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Profiting From Our Pain: Privileged Access to Social Impact Investing

Cary Martin Shelby*

Social impacting investing has become the latest trend to permeate the financial markets. With massive anticipated funding gaps for sustainable development goals, and a millennial-driven thirst for doing good while doing well, this trend is likely to continue in the coming decades. This burgeoning industry is poised to experience yet an additional boost, since it provides an alternative mechanism for private actors to "profit from our pain," particularly in the wake of the COVID-19 pandemic and the Black Lives Matter movement.

As to be expected, the law has not sufficiently adapted to this new wave of innovation. Scholars have thus focused on how social impact investing should be measured and disclosed. However, they have paid limited attention to whether federal securities laws' antiquated distinctions between public and private indicators—or rather its public-private divide—contributes to the harms that poorly overseen social impact investments can cause. This Article seeks to fill this scholarly gap by exploring how this public-private divide gives rise to the possibility that social impact investing will lead to exploitation. This divide permits regulatory loopholes where social impact investors can obscure information about potential negative externalities flowing from their investments. It further allows elite investors to exclusively profit from community pain.

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These loopholes are troubling because social impact investing has the highest potential for impact along the continuum of socially conscious strategies. However, due to the need for regulatory flexibilities, such as the power to invest in illiquid assets, most social impact investors operate as exempt entities. Retail investors, who encompass all members of the general public, are restricted from accessing these privately held investment vehicles due to investor protection concerns. Restricting investors in this manner is a primary indicator of privateness under federal securities laws. Affected community members, who are the targeted beneficiaries of these schemes, are thus excluded as investors. This exclusion also limits transparency, yet an additional indicator of privateness, which would enable the general public as well as policy makers to make assessments about the extent to which these schemes are maximizing net social welfare. This is particularly problematic given the potential for social impact investments to generate unaccounted for negative externalities, such as when seemingly clean energy technologies inadvertently destroy surrounding environments or habitats. Solely relying on privately ordered solutions can leave costly loopholes given that they are completely voluntary and lack standardization.

Innovative regulatory solutions that reconceptualize this public-private divide may best address potential harms of social impact investments. This Article proposes to combine existing indicators of "publicness" and "privateness" while perhaps creating new measures. Codified in an entirely new series of exemptions entitled the "Social Impact Exemptions" that would appear under the Securities Act of 1933 and the Investment Company Act of 1940, these exemptions would effectively recalibrate existing rules related to retail investor access and disclosure, while possibly creating new frameworks for accountability and management structure.

INTRODUCTION

Profiting from our pain is not a new phenomenon. The commodification of marginalization has taken many forms due to the increasing reliance on private investment as a response to an assortment of injustices.[1] Proponents of this approach have argued that it helps to eradicate bureaucratic inefficiencies and budgetary constraints connected to government oversight.[2] Even with these proffered benefits, this approach regularly leads to deleterious harms for its targeted communities. These harms often result from the limited oversight and accountability mechanisms within the laws that govern these transactions, which enable private actors to create and obscure such harms for a profit.

The plentiful examples of private actors profiting from our pain, while creating even more pain, are deeply troubling. Gentrification has led to an insidious history of forcibly displacing communities of color that have long suffered from poverty and discrimination, for the sake of creating highly

1. *See* Etienne C. Toussaint, *Dismantling the Master's House: Toward a Justice-Based Theory of Community Economic Development*, 53 U. MICH. J.L. REFORM 337, 341 (2019) ("Yet, legal scholars have long noted the intersectionality of both approaches; arguing, for example, that the social justice mission of the Civil Rights Movement of the 1950s and 1960s— in many ways carried on by today's movement for [B]lack lives—is inextricably linked to the economic justice of marginalized communities."); Nancy Koehn, *The Time Is Right for Creative Capitalism*, HARV. BUS. SCH. WORKING KNOWLEDGE (Aug. 20, 2008), https://hbswk.hbs.edu/item/the-time-is-right-for-creative-capitalism [https://perma.cc/LH4K-NVV4] ("According to [Bill] Gates, creative capitalism is 'an approach where governments, businesses, and nonprofits work together to stretch the reach of market forces so that more people can make a profit, or gain recognition, doing work that eases the world's inequities.'").

2. John B. Goodman & Gary W. Loveman, *Does Privatization Serve the Public Interest?*, HARV. BUS. REV., Nov.–Dec. 1991, at 26, 26 ("According to privatization's supporters, this shift from public to private management is so profound that it will produce a panoply of significant improvements: boosting the efficiency and quality of remaining government activities, reducing taxes, and shrinking the size of government. In the functions that are privatized, they argue, the profit-seeking behavior of new, private sector managers will undoubtedly lead to cost cutting and greater attention to customer satisfaction.").

lucrative development opportunities for wealthy or institutional stakeholders.[3] Similarly, the privatization of social services such as foster care, prisons, and even Medicaid has led to devastating harms that are difficult to fully quantify.[4] With respect to foster care in particular, one investigation revealed "that children in the care of private companies, such as the MENTOR Network, based in Massachusetts and operating in approximately 26 states, are plagued by shortcuts taken by these companies to increase profit."[5] These shortcuts all served to inflict additional layers of abuse and trauma for this already vulnerable population.[6] Vulture funds, where wealthy and institutional investors purchase the debt of distressed economies at discounted prices, often implement stringent austerity measures to ensure repayment.[7] These austerity measures can cause great harm to affected communities in the form of reduced funding for public education,

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3. Emily Chong, *Examining the Negative Impacts of Gentrification*, GEO. J.L. & PUB. POL'Y BLOG (Sept. 17, 2017), https://www.law.georgetown.edu/poverty-journal/blog/examining-the-negative-impacts-of-gentrification/ [https://perma.cc/7S75-QEEH] (summarizing the ill-effects of gentrification such as the displacement of entire communities, "through exponentially increasing property prices, coercion, or buyouts").

4. *See, e.g.*, Aram Roston & Jeremy Singer-Vine, *Senate Finds 86 Children Died in Care of Giant For-Profit Foster Care Firm, Citing BuzzFeed News*, BUZZFEED (Oct. 18, 2017), https://www.buzzfeednews.com/article/aramroston/senate-finds-86-children-died-in-care-of-giant-for-profit [https://perma.cc/LFQ6-X8JJ]; Toussaint, *supra* note 1, at 395 ("[O]ur current prison industrial complex is in fact a new system of social control designed to subjugate marginalized black communities, not merely a manifestation of wayward urban residents in need of 'tough love.'"); IN THE PUB. INT., HOW PRIVATIZATION INCREASES INEQUALITY 31 (2016), https://www.inthepublicinterest.org/wp-content/uploads/InthePublicInterest_InequalityReport_Sept2016.pdf [https://perma.cc/65UK-B2FN] ("Instead of administering the [Medicaid] program themselves, some states have contracted with private managed-care organizations (MCOs), which are typically private insurance companies, and pay a set amount per member per month to the MCOs based on the projected cost of services that Medicaid recipients will require that year.").

5. Jessalyn Schwartz, *Youth in Privatized Foster Care: What You as an Advocate Need to Know*, ABA (Oct. 30, 2017), https://www.americanbar.org/groups/litigation/committees/childrens-rights/practice/2017/youth-privatized-foster-care-what-you-as-advocate-need-to-know/ [https://perma.cc/F2QJ-5T4A].

6. *See id.* This population is frequently exploited for private gain. For instance, a family of five orphaned children was infamously exploited by a former reality show called *Extreme Makeover*, where a family was rewarded with a brand-new mansion as contestants of this show, after agreeing to care for these five children whose parents had tragically died. *See* Higgins v. Superior Ct. of Los Angeles Cnty., 45 Cal. Rptr. 3d 293, 296–99 (Cal. Ct. App. 2006). However, within weeks of *Extreme Makeover* constructing this mansion and airing its accompanying episode, the host family removed the orphaned children from their new mansion. *Id.* They were able to keep the mansion despite no longer caring for the children, while *Extreme Makeover* earned millions of dollars in advertising revenue from airing (and re-airing) this particular episode. *Id.* The orphaned children received little to no recourse due to the unconscionable contract that they had unknowingly signed. *Id.* at 302–06.

7. *See, e.g.*, Tom Hals, *Detroit Draws Attention from Hedge Fund Investors Looking to Profit Off City's Debt, Possible Bankruptcy*, REUTERS (July 8, 2013), http://www.huffingtonpost.com/2013/05/08/detroit-investors-hedge-funds-bankruptcy-debt_n_3234577.html [https://perma.cc/E8M2-CJDL]; Matt Wirz, *Big Hedge Funds Roll Dice on Puerto Rico Debt*, WALL ST. J. (Apr. 9, 2014), http://www.wsj.com/articles/SB10001424052702303873604579491992862363698 [https://perma.cc/C9VR-EKFD].

medical care, public pension payments, and other government-funded services.[8] Yet the law that regulates these funds has categorized them as exempt entities, making it exceedingly difficult to assess the full magnitude of these harms.[9]

The focal point of this Article, social impact investing, raises additional possibilities for elite investors to exploit disadvantaged groups. Definitionally, social impact investments seek to positively impact the environment or society at large, while simultaneously yielding a return for underlying investors.[10] For example, social impact investors are increasingly allocating to companies that produce innovations related to improving educational outcomes for K-12 students.[11] They often seek to provide nontraditional schooling options or emerging technologies that improve students' learning experiences.[12] However, privately developed solutions that receive limited community input can generate negative externalities in the form of increased inequalities and ineffective learning outcomes.[13] As one source noted, "an edtech company that is only selling to more affluent suburban schools, for example, is only exacerbating a gap between wealthy and poor students rather than closing it."[14] Students who

8. *See* Patrick Gillespie, *Hedge Funds Want Puerto Rico to Close Schools*, CNN BUS. (Aug. 4, 2015), http://money.cnn.com/2015/08/04/investing/puerto-rico-hedge-funds-close-schools/ [https://perma.cc/28RK-J738]; *see also* Kate Aronoff, *Hedge Fund-Driven Austerity Could Come Back to Bite the Hedge Funds Driving it in Puerto Rico*, INTERCEPT (Feb. 3, 2018), https://theintercept.com/2018/02/03/puerto-rico-debt-fiscal-plan [https://perma.cc/99T3-F9DY].

9. With respect to contract law jurisprudence, many would argue that it has enabled superior bargaining power with respect to contractual relationships, which has led to a similar phenomenon where wealthy counterparties can exploit the hardships of disadvantaged communities for their economic gain. *See, e.g.*, *Higgins*, 45 Cal. Rptr. 3d at 296–99; Schwartz, *supra* note 6 and accompanying text.

10. *See* Sarah Dadush, *Regulating Social Finance: Can Social Stock Exchanges Meet the Challenge*, 37 U. PA. J. INT'L L. 139, 143 (2015) ("With social finance, impact investors put their capital behind ventures (known as 'social businesses') that profitably cater to underserved populations. These businesses provide access to critical goods and services, such as financial services, healthcare, affordable housing and quality employment to the economically and socially disadvantaged—people excluded from ordinary markets because conventional businesses view them as being too costly or risky to service or employ."); *see also infra* Part II.A (deconstructing core characteristics of social impact investment schemes).

11. ASHWIN ASSOMULL, SUDEEP LAAD & AAKASH BUDHIRAJA, L.E.K. CONSULTING, IMPACT INVESTING IN EDUCATION: THE OPPORTUNITY TO MAKE A DIFFERENCE, (2020), https://www.lek.com/sites/default/files/PDFs/Impact-Investing-Education-Final_v2.pdf [https://perma.cc/9PMQ-XLD7].

12. *See, e.g.*, Alex Konrad, *Why the VCs at Reach Capital Are Doubling Down on Education with a New $82 Million Fund*, FORBES (July 30, 2018), https://www.forbes.com/sites/alexkonrad/2018/07/30/reach-capital-82-million-fund/?sh=6b6e66c54b38 [https://perma.cc/23K3-DTRC] ("Reach will look to invest in startups working in areas such as student debt repayment and nontraditional schooling on top of its K-12 roots.").

13. *See, e.g.*, Andrew Jack, *Lack of Clear Targets Hinders Impact Investing in Education*, FIN. TIMES (Sept. 24, 2018), https://www.ft.com/content/4f9ad318-786d-11e8-af48-190d103e32a4 [https://perma.cc/P26K-VMV7] ("[S]uch investments risk exacerbating inequalities, cherry-picking the best students and teachers while undermining government provision and leaving the poorest further behind.").

14. Mary Ann Azevedo, *Growth with an Impact: The Rise of VCs Looking to Fund a (Profitable) Cause*, CRUNCHBASE NEWS (Feb. 2, 2018), https://news.crunchbase.com/news/growth-impact-rise-vcs-looking-fund-profitable-cause [https://perma.cc/VQ7D-AT82].

live in distressed communities may be experiencing interconnected needs related to food, shelter, safety, and other necessities—needs which may be poorly understood by outsiders.[15]

Similarly, some sources have found that social impact investors may further increase allocations to charter schools and other private schooling options despite the unresolved debates as to whether these options cause harm to communities that already experience poor access to education.[16] One such study found that "[c]ost-cutting charters . . . offer a narrow curriculum focused on little more than reading and math test prep, inexperienced teachers with high turnover, and 'blended learning' products designed to enrich charter school board members' investment portfolios."[17] Irrespective of this ongoing debate, unaccounted for harms can increase the collective "pain" experienced by communities with already limited economic resources while disincentivizing investment in public education.

Social impact investing can admittedly provide innovative solutions to funding gaps, such as eradicating poverty, reversing climate change, reducing inequality, and other United Nations' global sustainable development goals.[18] However, this Article argues that the federal securities laws' public-private divide creates exploitation opportunities with respect to social impact

15. *See* Jill Barshay, *Impact Funds Pour Money into Ed Tech Businesses*, HECHINGER REP. (Oct. 21, 2019), https://hechingerreport.org/impact-funds-pour-money-into-ed-tech-businesses [https://perma.cc/L4KR-RK5E] ("The problem is that there isn't strong research evidence for the effectiveness of a lot of ed tech. . . . I worry that impact funds will help well-intentioned companies build effective marketing teams to sell ineffective products to schools.").

16. *See, e.g.*, Mark Medema, Opinion, *Charter Schools Are an Opportunity for Impact Investors*, WALL ST. J. (Oct. 27, 2019), https://www.wsj.com/articles/charter-schools-are-an-opportunity-for-impact-investors-11572209068 [https://perma.cc/K3QQ-FY9J] (arguing that charter schools are an "ideal opportunity for impact investing" that can also achieve "better education for America's children").

17. Valerie Strauss, *A Dozen Problems with Charter Schools*, WASH. POST (May 20, 2014), https://www.washingtonpost.com/news/answer-sheet/wp/2014/05/20/a-dozen-problems-with-charter-schools [https://perma.cc/83GE-YK2R].

18. The United Nations has predicted "a need for $3.9 trillion a year between now and 2030 to meet the Sustainable Development Goals. Philanthropy and government funding is not enough to meet this need and will require an additional $2.5 trillion a year to fill the gap." *What Is Impact Investing and Why Should You Care?*, BRIDGESPAN GRP. (Dec. 6, 2018), https://www.bridgespan.org/insights/library/impact-investing/what-is-impact-investing [https://perma.cc/62QY-ZJZD]; RICHARD KOGAN & KATHLEEN BRYANT, CTR. ON BUDGET & POL'Y PRIORITIES, PROGRAM SPENDING OUTSIDE SOCIAL SECURITY AND MEDICARE HISTORICALLY LOW AS A PERCENT OF GDP AND PROJECTED TO FALL FURTHER 1 (2019), https://www.cbpp.org/sites/default/files/atoms/files/2-29-12bud.pdf [https://perma.cc/GW69-F3LZ] (summarizing the Center on Budget and Policy Priorities' predictions that "[t]otal spending on federal programs outside Social Security and Medicare will equal 11.1 percent of GDP in 2019 — below the 40-year average of 11.9 percent — and is projected to decline further over the next ten years, to 9.7 percent of GDP in 2029"); *see Sustainable Development Goals*, UNITED NATIONS, https://www.un.org/sustainabledevelopment/sustainable-development-goals/ [https://perma.cc/B5T8-UZYG] ("The Sustainable Development Goals are the blueprint to achieve a better and more sustainable future for all. They address the global challenges we face, including those related to poverty, inequality, climate change, environmental degradation, peace and justice.").

investments. Publicness in this context implies heightened degrees of access and transparency for entities and offerings regulated by federal securities laws. Privateness entails exemptions from the arduous transparency requirements of these laws due to exclusive access by elite investors. Since social impact investors largely operate as exempt entities, this public-private divide allows elite investors to exclusively profit from community pain while obscuring information about potential negative externalities flowing from these investments.

