the outcomes of pending cases, loom over efforts to advance racial equity. These cases rest on Section 1981 of the Civil Rights Act, which prohibits discrimination on the basis of race in contracting.[58] In 2023, the Supreme Court is poised to rule on the permissibility of race-conscious admissions at Harvard University and the University of North Carolina,[59] with some justices encouraging "race-neutral" ways to promote diversity.[60] The court's ruling may have ripple effects on other policies. For

example, some cities are bracing for future legal challenges to race-based grantmaking, which explicitly uses race as part of a scoring matrix.[61] While several legal interviewees raise anti-discrimination law as a potential barrier to MRIs' racial equity and justice goals, a group of trustee interviewees did not view this as a barrier.

Options for Federal Policy Action

In this section, building on the discussion of the policy environment, we present three ways federal policymakers can encourage the use of MRIs. Although there are limits to what government alone can do to further the use of MRIs for racial equity, actions to bring along stakeholders that are risk averse but willing to consider how they might use their capital differently can be helpful.

1. Unlock Philanthropic Capital

To increase the amount of private foundation investment targeting mission-related outcomes, private foundation fiduciaries should not face federal policy barriers that would preclude this activity. In our research, we did not uncover any clear barriers from the Treasury and IRS that might limit private foundations from investing their endowments in this way. As detailed in the previous section on the public policy environment, IRS Notice 2015-62 intended to clear up any confusion about whether private foundations might face a jeopardizing tax when making investments to further its charitable purpose. This federal guidance, coupled with reassuring state-level UPMIFA and UPIA laws, should remove any lingering doubt about whether private foundations can prudently invest their endowment resources to drive financial returns alongside a mission-related goal.

To advance foundation mission investing, the Treasury can appoint a committee of private foundation leaders and impact investing field leaders from a variety of industries to help the Treasury and IRS develop future guidance and policies that best serve the field. Here are two possible directions to consider:

- ***Additional bulletin.*** Publish a follow-up bulletin to IRS Notice 2015-62 to clarify how closely the investment should align with the charitable mission. It could include a few examples of what mission-related investing could look like, including an example of an MRI that generated significant financial returns and how private foundations account for prudence when making these investments. This could provide additional reassurance but stop short of creating a formal definition for MRIs.

- ***New definition.*** Codify a formal definition for MRIs, just as the IRS does for PRIs. This definition should err on the broader side and not create an overly narrow understanding of what is permissible. This could remove confusion about what constitutes a MRI, bring some definitional clarity to a field in which private foundations currently take a variety of approaches to investing their endowments for mission and financial returns, and avoid having an unintended chilling effect on the field's growth. Like the additional bulletin, this new definition could have

accompanying examples to show what MRIs can look like. In addition to developing a codified IRS definition, here are two additional steps the federal government could consider:

- ***990 reporting.*** Require private foundations to report MRIs on the Form 990-PF, just as they are required to do for PRIs, so that researchers can easily track trends in MRIs. Data demonstrating to the private foundation community that MRI usage is not only legal but also a growing trend among their peers could potentially encourage further MRI activity.

- ***Demographics of fund managers reporting.*** Require private foundations to report on the race and gender demographics of their fund managers so researchers can measure progress toward diversifying the managers used by private foundations. Data on fund manager demographics, especially when compared with overall demographics of the United States, could potentially encourage more private foundations to diversify the fund managers they use to invest their charitable assets.

2. Facilitate Partnerships

Federal officials are uniquely positioned to use their offices as bully pulpits to share information that can help normalize the use of MRIs to advance racial equity. Building opportunities for knowledge sharing and public-philanthropic co-investing can happen through one-on-one meetings, communities of practice, and convenings. Between the Infrastructure Investment and Jobs Act and the Inflation Reduction Act, the federal government is preparing to deploy billions of dollars with community benefit requirements, and there are many near-term opportunities for private foundations to leverage their mission-related investments with public resources.[62] A few options for building relationships include:

- ***Racial equity public-philanthropic partnership communities of practice.*** In partnership with nonprofits or foundations, federal agencies could co-host issue-specific communities of practice to build relationships and exchange information between private foundations and federal agencies about priorities and co-investment opportunities to advance racial equity goals. For example, the US Department of the Treasury's State Small Business Credit Initiative, which sets aside $10 billion for underserved entrepreneurs of color, could benefit from identifying foundations supporting small businesses through MRIs.

- ***Showcase on MRIs for racial equity and justice.*** A White House office or federal agency could partner with nonprofit and foundation partners to host a showcase on MRIs that advance racial equity and justice. For example, modeled on the My Brother's Keeper What Works Showcase,[63] the event could spotlight approaches to and processes of sourcing, conducting due diligence, and measurement that foundations currently use when making racial equity–focused MRIs. It could also feature approaches to solidifying racial equity commitments within foundations' investment portfolios. A publicly available report on these approaches could inspire similar investments by private foundations.