Neither the public-private divide in securities law nor regulatory issues surrounding social impact investing are new to scholarly discourse, but limited attention has been paid to their interaction. Scholars have previously examined federal securities laws' incoherent notions of publicness in other contexts.[19] Researchers have further identified regulatory issues within the impact investing space, such as the extent to which impact should be measured and the optimal legal entity for effectuating social impact strategies.[20] Nevertheless, this Article

19. *See, e.g.*, Donald C. Langevoort & Robert B. Thompson, *"Publicness" in Contemporary Securities Regulation After the JOBS Act*, 101 GEO. L.J. 337, 339–40 (2013) (analyzing evolving assessment of publicness under the JOBS Act of 2012); *see also* Robert B. Thompson & Donald C. Langevoort, *Redrawing the Public-Private Boundaries in Entrepreneurial Capital Raising*, 98 CORNELL L. REV. 1573, 1578–88 (2013); A.C. Pritchard, *Revisiting "Truth in Securities" Revisited: Abolishing IPOs and Harnessing Private Markets in the Public Good*, 36 SEATTLE U. L. REV. 999, 1001 (2013) (arguing "that the resulting mismatch between the public-private dividing lines under [the Securities and Exchange Acts] means that the transition from private to public will inevitably be awkward, abrupt, and fraught with problems for issuers, investors, and regulators"); Onnig H. Dombalagian, *Principles for Publicness*, 67 FLA. L. REV. 649, 653 (2016) (proposing "reframing" a disclosure and compliance regime for public companies "around three well-worn regulatory principles: (1) suitability, (2) efficiency, and (3) representativeness"); Joan MacLeod Heminway, *Crowdfunding and the Public/Private Divide in U.S. Securities Regulation*, 83 U. CIN. L. REV. 477, 477 (2014) (examining how recent crowd-funding legislation affects the public/private divide under federal securities laws); Elisabeth de Fontenay, *The Deregulation of Private Capital and the Decline of the Public Company*, 68 HASTINGS L.J. 445, 445 (2017) (highlighting how "the new public-private divide [is] centered on its information effects . . . [though] private companies are thriving in part by freeriding on the information contained in public company stock prices and disclosure"). Others have examined the eroding public-private divide resulting from events surrounding the financial crises of 2007–2009, which was uniquely characterized by costly spillover effects from the interconnected failure of notable financial institutions. *See, e.g.*, Hillary A. Sale, *The New "Public" Corporation*, 74 LAW & CONTEMP. PROBS. 137, 137 (2011) (positing that "the failure of the fiduciaries of public corporations to understand their 'publicness' . . . accounts for many of the recent scandals"). Previous works by the author have examined the incoherency of publicness resulting from the patchwork of regulation historically imposed upon the investment fund industry, as well as the blurred line between private investment funds and publicly traded investment banks resulting from shadow banking, systemic risk, and widening regulatory loopholes. *See generally* Cary Martin Shelby, *Are Hedge Funds Still Private? Exploring Publicness in the Face of Incoherency*, 69 SMU L. REV. 405 (2016); Cary Martin Shelby, *Closing the Hedge Fund Loophole: The SEC as the Primary Regulator of Systemic Risk*, 58 B.C. L. REV. 639 (2017).

20. *See, e.g.*, IVY SO & ALINA STASKEVICIUS, MEASURING THE "IMPACT" IN IMPACT INVESTING 11–57 (2015), https://www.hbs.edu/socialenterprise/documents/measuringimpact.pdf [https://perma.cc/D2GL-UWRA] (recognizing the predominant focus on exploring the ways in which impact is measured, while specifically studying the practices and methodologies that a subset of impact investors is utilizing in measuring both social and financial impact); HAUKE HILLEBRANDT & JOHN HALSTEAD, FOUNDERS PLEDGE, IMPACT INVESTING REPORT (2018),

is the first to examine harms resulting from the federal securities laws' public-private divide in the context of the burgeoning social impact investing industry.

Laws that regulate the investment fund industry have effectively created an inverse relationship between impact potential and access to affected community members. Social impact investing has the highest potential for impact along the continuum of socially conscious strategies due to its primary objective of generating positive social or environmental impacts. However, most social impact investors operate as privately held entities, which are exempt from federal securities laws. These exemptions have a rational basis: often social impact investing requires long-term commitments, and accordingly requires additional regulatory flexibilities such as the power to invest in illiquid assets.[21] Yet, retail investors, who encompass all members of the general public, are restricted from accessing private offerings due to investor protection concerns that are rooted in the paternalistic nature of our federal securities laws.[22]

As a result, average investors are generally limited to mutual funds and other registered investment funds that trade in baskets of publicly traded equities, bonds, and cash instruments—which do pursue socially conscious strategies but have limited impact.[23] Mutual funds and exchange-traded funds have increasingly prioritized socially conscious strategies such as socially responsible investing ("SRI") and integrating environment, social, and governance factors ("ESG") in assessing allocations. Funds that implement ESG practices consider "the environmental, social, and governance practices of an investment that may

https://founderspledge.com/research/fp-impact-investing [https://perma.cc/K4DT-BF7E] (evaluating whether social impact investing produces a greater impact than simply donating to charity through philanthropic efforts); Deborah Burand & Anne Tucker, *Legal Literature Review of Social Entrepreneurship and Impact Investing (2007–2017): Doing Good by Doing Business*, 11 WM. & MARY BUS. L. REV. 1, 29 (2019) (positing that many scholars researching within the social enterprise field have heavily focused on choice of legal entity such as benefit corporations and L3Cs); Graeme Kerr, *Investors Warn over Impact Fund 'Greenwashing,'* PRIV. EQUITY INT'L (Nov. 1, 2018), https://www.privateequityinternational.com/investors-warn-impact-fund-greenwashing/ [https://perma.cc/2PR5-QY66] (advising that pension plans and other institutional investors engage in heightened due diligence procedures to protect against "greenwashing," where impact funds magnify or falsify the extent to which they are generating positive societal impacts); Magali A. Delmas & Vanessa Cuerel Burbano, *The Drivers of Greenwashing*, 54 CAL. MGMT. REV. 64, 65 (2011) (developing "a framework that examines the institutional, organizational, and individual drivers of greenwashing [to] then use this framework to develop recommendations for how to decrease firm greenwashing"); Etienne C. Toussaint, *The New Gospel of Wealth: On Social Impact Bonds and the Privatization of Public Good*, 56 HOUS. L. REV. 153 (2018) (examining the limitations of the social impact bond framework in that its design is rooted in neoliberal principles that serve to disregard the integral role of government in promoting the public interest).

21. *See infra* Parts II.B & C (providing an in-depth explanation as to how social impact investing is distinguishable from other socially conscious strategies, as well as why it requires a range of investment flexibilities under federal securities laws).

22. *See infra* Part II.C (summarizing applicable exemptions under federal securities laws which serve to exclude retail investors from a large number of social impact investing schemes).

23. *See infra* Part II.C.

have a material impact on the performance of that investment."[24] However, trading in publicly traded instruments likely produces lower levels of *impact*, since socially neutral investors tend to seize the opportunity to purchase undervalued securities resulting from SRI and ESG activities.[25] If such companies are already generating a return, investors will likely flock to these opportunities irrespective of whether they are employing a socially conscious strategy.[26]

Similar access and disclosure problems can admittedly occur within vehicles that *are* registered under federal securities laws, since affected community members may encounter hurdles in accessing mutual funds (and other registered structures) for reasons that are unrelated to the public-private divide.[27] However, a limited number of affected community members meet the wealth or income thresholds to qualify as investors in exempt social impact vehicles. Dictating who can profit from the commodification of community pain in this manner can also contribute to wealth inequality. Moreover, due to a range of issues related to a pervasive lack of diversity in this industry, targeted community members are even less likely to serve as managers of exempt vehicles than of registered vehicles. While the disclosure obligations of registered mutual funds are limited in terms of protecting outside stakeholder community interests, there is at least some accountability provided through their arduous registration requirements.[28] By contrast, exempt entities are empowered to significantly restrict disclosures to their underlying investors as well as to the general public.

This increased opacity amplifies the extent to which social impact investors can harm the very communities that they are intending to help. While the privatization of public functions has historically led to several unaccounted for costs, the federal securities laws' public-private divide exacerbates these harms because exempt vehicles face even lower accountability measures. This limited

24. Michelle Zhou, *ESG, SRI, and Impact Investing: What's the Difference?*, INVESTOPEDIA (Aug. 22, 2019), https://www.investopedia.com/financial-advisor/esg-sri-impact-investing-explaining-difference-clients [https://perma.cc/QHW3-6HTK]; *see also* DOUGLAS M. GRIM & DANIEL B. BERKOWITZ,VANGUARD, ESG, SRI, AND IMPACT INVESTING: A PRIMER FOR DECISION-MAKING 7–8 (2018), https://personal.vanguard.com/pdf/ISGESG.pdf [https://perma.cc/5ZY2-9FDK].

25. *See infra* Part I.B.

26. *See infra* Part I.B.

27. Affected community members may not have access to mutual funds via retirement accounts due to a number of issues related to chronic poverty, pervasive inequities, and several other social ills.

28. On May 21, 2020, the SEC Advisory Committee recommended a range of improvements related to ESG disclosures of publicly traded companies, which included a recommendation to "provide Issuers with a framework to disclose material, decision-useful, comparable, and consistent information in respect of their own businesses, rather than the current situation where investors largely rely on third party ESG data providers, which may not always be reliable, consistent, or necessarily material." *See* U.S. SEC. & EXCH. COMM'N INV. ADVISORY COMM., RECOMMENDATION OF THE SEC INVESTOR ADVISORY COMMITTEE RELATING TO ESG DISCLOSURE 1 (2020), https://www.sec.gov/spotlight/investor-advisory-committee-2012/esg-disclosure.pdf [https://perma.cc/QU7Z-6AUV].

transparency can potentially lead to an increase in negative externalities generated by social impact funds as well as their underlying operating companies, signaling market failures that warrant regulatory intervention. As further described in Part II.B of this Article, categories of such negative externalities can include: (1) seemingly clean energy investments inadvertently destroying a surrounding environment or habitat; (2) the crowding out of higher quality products or services that produce a greater level of impact; and (3) the wholesale displacement of targeted communities.[29]

Negative externalities are even more likely to occur given the projected growth of the social impact investment industry. Some have estimated that it nearly doubled in size between 2017 and 2018 as it currently accounts for approximately $228 billion in assets under management.[30] Commentators have found that millennial investors have largely driven this growth as they tend to favor investments that are tied to a social benefit.[31] According to Mark Haefele, global chief investment officer for the wealth management division at UBS, "[millennials] are extremely interested in sustainable investing, and 85 per cent of millennials are very interested in impact investing."[32] This industry, along with other socially conscious strategies, will probably experience even more growth given potential innovations arising in response to the many layers of the COVID-19 pandemic.[33] The pandemic also increased the extent to which already vulnerable communities are marginalized, making them even more attractive targets for social impact investors while further widening the gap between the wealthy and the poor.

The racial injustices unveiled by the Black Lives Matter movement will provide comparable opportunities for the private sphere to develop profitable responses, perhaps to the exclusion and detriment of the Black community that

29. *See infra* Part II.B (providing a detailed analysis of the negative externalities that have been generated by social impact investments).

30. JP Dallmann, *Impact Investing, Just a Trend or the Best Strategy to Help Save Our World?*, FORBES (Dec. 31, 2018), https://www.forbes.com/sites/jpdallmann/2018/12/31/impact-investing-just-a-trend-or-the-best-strategy-to-help-save-our-world/ [https://perma.cc/RP69-HKVN].

31. *See* Owen Walker, *Impact Investors Shoot for Clearer Goals*, FIN. TIMES (Sept. 19, 2018), https://www.ft.com/content/fc7964f2-7474-11e8-bab2-43bd4ae655dd [https://perma.cc/CY28-FZ9S].

32. *Id.*

33. *See* Alan Farley, *The Blackstone Group Could Profit from the Pandemic*, INVESTOPEDIA (Mar. 13, 2020), https://www.investopedia.com/the-blackstone-group-could-benefit-from-the-pandemic-4799689 [https://perma.cc/9WSB-5SW9] (predicting that "the Blackstone Group Inc. (BX) is likely to profit from the coronavirus pandemic in coming years, reopening the 2009 and 2010 playbook when the company stepped in and bought thousands of foreclosed properties"); Nigam Arora, *Opinion: The U.S. Stock Market May Enjoy the Biggest Rally Ever When the Pandemic Is Over*, MARKETWATCH (Apr. 18, 2020), https://www.marketwatch.com/story/its-time-for-scenario-analysis-heres-how-the-stock-market-could-boom-this-year-2020-04-15 [https://perma.cc/5JZ4-C7BB]; Caroline Lupini, *4 Companies Selling Masks and Helping Our Communities*, FORBES (May 1, 2020), https://www.forbes.com/sites/advisor/2020/05/01/4-companies-selling-masks-and-helping-our-communities/ [https://perma.cc/2KNP-X756].

the movement was intended to help.[34] For example, social impact investors may allocate to private entities that offer policing alternatives and are designed to be more responsive to community needs.[35] Private investors may flock to these alternatives given their potential to promote racial justice initiatives. Yet, these entities may be composed entirely of White, elite investors with no community oversight, crowding out actual community restorative justice groups or leading to disinvestment in public infrastructure and programming. Without the reforms posited in this Article, there is limited oversight to ensure that such initiatives actually serve to improve the lives of the community they proffer to serve.

Involving affected community members as investors or managers could mitigate many of these harms as their interests would be more closely aligned with the underlying projects of targeted social impact investments. Community members have an enhanced understanding of the nuanced issues affecting their surrounding environments, particularly regarding the interconnectedness of community needs. This understanding is essential to preventing negative externalities from occurring *ex ante.* Attempting to resolve one need without sufficiently understanding how it could deepen others or create new ones can cause irreparable damage that cripples entire populations. Enhanced disclosures would allow affected community members and policy makers to examine the extent to which social impact investors are measuring net social welfare, and whether they are conducting appropriate due diligence with regards to the impacts on surrounding communities.

Solely relying on privately ordered solutions may leave costly loopholes, which may continuously harm the unsuspecting general public. Moreover, evidence has emerged that these solutions do little to involve the targeted beneficiaries of these projects or to provide enhanced accountability mechanisms for affected community members.[36] Despite well-documented harms, proponents of private ordering would likely support the further development and growth of social impact investing with limited government intervention.[37] Such privately ordered solutions have recently emerged, and likely will continue to

34. *See* Meg Massey, *What Next? Black Business Leaders Share Thoughts on America in Wake of Floyd Death*, KARMA (June 8, 2020), https://karmaimpact.com/what-next-black-business-leaders-share-thoughts-on-america-in-wake-of-floyd-death/ [https://perma.cc/7UX2-CAPC]; Tim Nash, *This Investment Fund's Racial Principles Have Paid Off So Far*, THE STAR (June 15, 2020), https://www.thestar.com/business/opinion/2020/06/15/this-investment-funds-racial-principles-have-paid-off-so-far.html [https://perma.cc/RNE6-BA2W].

35. *See, e.g.*, David Risley, *Private Police Coming to a Neighborhood Near You! Why Private Police May Be an Important Element of Future Law Enforcement*, POLICE CHIEF MAG. (July 2015), https://www.policechiefmagazine.org/private-police-coming-to-a-neighborhood [https://perma.cc/L566-CF66] ("Many communities have already begun to contract with private security to supplement local law enforcement. Private sector companies are cheaper and focused more on customer service. In Oakland, California, several neighborhoods have hired private security to patrol their neighborhoods in response to rising crime rates and reductions in police staffing.").

36. *See infra* Part II.D.

37. *See infra* Part II.D (highlighting many of the limitations of relying on privately ordered solutions).

grow in popularity.[38] However, leaving these harms unexposed and unregulated could likewise disincentive the government or philanthropists from dedicating the necessary resources to resolve these funding gaps due to the misguided reliance on the private sector.

The public-private divide under federal securities laws must be reconceptualized to fully resolve these loopholes. Antiquated indicators of publicness must be updated under various facets of the federal securities laws to better reflect the innovations generated by regulated industries. Doing so would invariably require the creation of new regulatory frameworks.[39] This Article presents one such framework: an entirely new series of exemptions entitled the "Social Impact Exemptions" that should appear under the Securities Act of 1933 and the Investment Company Act of 1940.[40] These would recalibrate existing rules related to access and disclosure, while creating new frameworks for accountability and management structure.[41]

Part I of this Article begins by providing a detailed description of the landscape in which social impact investing operates. It explains how social impact investments are defined and measured, while highlighting some of the difficulties of doing so. It then illuminates how the regulatory flexibility afforded to these investments results in exclusive access by elite investors. Part II fully unveils the problem underscored in this Article: the restricted access created by the public-private divide under federal securities laws leads to a reduction of net social benefits of these schemes. This Section further explores how many such investments have generated negative externalities that ripple across communities and ecosystems. It concludes by challenging the overreliance on privately ordered solutions that can serve to promote the interests of private investors to the detriment and exclusion of the general public. Part III proposes a series of tailored "Social Impact Exemptions" that seeks to reconceptualize notions of "publicness" and "privateness" to better account for the realities of the expanding social impact investment industry.

I.
ASSESSING THE LANDSCAPE: RESTRICTED ACCESS TO IMPACT

This Section provides a foundational backdrop for understanding the range of social impact investing strategies utilized by investment funds. While multiple definitions of social impact investing exist, the term universally encompasses investments that seek to create broad categories of positive impact. Examples

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38. *See* INT'L FIN. CORP., INVESTING FOR IMPACT: OPERATING PRINCIPLES FOR IMPACT MANAGEMENT 2 (2019) [hereinafter INVESTING FOR IMPACT], https://www.impactprinciples.org/sites/default/files/2019-06/Impact%20Investing_Principles_FINAL_4-25-19_footnote%20change_web.pdf [https://perma.cc/BEY3-TWQH].

39. *See id.*

40. *See infra* Part III.A.

41. *See infra* Part III.A.

include investments that aim to reduce poverty, reverse climate change, and eliminate inequality. Strategies also vary with respect to the degree of returns sought by advisers and investors. The ways in which impact is measured likewise differs across such strategies. This Section begins by delving deeper into these core elements of social impact investing while highlighting some of the difficulties associated with measuring and creating impact. It then explains how social impact investing carries the greatest potential for impact among socially conscious investments. But to generate this impact, advisers must retain regulatory flexibilities under the federal securities laws to pursue illiquid investments. This Section concludes by highlighting how the public-private divide under federal securities laws excludes community members who are the targeted beneficiaries of these investments.

A. Core Characteristics

1. Impact is Broadly Defined and Flexible to Adviser and Investor Goals with Limited Constraints

The meaning of "social impact investing" has evolved into a broad concept encompassing a wide range of initiatives. The Global Impact Investing Network ("GIIN") defines social impact investing as "investments made with the intention to generate positive, measurable social and environmental impact alongside a financial return."[42] The GIIN further provides that "the growing impact investment market provides capital to address the world's most pressing challenges in sectors such as sustainable agriculture, renewable energy, conservation, microfinance, and affordable and accessible basic services including housing, healthcare, and education."[43] Examples of tailored social goals include allocations to companies that have developed mechanisms for reducing poverty, increasing access to education, or improving healthcare. In terms of environmental impact, advisers can target companies that have created innovative technologies for reducing energy use or increasing the use of recycled materials in a multitude of products.

Social impact investing "provided a broad, rhetorical umbrella [term] under which a wide range of investors could huddle. The microfinance investor, the green-tech venture capitalist, the low-income housing lender: all could now see their affinity within a broader movement and begin to collaborate to address the similar challenges they faced."[44] Social impact investing connects these advisers, no longer distinguishing them by their targeted social benefit.

42. *What You Need to Know About Impact Investing*, GLOB. IMPACT INVESTING NETWORK (2021), https://thegiin.org/impact-investing/need-to-know/ [https://perma.cc/82UF-NAXP].

43. *Id.*

44. ANTONY BUGG-LEVINE & JED EMERSON, IMPACT INVESTING: TRANSFORMING HOW WE MAKE MONEY WHILE MAKING A DIFFERENCE 8 (2011).

Investment fund advisers thus have great latitude in deciding the specific social impact allocations for underlying portfolios. However, they are often constrained by internal processes and procedures through which specific targeted impacts are selected. For instance, the United Way of the Bay Area ("UWBA") adopted a goal to reduce poverty in the San Francisco Bay Area as part of its mission. They implemented this mission pursuant to the following procedures:

> We identified a number of investment themes that would be aligned with a poverty alleviation mission. Those themes helped identify investable opportunities, securities, and funds. UWBA research and consensus identified the social drivers that alleviate poverty, such as job creation, and corresponding objective criteria were identified. This resulted in the creation of the 'Bay Area Employers' index of companies headquartered in the San Francisco Bay Area, including many large employers that generally support the mission of UWBA. We determined a series of social criteria that would be proxies for identifying companies that could be classified as being "good employers," having "good management," and behaving as "good environmental stewards" in the Bay Area. We ranked those criteria and used objective data sources to identify companies that rated well in these criteria. Using computer-driven portfolio optimization programs, we developed a portfolio of stocks that would maximize the aggregate custom ESG score . . . .[45]

In implementing its mission, UWBA created seemingly objective measures for alleviating poverty and constructed an index of companies that employed these measures.

Advisers face additional limitations beyond internal procedural mechanisms, including investor instructions and fiduciary obligations. Wealthy and institutional investors, who often possess greater bargaining power in negotiating for specific restrictions, can also limit advisers by giving specific instructions regarding social impact opportunities.[46] Fiduciary duties may further constrain the kinds of social impact initiatives pursued by advisers, as fiduciary law may not view social impact initiatives as consistent with an advisers' fiduciary duties. Thus, advisers frequently select social impact allocations based on the extent to which such investments can yield a return.[47]

2. *The Degree of Anticipated Return on Investment Varies Across Social Impact Investing Strategies*

Categorizing impact by desired return is an effective analytical tool. Social impact investing approaches generally fall within three categories along a

45. Lauryn Agnew & Seal Cove Fin., *Impact Investing for Small, Place-Based Fiduciaries: The Research Study Initiated by the United Way of Bay Area* 7 (Ctr. for Cmty. Dev. Invs., Working Paper No. 2012-05, 2012), https://www.frbsf.org/community-development/files/wp2012-05.pdf [https://perma.cc/QMC8-FZ6D].

46. *See infra* Part II.A.

47. *See infra* Part I.A.2.

continuum of possibilities in yielding a return: (1) strategies that maximize impact and sacrifice financial returns accordingly; (2) strategies that target a middle ground, prioritizing impact so long as the financial return approaches market rate; and (3) strategies that seek to earn at or above market-rate returns.

Social impact investing strategies that sacrifice financial returns for the sake of maximizing potential impact fall at one end of this spectrum. This approach has been referred to as "Impact First,"[48] or "concessionary,"[49] among other expert classifications. Foregoing a financial return in this manner is comparable to a philanthropist providing a grant or donation to a particular cause or non-profit organization. These kinds of allocations fall within the outer range of possible social impact investing strategies since a common characterization of social impact investing is making a difference while simultaneously earning a financial return. While fiduciary duties would likely restrict registered fund advisers from selecting such allocations, Private Fund advisers have more leeway to do so due to a web of exemptions under federal securities laws.[50]

Social impact strategies that yield returns falling slightly below the market-rate lie at the middle of this spectrum.[51] These kinds of approaches acknowledge that sacrifices related to anticipated returns are required for certain categories of social impact opportunities. Advisers possess greater freedoms to pursue these kinds of social impact investing strategies since they produce some degree of yield for their underlying investors. Advisers can further argue that social impact investing provides diversification benefits for investors while also hedging against the long-term harms that the social impact investing strategy seeks to improve. However, advisers still run the risk of violating the "best interests" duties under the Investment Advisers Act of 1940.

Social impact investments that seek to earn at or above market-rate returns fall at the opposite end of the spectrum. Researchers describe allocations of this nature as "non-concessionary,"[52] or "investment first,"[53] among other classifications. These kinds of allocations are more standard since the goal of most investment strategies is an above-market rate of return for investors. If not, then investors would fare better by simply allocating their limited capital to risk-free financial instruments without having to pay additional fees to advisers. Finding these kinds of social impact investing allocations are golden

48. *See* Agnew & Seal Cove Fin., *supra* note 45, at 12.

49. *See* Paul Brest & Kelly Born, *When Can Impact Investing Create Real Impact?*, STAN. SOC. INNOVATION REV., Fall 2013, at 22, 24.

50. *See infra* Part II.A.

51. *See* JACOB GRAY, NICK ASHBURN, HARRY DOUGLAS & JESSICA JEFFERS, WHARTON SOC. IMPACT INITIATIVE, GREAT EXPECTATIONS: MISSION PRESERVATION AND FINANCIAL PERFORMANCE IN IMPACT INVESTING 17 (2015), https://socialimpact.wharton.upenn.edu/wp-content/uploads/2016/09/Great-Expectations-Mission-Preservation-and-Financial-Performance-in-Impact-Investing.pdf [https://perma.cc/V3Y5-PWBE].

52. *See* Brest & Born, *supra* note 49, at 24.

53. *See* Agnew & Seal Cove Fin., *supra* note 45, at 12.

opportunities, as most investors would welcome the prospect of earning above-market returns while doing something good for society. Similarly, advisers do not have to be concerned about violating their fiduciary duties.[54] However, whether social impact opportunities even increase overall social impact can be difficult to assess.[55] Profitable social impact investing opportunities are likely to continue growing irrespective of whether advisers of social impact investing strategies specifically seek them out. If an enterprise is profitable, it will encounter little difficulties in accessing a wide range of investors.

Other categories of social impact enterprises aspire to build the infrastructure of this burgeoning industry, as opposed to investing directly into these opportunities. One such example is a "Catalyst First" strategy, which "includes those who want their investments to act as a catalyst that will bring other investors into collaborative partnerships or help build the infrastructure of this emerging [social impact investing] industry."[56] Companies that build rating systems for social impact investments also fall within this category. For example, the Boulder Institute created a rating system for micro-finance institutions as well as training programs to incentivize best practices within this industry.[57] Other categories that generally fall into this "Catalyst First" strategy include helping investors find and promote social impact investments and providing technical and governance assistance.[58] While these companies may not invest directly into social impact opportunities, they seek to earn returns based on the services that they provide to social impact market participants.

As this Section has shown, social impact investing strategies vary widely in their implementation and goals. The degree to which a particular strategy balances impact and profit influences both the investment's impact and the potential external harm created.

3. Measuring Impact

To measure impact, models focus on different aspects of an investment's impact.[59] Enterprise impact, for example, focuses on the product or operational impact of an individual company.[60] Product impact evaluates the social impact of an enterprise's goods and services, while operational impact "is the impact of the enterprise's management practices on its employees' health and economic

54. *See infra* Part II.A.

55. *See infra* Part II.C.

56. Agnew & Seal Cove Fin., *supra* note 45, at 12.

57. *See Boulder Institute at a Glance*, BOULDER INST. OF MICROFINANCE, https://www.bouldermicrofinance.org/boulder/EN/BOULDER/glance [https://perma.cc/B9EA-6PEA] (capturing an overview of the institute's programs and training methodologies).

58. *See* Brest & Born, *supra* note 49, at 26.

59. *See* Chris Addy, Maya Chorengel, Mariah Collins & Michael Etzel, *Calculating the Value of Impact Investing: An Evidence-Based Way to Estimate Social and Environmental Returns*, HARV. BUS. REV., Jan.–Feb. 2019, at 102 (providing an excellent summary of available measures, as well as a relatively new one).

60. *See* Brest & Born, *supra* note 49, at 24.

security, its effect on jobs or other aspect of the well-being of the community in which it operates, or the environmental effects of its supply chain and operations."[61] Measuring the "outcome" of a particular enterprise looks beyond product and operational impact to determine the short-term and long-term effects that the company's output has on its surrounding environment and people.[62]

These models are plagued by a pervasive lack of standardization with respect to how impact is measured and disclosed.[63] Impact categories naturally implicate a range of interconnected factors, which can occur across diverse geographical and sociological regions, making them exceedingly difficult to standardize.[64]

These deficiencies with impact-measuring models have also led to frequent incidences of "impact washing," which occurs when "actors . . . [adopt] the label without meaningful fidelity to impact."[65] Complicated corporate and fund structures make it easier for social impact investors and their underlying operating companies to engage in impact washing. For example, a fund or one of its operating companies (and even a subsidiary of an operating company) may be investing in "clean" energy alternatives while another within the same family of entities is investing in fossil fuels—counteracting the positive externalities generated by the clean energy investments. Given that these entities are typically treated as "separate" under state corporate governance and federal securities laws, it may be impossible for investors to accurately measure the full breadth of impact generated within an interrelated family of entities.[66]

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61. *Id.*

62. *See id.* ("Impact Reporting and Investment Standards (IRIS) and Global Impact Investing Rating System (GIIRS) provide standardized metrics for assessing some common output criteria. But these focus more on an enterprise's operations than on its products. With rare exceptions—most notably, the field of microfinance—there have been few efforts to evaluate actual outcomes of market-based social enterprises."). With respect to malaria nets, for example, an enterprise could successfully produce additional nets, but a reduction in malaria may be attributable to other factors such as increased access to vaccines. *Id.*

63. *See, e.g.*, U.S. SEC. & EXCH. COMM'N, 2020 EXAMINATION PRIORITIES: OFFICE OF COMPLIANCE INSPECTIONS AND EXAMINATIONS 15 (2020), https://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2020.pdf [https://perma.cc/EW4H-3UFF] (expressing "a particular interest in the accuracy and adequacy of disclosures provided by RIAs offering clients new types or emerging investment strategies, such as strategies focused on sustainable and responsible investing, which incorporate environmental, social, and governance (ESG) criteria").

64. *See* Alina Dizik, *The Difficulty of Measuring a Company's Social Impact*, WALL ST. J. (June 24, 2019), https://www.wsj.com/articles/the-difficulty-of-measuring-a-companys-social-impact-11561379621 [https://perma.cc/M82H-TRYZ].

65. ABHILASH MUDALIAR, RACHEL BASS & HANNAH DITHRICH, GLOB. IMPACT INVESTING NETWORK, 2018 ANNUAL IMPACT INVESTOR SURVEY, at III (2018), https://thegiin.org/assets/2018_GIIN_Annual_Impact_Investor_Survey_webfile.pdf [https://perma.cc/JX8X-QLSV].