- ***Convening on risk management and due diligence.*** The Securities and Exchange Commission, which has already acknowledged the ways due diligence practices can discriminate against diverse managers (US Securities and Exchange Commission 2021), could host a convening on risk management and due diligence to bring further attention to this important issue. The more the Securities and Exchange Commission can point to examples of alternative due diligence, the more it can elevate examples of inherent bias in the current system and reduce the need for extensive legal arguments to overcome risk-averse tendencies. The convening could highlight approaches to assessing risk for investments among first-time managers of color, such as considering alternatives to track records and assets under management. This approach would elevate the work that private sector and philanthropic institutions have already started in this vein, such as commitments to Due Diligence 2.0,[64] which urges assessors to consider proof of capabilities and skillsets of investment team members outside of their track records.[65] Part of the convening could feature legal and financial service providers with track records of helping shift private foundation endowment investments to MRIs to share approaches to assessing risk and conducting due diligence for MRIs focused on racial equity and justice.

3. Build the Market for Community Benefit

Our research suggests that most racial equity MRIs do not heavily focus on outcomes at the community level or engage communities in decisionmaking, despite the potential community benefit from these strategies. To date, most MRIs in support of racial equity and justice goals have been investments in fund managers of color. In order to support MRIs in moving beyond this approach and making investments that position capital closer to communities, the federal government can play a role in building the market for investing for community benefits. Foundations can think more boldly and innovatively about how to deploy their endowment capital for both financial returns and positive outcomes at the community level.

This approach could involve the use of federal subsidies, guarantees, and tax credits to support local wealth-building opportunities and help bring investors like private foundations to the table or to encourage MRI co-investment with public funds from the Infrastructure Investment and Jobs Act. Local wealth-building opportunities that target communities of color experiencing wealth disparities can help advance racial equity and justice. Two potential approaches include:

- ***Provide concessionary capital or federal tax credits for investing in locally owned entities.*** The federal government could provide incentives and support for blended capital vehicles that aggregate community-level investments that support wealth building in communities of color at a scale large enough for private foundation MRIs. It could directly capitalize investment vehicles that support local equity ownership opportunities with concessionary funding, such as guarantees or grants, or could provide tax credits for investing in funds or properties that offer residents in disinvested communities partial equity ownership.

- ***Offer local equity tax credits for residents.*** The federal government could supply states with funding to provide local equity tax credits to residents who invest equity locally into opportunities, such as pooled investments in local mixed-use developments, investments in properties on community land trusts, or investments in local businesses that serve the community. Recipients of local equity tax credits could be tracked at the state level and reported up to the federal level. The federal government could then share these project data with foundations looking to make MRIs alongside projects supported by residents who would benefit from the local equity tax credit.

Another example could be the federal government signaling the importance of private foundation endowments investing for community benefit:

- ***Require, incentivize, or support community benefit analysis of private foundation endowments.*** The IRS could require or incentivize private foundations to engage in a community benefit analysis of their endowments to signal the value of using philanthropic capital to drive impact. Private foundations can draw on existing impact assessment tools such as the Capital for Community Score[66] or Community Reinvestment Act reporting requirements that look at the share of loans going to low- and moderate-income census tracts. Asking foundations to assess the nonfinancial returns of their investments could push private foundation fiduciaries to view their endowments as another financial tool beyond grantmaking to achieve impact.

Conclusion and Next Steps

In this brief, we proposed three steps the federal government could take to advance private foundation endowment investments toward racial equity and justice goals in the context of the current state of mission-related investing and the policy environment. By unlocking philanthropic capital and listening to the needs of the field, facilitating public-philanthropic partnerships, and building a market for investing in community benefit, the federal government can play a substantial role in growing this field.

Alongside these federal actions, field leaders should address nonpolicy barriers that hold back private foundation mission-related investing. For example, participants noted the struggle to determine whether the programmatic or investment side of the foundation would source potential MRIs and how to make decisions about balancing the need for financial returns with impact goals, combatting systemic bias against investments in fund managers of color, and establishing an acceptable level of risk in MRIs. They also identified foundation boards, investment advisers, and investment committees as either hindrances to or helpful advocates for MRIs. Interviewees noted that some compensation structures can disincentivize investments that do not produce the highest possible financial return. The final set of barriers relates more broadly to the growing nature of the MRI field. These include a need for additional education that connects foundations to peers engaging in MRIs, better evaluation methods for nonfinancial risks and improved metrics for assessing progress on advancing racial equity, and more transparency about how private foundations invest their endowments.

Together, the federal government, private foundations, and impact investing field leaders and stakeholders all have an opportunity to take steps toward prioritizing both financial returns and social impact and encouraging investments to support the critical goals of advancing racial equity and justice.

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