66. *See* Virginia Harper Ho, *Theories of Corporate Groups: Corporate Identity Reconceived*, 42 SETON HALL L. REV. 879, 883–85 (2012) (contending that the complexity of corporate groups requires tailored regulatory frameworks); Anita K. Krug, *Escaping Entity-Centrism in Financial Services Regulation*, 113 COLUM. L. REV. 2039, 2043 (2013) (coining the term "entity centrism" to

B. Social Impact Investing Has the Highest Potential for Impact Amongst Socially Conscious Strategies

Commentators often use the terms ESG, SRI, and social impact investing interchangeably. However, social impact investing is the only strategy that directly prioritizes positive social impact. Social impact investing thus carries the greatest potential to generate positive social impact in comparison to other socially conscious strategies. While Registered Investment Companies ("RICs") are increasingly adopting aspects of these strategies, even socially conscious RICs have limited social impact because of the federal securities laws' public-private divide.

ESG refers to "the environmental, social, and governance practices of an investment that may have a material impact on the performance of that investment."[67] Advisers can therefore integrate ESG factors in performing traditional financial valuations of prospective allocations. Nonetheless, even if a fund adviser has disclosed its use of ESG factors in producing a portfolio valuation, the adviser is not necessarily obligated to avoid allocations that are deemed unethical under its ESG calculations.[68]

On the other hand, advisers that have adopted socially responsible investing ("SRI") strategies will not only utilize ESG factors (based on predetermined ethical standards) in their valuations, but also actually choose or divest from allocations based on those ESG valuations.[69] As one commenter noted, "early brand[s] of sustainable investing surfaced in response to rising demand for investment funds that avoided areas certain groups deemed unethical. For example, universities, nonprofit organizations, and religious institutions increasingly stipulated that their portfolios exclude or withdraw investment in the likes of tobacco or weapons manufacturers, as well those with significant business interests in South Africa."[70] Fund advisers employing SRI strategies

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argue that the law's focus on the regulation of a single entity defeats the underlying purposes of such regulations since entities "are components of groups of affiliated entities that, together, pursue related or mutually beneficial activities as a larger enterprise—as an association of entities"). *See generally* Carliss N. Chatman, *Corporate Family Matters*, SSRN (Feb. 1, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3697229 [https://perma.cc/BP8U-Q2GZ] (arguing that consumers and investors may be manipulated into doing business with companies that undermine their social values because of the veil of separateness within a "family" of corporate entities).

67. Zhou, *supra* note 24; *see also* GRIM & BERKOWITZ, *supra* note 24, at 4 (defining ESG investing as an "activity that accounts for some type of environmental, social, or governance consideration").

68. *See* James Hester, *Defining the Industry: SRI, ESG, and Impact Investing*, IMPACTIVATE (June 11, 2019), https://www.impactinvestingexchange.com/defining-the-industry-sri-esg-and-impact-investing/ [https://perma.cc/X2CZ-3GD8]; *see also* Dana Brakman Reiser & Anne Tucker, *Buyer Beware: Variation and Opacity in ESG and ESG Index Funds*, 41 CARDOZO L. REV. 1921, 1927 (2020) ("In all comparisons, we conclude that the ESG label acts more as a product signal and branding mechanism than it does a promise of a specific investment strategy or avoided externalities.").

69. *See* Hester, *supra* note 68.

70. *Id.*

also commonly exclude fossil fuels, firearms, tobacco, and alcoholic beverages.[71]

In contrast, according to a report published by Vanguard, "[social] impact investing involves allocating capital to companies, organizations, and funds with the intent to generate financial return and some form of material, positive social [or]environmental impact that aligns with the investor's personal values."[72] Fund advisers that adopt social impact investing strategies therefore exclusively target enterprises with a *primary objective* of creating goods, services, or technologies that directly generate positive social or environmental impacts. Investing in a start-up company that has created a novel technology for generating wind-powered energy would be the perfect example of a social impact investment due to its primary emphasis on creating a "clean" energy product. The desirability of such impacts largely depends on the personal preferences of underlying investors and advisers, along with the investment's ability to generate some level of returns, as the preceding section provided.

RICs available for investment by the general public, such as mutual funds,[73] are increasingly employing a range of these socially conscious investment strategies. Millions of households across the country rely on RICs to fund future retirement costs, pay for college tuition, or pursue other long-term savings goals.[74] Socially conscious investing strategies have become the latest trend to pervade the financial markets, potentially driven by millennial investors who have an appetite for generating a positive impact from their investments. As such, RICs have increasingly employed ESG screenings of prospective allocations and have gradually adopted SRI strategies through a growing number of passive index funds.

For instance, a plethora of exchange-traded funds ("ETFs") dedicated to ESG issues have cropped up in recent years.[75] ETFs are passively managed RICs, where the adviser simply allocates to baskets of financial instruments that follow an index.[76] ETF allocations can include bonds, commodities, equities, and other

71. *Id.*

72. GRIM & BERKOWITZ, *supra* note 24, at 15.

73. *See* U.S. SEC. & EXCH. COMM'N, MUTUAL FUNDS AND ETFS: A GUIDE FOR INVESTORS 4 (2016) [hereinafter MUTUAL FUNDS], https://www.sec.gov/investor/pubs/sec-guide-to-mutual-funds.pdf [https://perma.cc/33C2-F4FX] (summarizing how mutual funds work).

74. *See* Cary Martin Shelby, *How Did We Get Here? Dissecting the Hedge Fund Conundrum Though an Institutional Theory Lens*, 74 BUS. LAW. 735, 742 (2019).

75. *See* Prableen Bajpai, *How to Invest in ESG: Top ETFs to Consider*, NASDAQ (Dec. 17, 2019), https://www.nasdaq.com/articles/how-to-invest-in-esg%3A-top-etfs-to-consider-2019-12-17 [https://perma.cc/SW3M-VF83]; *see also* William A. Birdthistle, *The Fortunes and Foibles of Exchange-Traded Funds: A Positive Market Response to the Problems of Mutual Funds*, 33 DEL. J. CORP. L. 69, 71–78 (2008) (discussing the exponential rise of ETFs).

76. *See* Birdthistle, *supra* note 75, at 72 ("In order to make possible this novel pricing mechanism, ETF sponsors index their funds to benchmarks—such as the Standard & Poor's 500 Composite Stock Price Index (S&P 500)—so that investors in an ETF can confirm that the price of the fund's shares at any given moment fairly equals the price of all the underlying securities in the fund's portfolio.") (internal footnotes omitted).

financial products.[77] Fees are therefore significantly lower as the adviser is not actively managing the assets of the fund.[78] ETF ownership interests are publicly traded, which is distinct from a typical mutual fund.[79] ETFs are popular investments for retail investors due to their lower fees and immediate access to diversification.

ETFs also embrace social impact goals. According to one source, "[e]xchange-traded funds (ETFs) that invest in securities with sustainability goals are growing in popularity."[80] Further, "according to predictions from BlackRock, the world's largest asset management firm, sustainable ETF fund assets are poised to grow from the current $25 billion to more than $400 billion by 2028. Millennials, in particular, are attracted to these ETFs because they offer low fees and broad diversification while catering to social impact goals."[81] In fact, BlackRock has led the charge in incorporating socially conscious strategies into many of its offered products.[82] Index-mutual funds, which are not traded on exchanges, can achieve similar results. Index-mutual funds are comparable to ETFs in that they are structured to follow a particular index that tracks a range of social impact investments.

RICs may also engage in socially conscious strategies. Some RICs actively pursue companies that incorporate ESG principles or initiatives, or exercise SRI strategies by withdrawing from companies that go against their core values. Such strategies entail a strong shareholder activist role. Fund advisers may use their power as institutional shareholders to shift initiatives of underlying allocations towards more socially beneficial outcomes. This is a prevalent strategy in the pension plan space, as "many large shareholders, like CalPERS, are active in the public equity sector through shareholder activism: voting proxies, submitting resolutions, and working with management for long-term positive change."[83] However, research has demonstrated that mutual fund advisers are far less likely

77. *See id.* at 78–80 (discussing the pricing mechanisms of ETFs, including how these create opportunities "to invest in a diversified investment vehicle via shares that traded at accurate prices throughout the business day").

78. *See id.* at 72 ("Because a fund that merely tracks an existing index can be managed largely with algorithms and trading programs, as opposed to human discretion, the cost to run—and, accordingly, the price of investing in—these funds is often quite low.").

79. *See id.* ("ETFs, on the other hand, and as their name suggests, can be traded on securities exchanges constantly while their prices are updated every few seconds throughout the business day.").

80. *How Sustainable ETFs Let Small Investors Make a Difference*, KNOWLEDGE@WHARTON (July 11, 2019), https://knowledge.wharton.upenn.edu/article/how-sustainable-etfs-let-small-investors-make-a-social-impact/ [https://perma.cc/QB5V-FTNL].

81. *Id.*

82. *See generally Sustainable Investing*, BLACKROCK (2021), https://www.blackrock.com/za/individual/themes/sustainable-investing [https://perma.cc/YQ9A-NFXG] (outlining BlackRock's commitment to sustainability, particularly ESG, through its investment stewardship efforts).

83. Agnew & Seal Cove Fin., *supra* note 45, at 12.

to perform this shareholder activist role and tend to vote alongside management when given the discretion to do so.[84]

While RICs have responded to market pressures to provide mechanisms for average investors to access socially conscious strategies, purchasing publicly traded stock does little to affect overall societal impact as measured through an economic lens. As noted by leading scholars,

> Most economists agree that it is virtually impossible for a socially motivated investor to increase the beneficial outputs of a publicly traded corporation by purchasing its stock. Especially if—as is generally the case—stock is purchased from existing shareholders, any benefit to the company is highly attenuated if it exists at all. Impact investing typically does not take place in large cap public markets, however, but rather in domains subject to market frictions.[85]

However, the public-private divide under federal securities laws largely constrains RICs from accessing more innovative investment opportunities. RICs primarily allocate to baskets of publicly traded equities, bonds, and cash instruments due to restrictions under federal securities laws that are rooted in investor-protection principles.[86]

There are several reasons that purchasing stock in a publicly traded, socially conscious company may have limited overall impact. Leading experts Paul Brest and Kelly Born have asserted that impact only occurs in the context of "additionality."[87] More specifically, "a particular investment has impact only if it increases the quantity or quality of the enterprise's social outcomes beyond what would otherwise have occurred."[88] Thus, simply purchasing stock in a publicly traded company driven by ESG goals will do little to increase overall impact. Such stock is already traded in the secondary markets. If the company is performing well, investors will flock to these opportunities irrespective of whether such stocks are identified as socially conscious. With SRI strategies, where socially conscious advisers are pulling from an investment that generates negative impacts, socially neutral investors will seize the opportunity to purchase the now-undervalued stock.[89] Socially neutral investors' trading activities may counteract the positive impact initially generated by the socially conscious investors.[90]

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84. *See* Dorothy S. Lund, *The Case Against Passive Shareholder Voting*, 43 J. CORP. L. 493, 499 (2018) ("In the first place, proxy voting data seems to confirm that institutional investors take a passive approach to governance. During the 2007 to 2009 proxy seasons, for example, mutual funds proposed only 4.5% of all shareholder proposals, and only 0.9% addressed corporate governance or performance issues.").

85. Brest & Born, *supra* note 49, at 25.

86. *See* MUTUAL FUNDS, *supra* note 73, at 4.

87. *See* Brest & Born, *supra* note 49, at 22–24.

88. *Id.* at 22.

89. *See* HILLEBRANDT & HALSTEAD, *supra* note 20, at 2–3.

90. *See id.*

According to Brest and Born, impact "additionality" is most likely to occur when particular investors can discern social impact investing opportunities that average investors are unlikely to identify.[91] These kinds of opportunities often involve smaller start-up enterprises that are not yet publicly traded. They also tend to include unique opportunities for social impact investments in developing economies and emerging markets.

The implications of these limited opportunities for true impact will be further explored in subsequent sections of this Article. Purchasing social impact investing opportunities in smaller, private markets may yield greater opportunities for impact and returns since such advisers have particularized access to information required to exploit these unique opportunities.[92] Yet, as will be further discussed in Part II.C below, RICs are restricted from trading in illiquid financial instruments, which are often a necessary component of social impact investments.[93]

C. Federal Securities Law Excludes Targeted Communities from Social Impact Investing Opportunities

The companies and projects that are the most socially impactful often require long-term investment in private companies—both of which generally exclude retail investors. Private equity funds, venture capital funds, and other private funds ("Private Funds") are the most utilized investment fund structures for pursuing social impact investing strategies.[94] This is likely due to the regulatory flexibilities granted to such private entities. Private Funds are unconstrained by the trading restrictions under the Investment Company Act of 1940 ("1940 Act"). This complex piece of legislation provides additional layers of protection that extend well beyond the "truth in securities" framework of the inaugural Securities Act of 1933 ("Securities Act") and the Securities Exchange Act of 1934 ("Exchange Act"). In addition to mandating additional disclosure obligations, the 1940 Act imposes restrictions on RICs' ability to trade in "riskier" financial instruments and strategies. Consistent with the generally

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91. *See* Brest & Born, *supra* note 49, at 25.

92. *See id.* at 26.

93. *See* Agnew & Seal Cove Fin., *supra* note 45, at 12.

> Investment strategies and mutual funds are now offered in many flavors of ESG or Sustainability. It requires some corporate soul-searching to identify both the broad mission and the values of the organization as well as the process for implementing those values with investment vehicles. Appropriate due diligence is needed to align the values and mission of an organization with the investment objectives of the chosen funds and strategies. Some new websites and databases collect information on investment vehicles in each asset class that offer a combination of financial return and social impact.

Id.

94. *See* Emiko Kurotsu, Sara Terheggen & Linda Arnsbarger, *Social Impact Funds: Structuring Considerations*, MORRISON & FOERSTER: MOFO IMPACT BLOG (Jan. 19, 2017), https://impact.mofo.com/funding-financing/social-impact-funds-structuring-considerations/ [https://perma.cc/283A-PKT8].

paternalistic nature of federal securities laws, the 1940 Act severely restricts the extent to which RICs can trade in derivatives[95] or engage in leveraged transactions,[96] since these activities may expose retail investors to excessive losses.[97]

More importantly, Private Funds are not subject to standardized valuation requirements under the 1940 Act. This makes it easier for private investors to trade illiquid assets common in social impact investing.[98] Even if Private Fund advisers voluntarily adopt and disclose detailed valuation procedures, advisers often grant themselves unfettered discretion to deviate from such procedures.[99] Flexible valuation standards expand the categories of instruments that Private Fund advisers can trade for their funds,[100] enabling advisers to trade illiquid instruments without facing the same liability risks as mutual fund advisers.[101] Private fund advisers also have more flexibility to enter conflict of interest transactions, which widen the scope of available social impact opportunities, even if they reflect the idiosyncratic preferences of advisers.

By and large, the regulatory flexibilities that allow Private Funds to invest in illiquid instruments make it easier for them to support innovative start-ups requiring longer-term commitment horizons. Groundbreaking technologies that generate positive social impact are often created by start-up companies that initially rely on private capital before considering the transition to publicly traded companies. As one source noted, "[a]lthough there are some public options, impact investments are more often found in private markets (for instance green tech venture capital),"[102] that are typically illiquid in nature. Impact investments into emerging and developing markets may similarly require long-term commitment horizons due to the often unpredictable nature of surrounding

95. *See* 1 THOMAS P. LEMKE, GERALD T. LINS & A. THOMAS SMITH, III, REGULATION OF INVESTMENT COMPANIES § 8.06 [2][b][ii] (Matthew Bender ed., rev. ed. 2020).

96. *Id.*; *see also* PRESIDENT'S WORKING GRP. ON FIN. MKTS., HEDGE FUNDS, LEVERAGE, AND THE LESSONS OF LONG-TERM CAPITAL MANAGEMENT A-1, 12 (1999), https://www.treasury.gov/resource-center/fin-mkts/Documents/hedgfund.pdf [https://perma.cc/X93Z-ZQPF] ("[T]he Investment Company Act of 1940 denies mutual funds such a high degree of leverage by limiting their issuance of 'senior securities.' In practice, a mutual fund's debt effectively may not exceed 33 1/3% of its total assets."). The amount of leverage employed by a particular hedge fund is only limited to the extent requested by its actual counterparties. *See* LEMKE ET AL., *supra* note 95, § 8.06; *see also* Investment Company Act of 1940, 15 U.S.C. § 80a-18 (defining "senior security" for the Act's asset coverage test); Rules and Regulations, Investment Companies Act of 1940, 17 C.F.R. § 270 et seq. (outlining the Act's restrictions on RICs due to federal securities laws).

97. *See* MUTUAL FUNDS, *supra* note 73, at 7.

98. *See* 15 U.S.C. § 80a-2(a)(41)(B) (defining "value"); 17 C.F.R. § 270.2a–4 (defining "current net asset value"); *see also* Ryan Sklar, Note, *Hedges or Thickets: Protecting Investors from Hedge Fund Managers' Conflicts of Interest*, 77 FORDHAM L. REV. 3251, 3268 (2009) (noting that valuation models are often developed by hedge fund managers based on unspecific and vague guidelines, which confines an investor's ability to police the valuation process).

99. *See* Sklar, *supra* note 98, at 3268–69.

100. *See* LEMKE ET AL., *supra* note 95, § 3.07.

101. *See id.*

102. GRIM & BERKOWITZ, *supra* note 24, at 16.

socioeconomic climates. Comparable investments into communities through educational ventures or community development projects may equally require longer-term investments. Since RICs must also permit daily redemption requests by their underlying investors under the 1940 Act, they are completely excluded from making these kinds of flexible investment allocations.[103]

Private Funds access exemptions and regulatory flexibilities are not available to RICs, resulting in a divide between public and private in the legal framework under federal securities law.[104] Private Funds restrict investments to elite investors such as high net worth individuals or institutional investors and receive flexibility under securities regulations.[105] Elite investors presumably have the resources to protect themselves sufficiently against fraudulent schemes and riskier strategies.[106] Under the most commonly utilized Securities Act exemption, Private Funds must restrict investments to "accredited investors" in exchange for the power to raise an unlimited amount of capital from an unlimited number of investors. Accredited investors are statutorily defined as individuals who earn over $200,000 per year, as well as a variety of institutions such as insurance companies, pension plans, endowments, and other institutional investors.[107]

Private Funds also utilize exemptions under the 1940 Act to exercise the regulatory flexibilities needed to pursue social impact strategies. The most used exemption under the 1940 Act imposes even higher income and net worth standards for individual investors. Private Funds rely on the Section 3(c)(7) exemption under the 1940 Act because it allows them to raise an unlimited amount of capital while accepting an unlimited number of investors if the fund is restricted to "Qualified Purchasers."[108] These investors include institutions and natural persons with at least $5,000,000 in investments.[109]

However, an extremely low percentage of individuals meets these income and net worth thresholds. With respect to accredited investors, some estimates provide that roughly 8.9 percent of the U.S. population met this threshold in 2019.[110] A significantly lower percentage of the U.S. population meets the Qualified Purchaser standard, and an even lower percentage presumably does so on a global scale. As a result, most community members who are the targeted

103. *See, e.g.*, *Investment Company Registration and Regulation Package*, U.S. SEC. & EXCH. COMM'N (Feb. 19, 2013), https://www.sec.gov/investment/fast-answers/divisionsinvestmentinvcoreg121504htm.html [https://perma.cc/XD5W-EP2T].

104. *See* de Fontenay, *supra* note 19, at 447–52.

105. *See* 17 C.F.R. § 230.501 (2020).

106. *See* Sec. Exch. Comm'n v. Ralston Purina Co., 346 U.S. 119, 124–27 (1953).

107. *See* 17 C.F.R. § 230.501(a).

108. 15 U.S.C. § 80a-3(c)(7).

109. *See* Investment Company Act of 1940, 15 U.S.C. § 80a-2(a)(51)(A)(i)–(ii).

110. Ben Jessel, *Legal and Regulatory Experts Weigh in on the SEC's Proposed Changes to the Accredited Investor Status*, FORBES (Jan. 21, 2020), https://www.forbes.com/sites/benjessel/2020/01/21/legal-and-regulatory-experts-weigh-in-on-the-secs-proposed-changes-to-the-accredited-investor-status/ [https://perma.cc/ECE7-CZXU].

beneficiaries of many social impact vehicles are completely excluded from accessing these entities as investors. Recently enacted crowdfunding exemptions permit a degree of retail investment into privately held start-up companies.[111] But, many social impact investors do not rely on these exemptions due to their $1,070,000 capital raising cap coupled with arduous disclosure requirements.[112]

This legally sanctioned exclusion of retail investors can lead to negative externalities. Although elite investors often negotiate for additional layers of transparency and accountability from Private Fund advisers, their interests are often not closely aligned with the broader community goals applicable to targeted beneficiaries. And while they have greater latitude to advocate for particularized social impact goals given their enhanced bargaining power as elite investors, their selections can be misguided given the limited participation of targeted community members, which can lead to declines in net social welfare.[113] The limited incentives of both advisers and the small pool of qualified investors to calculate and disclose net social welfare can cause significant unintended harms.

II.
THE PROBLEM: PRIVILEGED ACCESS PRODUCES UNINTENDED HARMS

When impacted communities are excluded from social impact investing, those investments may fail to live up to their potential—and may actually harm the communities they are intended to serve. As detailed in the preceding section, elite investors have greater access to impact as they can freely access strategies that incorporate ESG and SRI, and have almost exclusive access to social impact investing, which arguably carries the greatest impact potential. Moreover, there

111. 17 C.F.R. § 227.100 (2020).

112. *See* Jason W. Parsont, *Crowdfunding: The Real and the Illusory Exemption*, 4 HARV. BUS. L. REV. 281, 284–85 (2014).

113. *See* Alyssa Ely & Denise Hearn, *Impact Investors Need to Share Power, Not Just Capital*, STAN. SOC. INNOVATION REV. (Apr. 14, 2021), https://ssir.org/articles/entry/impact_investors_need_to_share_power_not_just_capital ("[M]oving capital to communities of color or women, on its own, does not achieve equity. The way capital is shared, and the power dynamics underlying that process, is equally important."); *see also* GRAY ET AL., *supra* note 51, at 19.

> In traditional investment arrangements between fund managers and investors, GPs are held by professional standards and legal requirements to make investment decisions that deliver maximum risk-adjusted financial returns for LPs. In the context of impact investing, many LPs expect that investment decisions include a consideration of social or environmental impact. GPs must weigh their fiduciary duty to their LPs with the impact mission of the fund. [Wharton Social Impact Investing] asked respondents to report the level of structural protection for fund managers to consider non-fiduciary factors in their investment decisions. Unsurprisingly, survey respondents report the vast majority of Limited Partnership Agreements, Private Placement Memoranda, or other comparable investment agreements either explicitly allow or, in most cases, require fund managers to consider mission in investment decisions. Specifically, 90% have investment or legal documents that explicitly allow fund managers to consider social and/or environmental issues and 70% go so far as to require them to do so.

is no mandate that requires community input or involvement with respect to the selection and operation of such projects, and private ordering is unlikely to fill that gap.[114] Without the meaningful participation of affected communities as either investors or managers within social impact funds, potential harms of these investments will likely reduce the net social benefits. Unlike members of the targeted investment community, elite investors and managers are not well-positioned to foresee negative externalities. Since social impact investment vehicles mostly operate in the private sphere, advisers face limited accountability from the surrounding community or public at large in scrutinizing their decisions. Many parties have proffered privately ordered solutions to these problems.[115] However, the lack of mandatory compliance and standardization of privately ordered solutions creates unintended harms.

These harms can be significant. Environmentally conscious investments have led to deforestation, contamination, and pollution.[116] Community development investments have caused gentrification and displacement.[117] Organizations created to administer socially conscious investments have resisted accountability and actively abused the communities they were created to serve.[118] Each of these harms are disproportionately borne by Black communities, Indigenous communities, and other communities of color. And investors continue to profit. New investment opportunities may spring up to fix the problems created by old, failed programs. More pain—more profit. And investors will do well, thinking they are doing good. While social impact investing is still in its infancy relative to other categories of private investments, exploring innovative reforms is essential in mitigating these vicious cycles.

A. Limited Net Social Benefit Analysis in the Private Sector

A countervailing problem with private actors performing public functions—or privately ordered solutions to public problems—is that the private sphere can obscure its inability to fully account for a range of anticipated and unanticipated harms experienced by the general public. By further empowering exempt vehicles that are primarily engaged in social impact investing, federal securities laws exacerbate this problem. The public sector typically utilizes detailed cost benefits analyses to make informed decisions on whether to pursue a particular policy or project.[119] Administrative agencies such as the Securities

114. *See infra* Part II.B.

115. *See infra* Part II.D.

116. *See infra* Part II.B.

117. *See infra* Part II.B.

118. *See infra* Part II.B.

119. *See* ANTHONY E. BOARDMAN, DAVID H. GREENBERG, AIDAN R. VINING & DAVID L. WEIMER, COST-BENEFIT ANALYSIS: CONCEPTS AND PRACTICE 2 (4th ed. 2017); *see also* CONG. BUDGET OFF., 10 THINGS TO KNOW ABOUT CBO 1 (2021), https://www.cbo.gov/sites/default/files/10-Things-CBO-2021.pdf [https://perma.cc/HVD6-LJMC] ("[The Congressional Budget Office] was established under the Congressional Budget Act of 1974 to provide objective, nonpartisan information

and Exchange Commission ("SEC") and the Environmental Protection Agency ("EPA") similarly produce and publicly disclose a cost-benefit analysis prior to adopting a rule or regulation.[120] The private sector is under no such obligation, and potential negative externalities of social impact investments may accordingly be understudied and undisclosed.

A comprehensive measure of net social benefits is often included within public investment decisions, which calculate whether total benefits to society exceed costs.[121] Costs incorporate any direct expenses associated with launching the underlying projects such as construction expenditures, compliance costs, and even forgone tax revenue.[122] Any resulting negative externalities should also be included within these costs, which occur when third parties, who are not direct participants in the transaction, bear spillover costs such as an increase in water, air, or noise pollution, or unanticipated effects such as the crowding out of superior alternatives.

The net social benefits included in public investment calculations encompass the private gains that are received by the parties directly involved in the underlying transaction, as well as any positive externalities generated by the same transaction.[123] Positive externalities occur when third parties, who are not direct participants in the transaction, experience benefits such as the reduction of air and water pollution, or an increase in surrounding property values.[124] Benefits can also include reducing negative externalities.[125] Debates contest what kinds of costs and benefits should be included in these calculations, as well as the

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that would support the budget process . . . CBO is also required by law to produce a formal cost estimate for nearly every bill that is approved by a full committee of either the House or the Senate.").

120. *See* Bruce Kraus & Connor Raso, *Rational Boundaries for SEC Cost-Benefit Analysis*, 30 YALE J. REGUL. 289, 295–308 (2013) (providing historical analysis of SEC's provision of cost benefit analyses with respect to proposed rules); *Economic and Cost Analysis for Air Pollution Regulations*, U.S. ENV'T PROT. AGENCY (Dec. 1, 2020), https://www.epa.gov/economic-and-cost-analysis-air-pollution-regulations [https://perma.cc/UA3Y-H88Q] (disclosing reports related to cost benefit analyses of various EPA programs and rules); *see also* Exec. Order No. 12,291, 46 Fed. Reg. 13,193 (Feb. 17, 1981) (requiring agencies to conduct a cost-benefit analysis of any proposed or finalized rule); Exec. Order No. 12,866, 58 Fed. Reg. 51,735 (Oct. 4, 1993) (requiring executive agencies to perform and disclose cost benefit analyses prior to adopting prospective rules).

121. *See* Martin S. Feldstein, *Net Social Benefit Calculation and the Public Investment Decision*, 16 OXFORD ECON. PAPERS 114, 114 (1964); *see also What Is Net Social Benefit*, IGI GLOB., https://www.igi-global.com/dictionary/some-economics-of-conservation-of-cultural-heritage/62132 [https://perma.cc/9HML-XZ6J] (defining net social benefit as "the increase in the welfare of a society that is derived from a particular course of action. Some social benefits, such as greater social justice, cannot easily be quantified").

122. *See* BARRY P. KEATING & MARYANN O. KEATING, BASIC COST BENEFIT ANALYSIS FOR ASSESSING LOCAL PUBLIC PROJECTS 48–49 (Philip J. Romero & Jeffrey A. Edwards eds., 2014).

123. *See Social Benefits*, ECON. ONLINE, https://www.economicsonline.co.uk/Definitions/Social_benefit.html [https://perma.cc/9UR8-GJGJ] (defining social benefits as "private benefits gained by individuals directly involved in a transaction together with the external benefits gained by third parties not directly involved in the transaction").

124. *See* KEATING & KEATING, *supra* note 122, at 47.

125. *See id.*

extent to which certain benefits are even quantifiable.[126] Political and economic shifts have caused commentators to be more skeptical of the costs associated with government intervention.[127] Even still, the availability and public scrutiny of such studies is essential given government intervention's potential impact on surrounding communities.

The obligation to consider net social benefits conflicts with the fiduciary obligations of private sector actors. While the public sector seeks to maximize net social benefits through policy decisions, the private sector seeks to maximize profits and shareholder wealth. Private sector actors are not required to maximize net social welfare, particularly since doing so could cause such actors to run afoul of their fiduciary duties. In the corporate context, directors are bound by an assortment of fiduciary duties that require them to place the interests of the corporate entity and its underlying shareholders ahead of their own personal interests.[128] In the investment advisory context, fiduciary duties automatically obligate advisers to act in the best interests of their fund clients.[129] A rich blend of studies have theorized the extent to which directors *can* or *should* consider outside stakeholder interests in making decisions on behalf of corporations.[130]

126. *See, e.g.*, David Dayen, *Congress's Biggest Obstacle*, AM. PROSPECT (Jan. 28, 2020), https://prospect.org/politics/congress-biggest-obstacle-congressional-budget-office [https://perma.cc/9XM4-GBF4] ("Congress has created a structure to simply [consider] the costs [implicit in CBO scores] without the benefits. That mentality must change if we're to have a decent conversation about the role of government.").

127. *See, e.g.*, Gabriel Ehrlich & Ryan Nunn, *Eliminating In-House CBO Scoring Would Be 'Profoundly Unwise,'* THE HILL: BLOG (Aug. 2, 2017), https://thehill.com/blogs/pundits-blog/economy-budget/344913-rep-meadows-plan-to-to-end-in-house-cbo-scoring-profoundly [https://perma.cc/Y7LE-H452] ("CBO's budgetary analysis has, at times, drawn criticism from both Republicans and Democrats. Some Republicans have recently lambasted the agency's scoring of efforts to repeal and replace the Affordable Care Act. But in other instances, CBO's analysis has been criticized by Democrats. For example, during the debate preceding passage of the Affordable Care Act, several prominent Democrats questioned the reliability of CBO analysis showing higher-than-expected costs of Democratic healthcare reform proposals.").

128. *See* ARTHUR R. PINTO & DOUGLAS M. BRANSON, UNDERSTANDING CORPORATE LAW 283–313 (5th ed. 2018) (providing a comprehensive overview of the fiduciary duties that automatically apply to corporate directors).

129. *See* Anita K. Krug, *Moving Beyond the Clamor for "Hedge Fund Regulation": A Reconsideration of "Client" Under the Investment Advisers Act of 1940*, 55 VILL. L. REV. 661, 662–63 (2010) (revealing that investment advisers owe fiduciary duties directly to their fund clients, as opposed to the individual investors within those funds, and further arguing that this unique fiduciary structure denies such individual investors essential protections under federal securities laws).

130. *See generally* LYNN STOUT, THE SHAREHOLDER VALUE MYTH: HOW PUTTING SHAREHOLDERS FIRST HARMS INVESTORS, CORPORATIONS, AND THE PUBLIC (2012) (debunking the notion that directors are obligated to maximize shareholder value, and further advocating that they are empowered to consider outside stakeholder interests in managing the long-term interests of corporations); Lisa M. Fairfax, *Doing Well While Doing Good: Reassessing the Scope of Directors' Fiduciary Obligations in For-Profit Corporations with Non-Shareholder Beneficiaries*, 59 WASH. & LEE L. REV. 409, 414 (2002) (concluding that "corporate law allows directors of post-conversion companies to take actions that advance the interests of their beneficiaries, even when those actions fail to generate the maximum level of shareholder profit"); Lyman Johnson & David Millon, *Corporate Law After Hobby Lobby*, 70 BUS. LAW. 1, 10 (2015) (stating that "corporate law confers on [directors] broad

Yet, completely prioritizing public sector interests is a relatively new phenomenon for Private Funds hoping to simultaneously earn returns while making a measurable impact on society. Corporations or advisers that are organized as benefit corporations have actually agreed to balance shareholder interests with broader stakeholder interests, such as employees, communities, or society at large.[131] This novel legal designation for business structures has arguably made it easier for social entrepreneurs to pursue socially desirable goals without running afoul of shareholder and corporate fiduciary duties.[132] More than thirty-five states have statutorily authorized benefit corporations, which typically include accountability measures and transparency requirements to either shareholders or the general public.[133]

Even with this new avenue for prioritizing broader social goals, benefit corporations are still subject to widespread criticism by corporate law scholars. One common area of criticism is the lack of standardized mechanisms for measuring and disclosing public benefits.[134] For instance, some benefit corporation statutes require disclosures to both shareholders and the general public with respect to their measured public benefit, while others only require disclosures to shareholders—who may have limited incentives to represent the interests of outside stakeholders.[135] There is no universal obligation for benefit corporations to perform comprehensive assessments of net social benefits for anticipated projects, which would necessarily entail evaluating any negative externalities generated by such projects. There is also no universal requirement for participation or insights from targeted community members which could prevent such negative externalities from occurring in the first place. Further, social impact entrepreneurs are not required to organize their ventures as benefit corporations, making these additional, albeit limited, protections inapplicable to the bulk of private actors acting in this capacity.

Despite the limited requirement of corporate actors to perform net social benefit analyses, at least one group of scholars has applied it to evaluate whether

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discretion to determine the extent to which they choose to temper the pursuit of profit by regard for other values").

131. *See* Press Release, CSRwire, Maryland First State in Union to Pass Benefit Corporation Legislation (Apr. 14, 2010), https://www.csrwire.com/press_releases/29332-Maryland-First-State-in-Union-to-Pass-Benefit-Corporation-Legislation [https://perma.cc/D3EV-SDPF].

132. *See id.*

133. *See generally State by State Status of Legislation*, BENEFIT CORP., https://benefitcorp.net/policymakers/state-by-state-status [https://perma.cc/9527-UV5Y] (cataloging which states have passed benefit corporation legislation); CHRISTOPHER WIRTH, DRINKER BIDDLE & REATH LLP, BENEFIT CORPORATION REPORTING REQUIREMENTS (2015), https://benefitcorp.net/sites/default/files/Benefit%20Corporations%20Chart.pdf [https://perma.cc/UKX9-8DJT] (providing summary charts of applicable state's benefit corporation reporting requirements).

134. *See* Dana Brakman Reiser, *Benefit Corporations—A Sustainable Form of Organization?*, 46 WAKE FOREST L. REV. 591, 604 (2011) (highlighting some of the varying disclosure rules of benefit corporation statutes).

135. *See id.* at 604.

corporate managers are maximizing decisions with respect to their corporate social responsibility ("CSR") activities.[136] CSR is fundamentally different than social impact investing, although it falls along the same continuum of socially conscious strategies. It generally refers to self-imposed obligations for companies to be socially accountable to outside stakeholders, including but not limited to their surrounding environments, while "embody[ing] the economic, legal, ethical, and discretionary categories of business performance."[137] It can include engaging in philanthropic efforts, promoting internal employment policies that serve to increase diversity, or engaging in business activities that are beneficial to the environment. The authors of the aforementioned study suggest that firms employing CSR mechanisms should invest in projects that yield the highest degrees of net social welfare.[138] They identified the following limitations in managers selecting optimal CSR choices:

> First, firms' CSR investment choices are influenced by managers' personal preferences and by firm characteristics. . . . Second, although firms may be well informed about the private costs of CSR, they may have little experience evaluating its social benefits, leading them to choose inefficient levels of environmental protection effort. Third, firms may fail to consider alternative mechanisms to achieve their social goals. For example, firms may be able to achieve higher social returns by donating profits to charities, which are dedicated exclusively to the task of improving social welfare and thus presumably are well-suited to the task.[139]

The authors similarly identified several possible benefits resulting from CSR activities within the corporate context, such as firms gaining "access to private information about their current and future pollution activities, including control costs[,] . . . [which] can lead firms to identify better policies than less well-informed government agencies."[140] However, it still remains questionable whether private actors can sufficiently overcome their inherent limitations in identifying and calculating net social benefits. These limitations largely arise from private actors attempting to perform public functions, when they lack experience doing so and are not legally mandated to fill in social benefit gaps. The lack of public accountability with respect to the private arena in which the bulk of social impact investing occurs reduces the incentives to rectify these deficiencies.

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136. *See* Forest L. Reinhardt, Robert N. Stavins & Richard H. K. Vietor, *Corporate Social Responsibility Through an Economic Lens* (Nat'l Bureau of Econ. Rsch., Working Paper No. 13989, 2008), https://www.nber.org/system/files/working_papers/w13989/w13989.pdf [https://perma.cc/AA34-RWZC].

137. Archie B. Carroll, *A Three-Dimensional Conceptual Model of Corporate Performance*, 4 ACAD. MGMT. REV. 497, 499 (1979).

138. *See* Reinhardt et al., *supra* note 136, at 25.

139. *Id.* at 26–27.

140. *Id.* at 27.

Exacerbated by the federal securities laws' public-private divide, the private sector's lack of robust net social benefit analysis and public disclosure contributes to the difficulty in understanding and preventing negative externalities caused by social impact investments. Two recent developments have increased private social impact investing's focus on net social benefit. Benefit corporations permit corporate actors to consider stakeholder interests, although they suffer from a lack of standardization. CSR obligations privately tie corporate actors to social impact accountability, despite a lack of public accountability. While each provides some additional means to prioritize net social benefit, neither has proven sufficient to eliminate the negative externalities associated with private social impact investing.

B. Increased Potential for Negative Externalities

The same analytical framework utilized in the aforementioned study on CSR can be applied to evaluate the net social benefits—including negative externalities—of social impact investments. Like CSR's inherent limitations in asking private actors to perform public functions, private entities have limited expertise in managing and optimizing social enterprises. They are likewise free to make investments based on biases and personal preferences as opposed to optimizing selections among a variety of alternative options. Even if they are organized as benefit corporations, they have limited fiduciary duties to the general public.

While many social impact investors compile consolidated impact statements to harmonize impact reporting across their portfolios,[141] others fail to make these voluntary assessments, increasing the likelihood of impact washing. These consolidated statements can also reflect the overall impact or negative externalities generated by social impact investors through their collective allocations. In addition, social impact investors often form strategic relationships with their underlying portfolio companies. This can occur through board participation, voting rights,[142] and other granular management decisions such as

141. *See, e.g.*, *Cool Tool: Consolidated Impact Is the Goal of iPAR Reporting for Investors and Fund Managers*, IMPACTALPHA (Apr. 26, 2016), https://impactalpha.com/cool-tool-consolidated-impact-is-the-goal-of-ipar-reporting-for-investors-and-fund-managers-6d20db66e00a/ [https://perma.cc/QYF5-A46V].

142. *See* Christopher Charles Geczy, Jessica S. Jeffers, David K. Musto & Anne M. Tucker, *Contracts with (Social) Benefits: The Implementation of Impact Investing*, J. FIN. ECON. (forthcoming 2021) (manuscript at 3), https://www.sciencedirect.com/science/article/pii/S0304405X21000179/pdfft?md5=9046b649bc73c3b2bba510032bd2ec4a&pid=1-s2.0-S0304405X21000179-main.pdf [https://perma.cc/THV4-TK4N] (concluding that social impact investors often secure board seats or voting rights of their underlying portfolio companies); *see also* Steven E. Boschner & Amy L. Simmerman, *The Venture Capital Board Member's Survival Guide: Handling Conflicts Effectively While Wearing Two Hats*, 41 DEL. J. CORP. L. 1 (2016) ("Venture firms often invest very early in a company's life cycle and, as a result, own a sizeable percentage of the company at the outset. With these early investments, venture capitalists frequently negotiate for a position on the corporation's board of directors, as well as equity holdings that come with certain contractual and corporate charter-based preferences over the common stock in areas

determining the ways in which portfolio companies measure and disclose impact. Nevertheless, if social impact investors are passive in effectuating these roles, then their underlying operating companies face a higher likelihood of generating negative externalities. Moreover, social impact investors are providing somewhat of a gatekeeping role for socially conscious industries in that these start-up companies frequently rely on social impact investors to provide vital rounds of venture capital funding. However, these socially conscious industries can produce negative externalities without proper oversight and disclosure.

To combat these limitations, social impact managers should actively engage in the process of optimizing net social benefits. This entails calculating the anticipated increase to private benefits and positive externalities, as well as any resulting costs, which would include an estimation of any negative externalities. However, there is very limited proof that this occurs on a wide scale basis. Evidence reveals the sparse interactions that social impact managers have with community members that are the targeted beneficiaries of underlying projects:[143]

> Successful businesses continuously update their knowledge of what customers want. Walmart collects more than 2.5 million gigabytes of customer data per hour and Yelp users post 26,380 reviews per minute. So why do many impact investors, who seek social, environmental, and economic returns on patient timelines, park customer insight at the door when they want to achieve multiple bottom lines? It's a question I've asked more than 500 senior business executives from 90 countries who have attended the Oxford Impact Investing and Oxford Social Finance programs at Saïd Business School over the past six years. And it's one I've pursued in research involving 1,200 social investors across 20 countries. Their answers indicate they think of social impact beneficiaries differently than commercial customers. But they shouldn't. Overlooking any target customers' needs can lead to failed investments.[144]

Social impact managers' miscalculation of net social benefits is implicit within this lack of engagement. Social impact managers' troubling assumption that even incremental increases to positive externalities serve to enhance social welfare is likely the root cause of many costly and devastating negative externalities generated by social impact investments. Ongoing conversations and studies with affected community members through enhanced due diligence procedures could have reduced or even eliminated the occurrence of these

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such as the divvying up of proceeds in a merger, protection against certain types of future dilution, and special voting rights.").

143. *See* Gayle Peterson, *Three Community Feedback Tools for Impact Investors*, STAN. SOC. INNOVATION REV. (Dec. 19, 2018), https://ssir.org/articles/entry/three_community_feedback_tools_for_impact_investors [https://perma.cc/Q2CC-A26F] (revealing that large numbers of impact investors do not see the need for obtaining feedback from affected community members regarding underlying projects).

144. *Id.*

negative externalities. Since social impact investors are not required to internalize these costs due to the limited liability nature of these investments, there are limited incentives to prevent them from occurring.

A common category of such negative externalities occurs when a seemingly clean energy impact investment inadvertently destroys a surrounding environment or habitat. An example of this transpired when Buchanan Renewables, a company that touted its social impact projects, created a plan to convert latent rubber trees into biomass chips that could be used to supply electricity to Monrovia, Libya.[145] When the project failed after the company determined that it was no longer economically viable, many of the biomass chips that were left behind contaminated surrounding natural water supplies.[146] In addition, according to some sources, "the lack of old rubber trees is contributing to deforestation in the area as local charcoal producers in search for wood are now cutting down trees in nearby threatened natural forest."[147] Workers who were severely injured as a result of the project's operations were left with little to no recourse.[148] Reports of rampant sexual abuse committed by the project's employees also arose from surrounding community members who were the targeted beneficiaries of this project.[149]

Even in the United States, where an enhanced network of interlocking state and federal regulations could prevent such cascading harms, private industries have an insidious history of targeting marginalized communities for hazardous waste disposal among other harmful activities. For instance, Professors Paul Mohai and Robin Saha found "a consistent pattern over a 30-year period of placing hazardous waste facilities in neighborhoods where poor people and people of color live."[150] They similarly concluded that,

> Racial discrimination in zoning and the housing market, along with siting decisions based on following the path of least resistance, may best explain present-day inequities . . . hazardous waste sites are often built in neighborhoods where whites have already been moving out, and poor minority residents have been moving in, for a decade or two before the

145. *See Liberian Communities Still Suffering from Failed Bioenergy Project*, SWEDWATCH (May 25, 2018), https://swedwatch.org/en/regions/africa-south-of-the-sahara/liberian-communities-still-suffering-failed-bioenergy-project/ [https://perma.cc/4R3P-3F5H].

146. Ronnie Greene & Jonathan Paye-Layleh, *US Loans Fueled Insider Deal, Failed Power Plan in Liberia*, ASSOCIATED PRESS (Jan. 27, 2015), https://apnews.com/52cad7bc134d4057a76b6a8cf2263c1a/us-loans-fueled-insider-deal-failed-power-plan-liberia [https://perma.cc/7KW9-Q3AS].

147. *See Liberian Communities Still Suffering from Failed Bioenergy Project*, *supra* note 145.

148. *See id.*

149. *See id.*

150. Jim Erickson, *Targeting Minority, Low-Income Neighborhoods for Hazardous Waste Sites*, UNIV. OF MICH. NEWS (Jan. 19, 2016), https://news.umich.edu/targeting-minority-low-income-neighborhoods-for-hazardous-waste-sites/ [https://perma.cc/SB89-69S8].

project arrived. Such changes may result in a further eroding of resources and political clout in these neighborhoods.[151]

Scholars have likewise found a correlation between these higher rates of pollution and the higher rate of asthma among Black people in this country.[152] Social impact investments would presumably be designed to mitigate harms of this nature. However, this disturbing history provides ample reasons to be wary of emerging technologies and developments that can inadvertently lead to even more harms, particularly when they are allowed to operate within such a heightened zone of opacity under federal securities laws.

Social impact investments that are ill conceived and poorly executed can also crowd out higher-quality products or services that have greater impact. Investing in a solar production company for instance may appear to be beneficial for the environment on its face.[153] However, the company might produce lower quality solar panels than existing competitors.[154] If social impact investing then crowds out superior competitors from the marketplace, it will have a negative effect on the surrounding environment.[155] This "crowding out" effect is more likely to occur if social impact investing is concessionary in nature.[156] A scenario of this nature could also lead to lost jobs of such crowded-out competitors, leading to yet an additional negative externality.

This crowding-out phenomenon becomes even more problematic in the context of the provision of social services, where the public sphere could be crowded out of the market by social impact investors despite being better equipped to prioritize community needs. For instance, social impact investors may increase allocations to charter schools and other private modes of education particularly given the new tax incentives associated with investing in distressed communities that are identified as opportunity zones.[157] This could crowd out public school alternatives despite the well-documented harms of charter

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151. *Id.*

152. *See* U.S. ENV'T PROT. AGENCY, EPA 100-F-08-029, CHILDREN'S ENVIRONMENTAL HEALTH DISPARITIES: BLACK AND AFRICAN AMERICAN CHILDREN AND ASTHMA (2008), https://www.epa.gov/sites/production/files/2014-05/documents/hd_aa_asthma.pdf [https://perma.cc/UW6N-ZVKN].

153. *See* Kelsey Piper, *"Impact Investment" Funds Advertise Great Returns and Social Impacts. They Aren't Delivering.*, VOX (Dec. 19, 2018), https://www.vox.com/future-perfect/2018/12/18/18136214/impact-investing-socially-responsible-sri-report [https://perma.cc/7BQH-S4MP].

154. *See id.*

155. *See* Wendy Abt, *Almost Everything You Know About Impact Investing Is Wrong*, STAN. SOC. INNOVATION REV. (Dec. 18, 2018), https://ssir.org/articles/entry/almost_everything_you_know_about_impact_investing_is_wrong [https://perma.cc/B5ET-XWBX].

156. *See id.*

157. *See e.g.*, Medema, *supra* note 16; ECON. INNOVATION GRP., THE TAX BENEFITS OF INVESTING IN OPPORTUNITY ZONES (2018), https://eig.org/wp-content/uploads/2018/01/Tax-Benefits-of-Investing-in-Opportunity-Zones.pdf [https://perma.cc/7BQ4-DM4S].

schools.[158] Even still, targeted communities will have limited access to disclosures related to such allocations given the federal securities laws' archaic dichotomy between public and private investments.

Beyond crowding out of businesses and publicly funded services, social impact strategies can also crowd out entire communities, and lead to the wholesale displacement of the very communities they are intended to serve. As one example, social impact investors are now targeting opportunity zones ("OZ") as a potential avenue for "doing well, while doing good."[159] The 2017 Tax Cut and Jobs Act created these zones to incentivize private investment in the over 8,000 designated neighborhood "zones" that are deemed economically distressed.[160] This legislation effectively reduces the tax rate of capital gains that are reinvested in these distressed neighborhoods.[161] While other categories of businesses can invest in OZ, the long-term investment horizons for receiving such tax benefits, as well as the easily touted benefit of "doing well" by spurring private investment in distressed communities invite social impact investing.[162] However, this legislation failed to include any concrete obligations to report or measure any identified impact objectives for enterprises taking advantage of these tax breaks.[163] The law similarly fails to include any requirements that community members within these designated zones must benefit from any housing units or jobs created by these investments.[164] Moreover, such community members are highly unlikely to generate the capital gains that would trigger the tax breaks guaranteed under this law. Concerns have therefore arisen from community groups, lawmakers, and other commentators that these projects will lead to the gentrification of targeted communities, which will benefit the wealthy at the expense and to the detriment of the poor.[165]

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158. *See* Strauss, *supra* note 17.

159. *See* Anne Field, *Tapping Opportunity Zones, Social Impact Investor SoLa Raises Its Biggest Fund*, FORBES (May 31, 2019), https://www.forbes.com/sites/annefield/2019/05/31/tapping-opportunity-zones-social-impact-investor-sola-raises-its-biggest-fund/ [https://perma.cc/7TKE-MV4E]; Elise Hansen, *Fifth Third Bank Pledges $100M for Opportunity Zone Projects*, LAW360 (Jan. 24, 2020), https://www.law360.com/articles/1237388/fifth-third-bank-pledges-100m-for-opportunity-zone-projects [https://perma.cc/X29Q-H7X9].

160. *See* Amy Cortese, *Fifth Third Bank Commits $100 Million to Impact-Focused Opportunity Zone Projects*, IMPACTALPHA (Jan. 27, 2020), https://impactalpha.com/fifth-third-bank-commits-100-million-to-impact-focused-opportunity-zone-projects [https://perma.cc/GSS8-5JPH].

161. *See generally* 26 U.S.C. § 1400Z–2 (outlining and defining the Special Rules for Capital Gains Invested in Opportunity Zones).

162. *See* Matthew Erskine, *Qualified Opportunity Zone Investments: Does It Make Sense During the Covid 19 Crisis?*, FORBES (Dec. 8, 2020), https://www.forbes.com/sites/matthewerskine/2020/12/08/qualified-opportunity-zone-investments-does-it-make-sense-during-the-covid-19-crisis/ [https://perma.cc/BY9P-MHCE].

163. *See* Oscar Perry Abello, *Boulder Presses Pause on Some Opportunity Zone Development*, NEXT CITY (Mar. 6, 2019), https://nextcity.org/daily/entry/boulder-presses-pause-on-some-opportunity-zone-development [https://perma.cc/9QZG-W8R2].

164. *See id.*

165. *See, e.g.*, Eric Lipton & Jesse Drucker, *Lawmakers Increase Criticism of 'Opportunity Zone' Tax Break*, N.Y. TIMES (Nov. 6, 2019), https://www.nytimes.com/2019/11/06/business/opportunity-

Early studies and anecdotal evidence seem to suggest that at least some such concerns are coming into fruition. While one study concluded that a sample of opportunity zone investments led to a "small increase in liquidity at the end of the sample period and evidence of more vacant land sales," it also found that "the OZ program does not yet show any general effects on land price appreciation [and] [t]he estimated effects are temporarily and spatially limited, and do not affect all properties of all types equally."[166] Other reports have revealed that opportunity zone investors seem to be targeting projects related to luxury real estate developments as opposed to affordable housing that would directly benefit surrounding communities.[167] These sorts of developments could also lead to increased property taxes, further pushing out members of these targeted communities who may not be able to afford these increased rates. "This leaves room for bigger conglomerates such as Whole Foods and Starbucks to come in, leading to a displacement of residents due to a rise in rent and retail prices."[168] Smaller black-owned businesses located in marginalized communities could similarly be pushed out of business by these larger conglomerates. Interestingly enough, minority depository institutions and community development financial institutions do not qualify for opportunity zone tax benefits despite the important role that they play in disadvantaged communities.[169]

Providing a mechanism to require input from community members that are the targeted beneficiaries of these investments could reduce at least some of the negative externalities generated by these schemes. As investors, affected community members would yield more power to negotiate for additional disclosures related to impact, and to vote on key issues pertaining to the ways in which these projects are managed. Managers of social impact investments that include affected community members as investors would likewise face greater incentives to manage the vehicle in a way that serves to benefit community member investors. While many such investments may be too risky for

zones-congress-criticism.html [https://perma.cc/F6HF-2JB7] (reporting that "[t]wo Democrats and a Republican on the House Ways and Means Committee introduced a bill on Wednesday to require funds that invest in opportunity zones to file annual reports with the Treasury that disclose details of their development projects and any new businesses").

166. Alan Sage, Mike Langen & Alex van de Minne, Where Is the Opportunity in Opportunity Zones? 36 (Feb. 19, 2021) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3385502 [https://perma.cc/N8YF-TBVJ].

167. *See* Sophie Quinton, *Black Businesses Largely Miss Out on Opportunity Zone Money*, PEW: STATELINE (June 24, 2020), https://www.pewtrusts.org/en/research-and-analysis/blogs/stateline/2020/06/24/black-businesses-largely-miss-out-on-opportunity-zone-money [https://perma.cc/L8ZW-YBFV].

168. Tracey Onyenacho, *How Opportunity Zones Are Hurting the Growth of Low-Income Black Neighborhoods*, BLAVITY (July 15, 2019), https://blavity.com/blavity-original/how-opportunity-zones-are-hurting-the-growth-of-low-income-black-neighborhoods [https://perma.cc/R8HA-2KX2].

169. *See* James R. Barth & Kenneth Kelly, *Missed Opportunity Zone Investments: Minority-Owned Banks*, CRAIN'S DETROIT BUS. (Oct. 22, 2019), https://www.crainsdetroit.com/other-voices/missed-opportunity-zone-investments-minority-owned-banks [https://perma.cc/CXU2-FDMU].

community member participation, particularly concerning emerging and untested technologies, others may provide innovative opportunities to economically participate in and benefit from the development of projects that impact their surrounding communities.

As managers, community members would be empowered to dictate directly how the project is developed and implemented to protect against the wholesale displacement of their communities. Targeted beneficiaries are more familiar with the unique characteristics and risks of their surrounding communities, many of which are labeled as "unforeseen" to outsiders. Including targeted community members within some level of management could help to ensure that such costs are fully accounted for, or at least considered.

Even if the inclusion of targeted community members as managers or investors is unfeasible from a regulatory and practical perspective, requiring advance notice, consultation, or informed consent of future projects could provide additional mechanisms for reducing such unanticipated harms. Given the opaque environment in which these vehicles operate, there are limited opportunities for accountability. By and large, the antiquated ways in which federal securities laws distinguish between public and private investment schemes contributes to the harms discussed herein. A new set of exemptions for social impact investments would incorporate both the private and public elements of social impact investing strategies while introducing new mechanisms for regulating the increasing publicness of these schemes.

C. Resulting Opaqueness Under Federal Securities Laws Reduces Opportunities for Accountability

Since the public-private divide under the federal securities laws reduces the disclosure obligations for privately held companies, social impact investors operate in a zone of opacity. Both affected community members and the public at large lack access to meaningful information related to projects financed by social impact investments. As a result, it is virtually impossible to know with any degree of certainty the extent to which social impact investors are optimizing net social benefits in selecting their allocations. For all we know given existing disclosure requirements, advisers could be selecting social impact opportunities based on undisclosed conflicts of interest or idiosyncratic personal preferences, as opposed to selecting opportunities that generate optimal impact within a particular community.

Under existing federal securities laws, social impact investors can similarly abandon meaningful due diligence procedures related to the potential adverse effects that these investments can generate. This is quite troubling given the well-documented negative externalities that have occurred in a myriad of distressed communities within the project development space.[170] The restrictions on

170. *See supra* Part II.B.

targeted beneficiaries' participation in social impact investments—which could mitigate these negative externalities before they occur—exacerbate the already-limited transparency of social impact investments.

Elite investors have access to varying degrees of information regarding their investments but do not have sufficient incentive to use that information to protect targeted communities from unintended harms. Many receive disclosures in the form of private placement memoranda and other periodic disclosure documents consistent with best practices models.[171] Many negotiate for additional transparency, which frequently depends on their respective bargaining power drawn from institutional status or ownership share.[172] Most perform extensive due diligence procedures before making investment decisions.[173] This is consistent with the underlying theory supporting the public-private divide under federal securities law, namely, that elite investors can sufficiently protect themselves without the need for government intervention.[174] But herein lies the problem. These kinds of investors have no real incentives to hold advisers accountable for unintended harms to targeted communities for which they do not belong. If they can exploit these communities for profit without having to absorb the costs of any resulting negative externalities, then they are highly unlikely to hold advisers accountable.

One class of elite investors provide a sliver of hope: public pension plans. David Webber's book *The Rise of the Working-Class Shareholder: Labor's Last Best Weapon,* documents in detail the extent to which such pension plans have successfully advocated on behalf of their underlying retail investor beneficiaries.[175] Pension plan trustees have frequently utilized their power as shareholder activists to preserve and create jobs and to impede purely self-interested board decisions.[176] Unfortunately, despite the notable power of prominent pension plans such as CalPERS, public pension plans are a dying breed.[177] The bulk of average investors save for retirement through a defined contribution plan such as a 401(k) or 403(b), where they are primarily selecting from a range of mutual fund investments.[178] Defined contribution plans are not

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171. *See* Houman B. Shadab, *The Law and Economics of Hedge Funds: Financial Innovation and Investor Protection*, 6 BERKELEY BUS. L.J. 240, 287–88 (2009) (noting that hedge fund investors frequently demand and receive additional disclosures from hedge fund advisers).

172. *See* Troy A. Paredes, *On the Decision to Regulate Hedge Funds: The SEC's Regulatory Philosophy, Style, and Mission*, 2006 U. ILL. L. REV. 975, 992 (2006) (contending that hedge fund investors, "particularly institutional investors, engage in active due diligence before investing, routinely retain advisory firms to evaluate options for them, and negotiate for more disclosure from hedge funds . . . .").

173. *See id.*

174. *See id.* at 994–95.

175. DAVID WEBBER, THE RISE OF THE WORKING-CLASS SHAREHOLDER: LABOR'S LAST BEST WEAPON (2018).

176. *See id.* at 211.

177. *Id.* at 214–15.

178. *See id.* at 218.

centrally managed by advisers who can wield their significant power to thwart corporate malfeasance.[179] Individual investors of these plans likely rely on the advisers of their mutual fund holdings to vote on their behalf. As previously mentioned, mutual fund advisers are far less likely to perform a shareholder activist role and tend to vote alongside management—particularly when considering their potential business conflicts.[180] For these reasons, this Article proposes a novel exemption that extends beyond shareholder activism to include additional mechanisms for disclosure, access, and accountability.

To the extent that social impact investing does generate negative externalities, there is no mechanism in place for underlying advisers to face any level of accountability for their decisions gone awry. Information received by elite investors is not distributed to the general public or made available through an accessible medium such as a website or database. Even if it were publicly available, it is not standardized, so it would be difficult to make meaningful comparisons across a range of investments.[181] As a result, there is no formal or informal mechanism for processing community complaints, and the opacity of these markets prevents even public embarrassment from serving that role. This is contrary to other comparable categories of investments such as development finance institutions.[182] As noted by prominent experts Natalie Bridgeman Fields and Gayle Peterson,

> Development finance institutions, which until recently were the only investors operating in the development space, have accountability offices in place to respond when things go wrong, after 50 years of experience in the space. For example, the Compliance Advisor Ombudsman is the grievance body for the International Finance Corp., the World Bank's private sector arm. It receives, evaluates, and also mediates complaints about social and environmental harm caused by IFC-backed projects. Elsewhere, the United States Overseas Private Investment Corporation has an accountability mechanism to address claims from community members. Every multilateral development bank now has access to an accountability office. However, no such bodies exist in the impact investing space.[183]

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179. *See id.*

180. *See id.* at 220. *See generally How Sustainable ETFs Let Small Investors Make a Difference*, *supra* note 80.

181. *See generally* Cary Martin, *Is Systemic Risk Prevention the New Paradigm? A Proposal to Expand Investor Protection Principles to the Hedge Fund Industry*, 86 ST. JOHN'S L. REV. 87 (2012) (unveiling the difficulties associated with optimizing a range of investment decisions when provided disclosures lack standardization).

182. *See, e.g.*, Shalanda H. Baker, *Why the IFC's Free, Prior, and Informed Consent Policy Does Not Matter (Yet) to Indigenous Communities Affected by Development Projects*, 30 WIS. INT'L L.J. 668, 669–71 (2012) (summarizing and critiquing the IFC's informed consent policy).

183. Sophie Edwards, *Impact Investors Must Set Up 'Accountability Tools,' Experts Say*, DEVEX (Apr. 13, 2018), https://www.devex.com/news/impact-investors-must-set-up-accountability-tools-experts-say-92528 [perma.cc/S8MU-ELQ9].

It is not entirely clear whether regulators will heed these concerns and pull impact investors under a comparable accountability model. Doing so would alleviate some of the issues resulting from elite investors' privileged access to social impact investments. However, retooling exemptions under federal securities laws to better reflect the updated notions of publicness within social impact investing could help to prevent these harms from occurring in the first place, thereby reducing the need for accountability.

D. Limitations of Private Ordering

Many commentators support private ordering as a solution to the problems outlined in this Section, but privately ordered solutions are inherently limited. First, because compliance is voluntary, noncompliant entities may continue to generate significant externalities with no enforceable recourse for the intended beneficiaries. Second, the lack of standardization in measurement and disclosure of impact makes it virtually impossible for stakeholders to evaluate the net social benefits of privately ordered solutions. Finally, the elite private investors who currently dominate social impact investing may not have sufficient incentive to implement reforms that cut into the profitability of the industry. Yet, privately ordered solutions remain popular.

There are several reasons that researchers and commentators support the further development of social impact investing with limited government intervention despite the noted drawbacks. First, privately ordered solutions are sometimes considered superior to government-imposed regulations which can be unnecessarily cumbersome and costly.[184] Government entities have an infamous history of failing to incorporate private sector perspectives, which can lead to regulations that are not closely tailored to the underlying problems that they are

184. *See, e.g.*, Knowledge@Wharton, *Taking Stock of Dodd-Frank: Hits, Misses and Unfinished Business*, WHARTON SCH. UNIV. OF PA., at 03:07 (July 22, 2015), https://knowledge.wharton.upenn.edu/article/taking-stock-of-dodd-frank-hits-misses-and-unfinished-business/ [https://perma.cc/7Y6C-SX9V] (capturing Todd Zywicki asserting that "[U.S. Congress] rushed into Dodd-Frank without having any idea of what they were doing; they never properly diagnosed the underlying causes of the crisis"); *see also* JOEL SELIGMAN, THE TRANSFORMATION OF WALL STREET 52 (3d ed. 2003) (remarking that "[President] Roosevelt was determined to draft and quickly submit to Congress a securities bill that could be voted on while he still enjoyed the extraordinary political support generated by the bank crisis"); William Dunkelberg, *The Insidious Cost of Regulation*, FORBES (Apr. 4, 2017), https://www.forbes.com/sites/williamdunkelberg/2017/04/04/the-insidious-cost-of-regulation/ [https://perma.cc/8GTE-RHQY] (observing that "[t]he Competitive Enterprise Institute noted that in 2015 the government issued over 80,000 pages of rules including 76 'major' rules costing more than $100 million to implement"). *But see* PEW CHARITABLE TRUSTS, GOVERNMENT REGULATION: COSTS LOWER, BENEFITS GREATER THAN INDUSTRY ESTIMATES 1 (2015), https://www.pewtrusts.org/-/media/assets/2015/05/industry/government_regulation_costs_lower_benefits_greater_than_industry_estimates.pdf [https://perma.cc/2FQ6-7YHG] ("Although an argument is sometimes made that the cost of complying with regulations is too high, that the societal benefits do not justify the investment, or that job losses will result, a review of past regulations reveals just the opposite. Historically, compliance costs have been less and benefits greater than industry predictions, and regulation typically poses little challenge to economic competitiveness.").

intended to resolve.[185] Second, regulatory responses involving federal securities laws are often hurried and ill-conceived as they are frequently developed in response to a financial crisis or massive fraud.[186] It can be difficult for regulators to generate the political capital needed to advocate for regulatory proposals that are contrary to prevailing political powers. Third, imposing stringent regulatory requirements could deter advisers from pursuing these strategies altogether. This concern may be justifiable, as the government and philanthropists are unlikely to have the resources to sufficiently fill funding gaps related to eradicating poverty, reducing inequality, and reversing climate change.

The support for privately ordered solutions is not simply academic, as several privately enforced models have emerged in recent years. In the spring of 2019, the International Finance Corporation ("IFC") launched a set of principles aimed to "support the development of the impact investing industry by establishing a common discipline around the management of investments for impact."[187] The Georgetown Beeck Center on Social Impact and Investing has "launched a national effort . . . to incorporate impact objectives into investment strategies for low-income communities . . . [and are using] the conversation swell around Opportunity Zones to convene a diverse group of stakeholders . . . and test new models of community investment."[188] Howard W. Buffett, Warren Buffet's grandson, has recently unveiled an innovative software tool that provides novel measures of various categories of impact for OZ investments, including social, environmental, and economic impacts.[189] B-Lab, a nonprofit organization, developed a pioneering framework to ensure that companies that are labeled as B corporations are, in fact, doing well while doing good for society.[190] Under this framework, enterprises that are organized as Certified Benefit Corporations are required to comply with arduous public transparency mandates and independently verified impact measures.[191]

But solely relying on private ordering is likely to leave costly loopholes due to the inherent limitations of these models. First and foremost, compliance with these frameworks is completely voluntary, leaving vast gaps in terms of the

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185. *See* Knowledge@Wharton, *supra* note 184.
186. *See id.*
187. *Impact Investing at IFC*, INT'L FIN. CORP., https://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/development+impact/principles [https://perma.cc/HB93-2SQL]; *see also* INVESTING FOR IMPACT, *supra* note 38, at 3–6 (enumerating principles for impact investing).
188. *Inclusive Community Impact Investing*, BEECK CTR. GEO. UNIV. (Feb. 2018), https://beeckcenter.georgetown.edu/project/inclusive-impact-investing-opportunity-zones/ [perma.cc/MS6N-2434].
189. *See* Keith Larsen, *Warren Buffett's Grandson and the Art of Opportunity Zone Social Impact Investing*, REAL DEAL (Feb. 7, 2020), https://therealdeal.com/2020/02/07/warren-buffetts-grandson-and-the-zen-of-opportunity-zone-social-impact-investing/ [https://perma.cc/E7KW-UW4W].
190. *See About B Corps*, B LAB, https://bcorporation.net/about-b-corps [https://perma.cc/KZ88-75ZB].
191. *See id.*

negative externalities that could be generated by noncompliant entities. Given the multitude of models proliferated by a wide range of private actors, there is a complete lack of standardization regarding how impact is measured and disclosed arising from these models. This lack of standardization is particularly problematic as it makes it virtually impossible for affected stakeholders to assess the extent to which social impact investors are truly maximizing net social welfare. Attempting to compare a range of privately held entities following divergent frameworks for measuring and disclosing impact would likely be a fruitless endeavor.

Furthermore, elite investors will likely support models that help to preserve their self-interest as opposed to models that prioritize the interests of targeted community members. There is already evidence implying that elite investors prefer to preserve their self-interest. The Accountability Counsel, which "advocates for people harmed by internationally financed projects,"[192] highlighted several limitations regarding the model proposed by the IFC—a model that gathered over 120 global investor signatories.[193] According to the Accountability Counsel, "the Principles [adopted by the IFC] should go further in their reference and incorporation of transparency, accountability, consultation, and harm avoidance and remediation."[194] The Accountability Counsel further notes that "guidance for managing negative impacts . . . should be equally or more robust than for positive impacts. This includes proactively consulting affected local communities at every stage of investment and providing them with a mechanism to provide feedback about positive and negative impacts."[195] The IFC principles are shockingly devoid of any concrete recommendations for impact investors to consult with or provide meaningful accountability mechanisms for community members who are the targeted beneficiaries of social impact investments.[196] This is quite troubling given the minimal involvement of

192. *About Us*, ACCOUNTABILITY COUNS., https://www.accountabilitycounsel.org/about-us [https://perma.cc/6SKH-P8Q3].

193. *See Signatories & Reporting*, OPERATING PRINCIPLES IMPACT MGMT., https://www.impactprinciples.org/signatories-reporting [https://perma.cc/2NCB-H7M4]; INVESTING FOR IMPACT, *supra* note 38 (enumerating principles for impact investing based on the IFC model); Letter from Accountability Couns., Action Paysanne Contre la Faim, Afr. Ctr. for Corp. Resp., Afr. L. Found. (AFRILAW), Arbeitsgemeinschaft Regenwald und Artenschutz (ARA), Bank Info. Ctr., BankTrack, Ctr. for In'l Env't L. (CIEL), Conseil Régional des Organisations Non Gouvernementales de Développement, Due Process of L. Found., Fund Our Future, Gender Action, Glob. Network for Good Governance (GNGG), Inclusive Deve. Int'l, Int'l Accountability Project (IAP), Int'l Rivers, Afr. Program, MiningWatch Can., Observatoire d'Etudes et d'Appui à la Responsabilité Sociale et Environnementale (OEARSE), Oxfam Int'l, Oyu Tolgoi Watch, Responsible Sourcing Network, Rts. CoLab, Rivers without Boundaries, Soc. Just. Connection, & Urgewald, to Hans Peter Lankes, Vice President, Econ. Priv. Sector Dev., Int'l Fin. Corp. (Dec. 21, 2018) [hereinafter *Accountability Counsel Recommendations*], https://www.accountabilitycounsel.org/wp-content/uploads/2018/12/12-21-18-submission-on-ifc-operating-principles-for-impact-management.pdf [https://perma.cc/5G3C-GUBB] (noting limitations of the IFC model and recommending revisions).

194. *Accountability Counsel Recommendations*, *supra* note 193, at 1.

195. *Id.*

196. *See id.* at 2–5.

such community members as investors, managers, or consultants within these schemes.

Leaving these harms unregulated can deepen the problems that these investments are purportedly trying to solve. The negative externalities frequently generated by these privately held entities can increase the costs associated with poverty, climate change, and inequality. Arguably, the public-private divide under the federal securities laws is itself perpetuating wealth inequality. Federal securities laws are deeply embedded with antiquated notions of publicness that can serve as a gateway for wealthy investors to profit from the pain of the poor and disadvantaged. This serves to leave behind trails of additional pain and destruction with little to no accountability. These lingering loopholes could also disincentivize the creation of government-funded programs or philanthropic efforts due to the potential overreliance on these flawed private sector solutions. Evidence shows that simply donating money to charity yields higher degrees of impact than allocating to social impact investments.[197] While scrutinizing this evidence is largely beyond the scope of this Article, the next Section will discuss how additional transparency and accountability mechanisms in the social impact investing space can help to better answer this question.

III.
RECONCEPTUALIZING THE PUBLIC-PRIVATE DIVIDE THROUGH NEW SOCIAL IMPACT EXEMPTIONS

For these loopholes to be resolved, the public-private divide under federal securities laws must be reconceptualized. The inconsistent treatment of publicness under the Securities and Exchange Acts, or the incoherent responses of lawmakers to increasing notions of publicness due to the events contributing to the global financial crisis of 2007-2009 present similar problems.[198] However, this Article is the first to explore the reconceptualization of publicness in the context of social impact investing. By and large, Congress must reconsider antiquated indicators of publicness across various facets of the federal securities laws to better reflect the innovations generated by regulated industries. Lawmakers must similarly update mandated protections under federal securities laws to better protect the general public against the spillover effects of private entities. This Section offers a novel regulatory solution and proposes that lawmakers create new tailored exemptions for social impact investments.

Revising federal securities law would resolve some of the limitations of existing frameworks. It would obligate social impact investors to comply with a standardized disclosure framework, making benefit corporation compliance mandatory rather than voluntary. This proposal would likewise increase community participation to mitigate negative externalities *ex ante*. It would also

197. *See, e.g.*, HILLEBRANDT & HALSTEAD, *supra* note 20, at 5, 54–56.
198. *See* Langevoort & Thompson, *supra* note 19 and accompanying text.

engage targeted community members who would no longer have to rely on the few remaining activist pension plan shareholders to exercise their diminishing power. They would instead be able to directly access these investments to varying degrees as investors or managers. Together these effects would help ensure that social impact investments do not merely profit from the pain of their targeted beneficiaries but create positive social impacts in the communities they are intended to serve.

A. Social Impact Exemptions

Any solution that seeks to reconceptualize publicness will inevitably require the creation of new regulatory frameworks that combine existing indicators of public and private and create new measures of each. Reconceptualizing publicness in a truly comprehensive manner would entail rigorous analysis in the fields of economics, law, finance, behavioral psychology, and more. The preexisting divisions between public and private have been effectively eroded through financial innovation and widening regulatory loopholes. Categorizing funds as private simply because they are restricted to elite investors who can fend for themselves no longer works in a world where their investments can generate massive negative externalities.

One solution is to create an entirely new series of exemptions that recalibrate rules related to access and disclosure, while creating new mechanisms for accountability and management structure. There are four components to the proposed exemptions: (1) disclosure, (2) access, (3) accountability, and (4) management. The collective impact of these components would further engage the government and affected community members in eradicating social harms, instead of solely relying on benevolent private investors. Not each of these components is equally feasible. Disclosure would probably be the most feasible component to effectuate since it falls within the historical purview of the SEC's regulatory powers. As such, new social impact exemptions should at minimum include tailored disclosure requirements to increase protections for targeted community members.

The other components present more practical difficulties. The access and accountability components would require significantly more analysis and scrutiny from a wide variety of experts. Further, the SEC has not traditionally utilized accountability to enforce its broader investor protection mandate outside of its mandatory disclosure framework, so adding an accountability component to new social impact exemptions may require an expansion of SEC powers that could be politically difficult. Finally, the management component of this proposal would be exceedingly difficult, both politically and practically, to obligate entities to include affected community members within their management structure.

This proposal urges lawmakers to consider each of these components as innovative mechanisms to prevent the negative externalities discussed herein.

The SEC is mandated to protect investors. Adequately ensuring such investor protection in light of a rapidly changing marketplace likely requires tools that extend beyond disclosure and access. Moreover, the definition of investor has arguably been expanded to include underlying beneficiaries of institutional investors, such as pension plans and endowments, which qualify as elite investors. And potential harms generated by Private Funds warrant further analysis of inventive mechanisms to regulate the blurred distinction between private and public entities. The final sections of this Article will discuss the pros and cons of further regulation of access, disclosure, and management in investing entities to address negative externalities.

This Article proposes new Social Impact Exemptions that would appear under the Securities Act and the 1940 Act and be subject to SEC oversight. Funds and companies that effectuate social impact investing strategies would be obligated to comply with these exemptions in exchange for regulatory flexibilities. These flexibilities could include greater freedom to invest in illiquid instruments and a clear expansion of fiduciary duties, which is necessary to access social impact investments yielding lower returns. Compliance with the Social Impact Exemptions would also permit investment funds and other corporate entities to avoid any remaining registration requirements that may appear under the Securities Act and the 1940 Act.

The SEC's Division on Economic Risk and Analysis should compile a team of experts to create the tailored rules within these new exemptions and the triggers for their application.[199] Before crafting the rules within the exemptions, this team would face the arduous challenge of adopting appropriate thresholds to trigger compliance with the new exemptions. Bright-line thresholds can be inherently overinclusive or underinclusive, whereas principles-based standards can require excessive resources to effectively implement. A bright-line threshold would automatically trigger compliance; for example, the threshold could state that the exemption automatically applies to any funds and companies seeking to utilize special tax treatment resulting from investment in opportunity zones, or any entities that are organized as benefit corporations. Similarly, the SEC could require compliance from any entities that have adopted a social impact investing strategy, although social impact would have to be more clearly defined. Once these compliance triggers are determined, the team should then consider the regulatory nuances of the disclosure, access, accountability, and management components discussed above. Ultimately, regulatory focus on these components will be of paramount importance in moving beyond a federal securities landscape

199. *See About the Division of Economic and Risk Analysis*, U.S. SEC. & EXCH. COMM'N (Jan. 13, 2021), https://www.sec.gov/dera/about [https://perma.cc/2KBV-NDJK] (describing how this relatively new "think tank" division "engages across the entire range of the agency's functions, including rulemaking, examination, and enforcement [and] [i]ts multi-disciplinary analyses are informed by research insights, and they rely on the knowledge of institutions and practices when examining regulatory and risk-related matters").

that allows elite investors to profit from the pain of the same marginalized communities they proffer to support.

1. Disclosure

Disclosure obligations are typically triggered under federal securities laws when securities are offered for sale to the general public.[200] This obligation is consistent with the investor protection principles embedded in these laws. Retail investors are generally entitled to receive any material information regarding an issuer's offering, its overall business and management structure, its audited financial statements, and other relevant information.[201] Importantly, private entities' generation of negative externalities typically do not trigger disclosure obligations, a key issue this section seeks to address.

Many researchers do not agree that privately held entities create high levels of negative externalities. Even if researchers do think that privately held entities create negative externalities, many do not agree that the SEC is the appropriate regulatory body to resolve or mitigate these harms.[202] For instance, many researchers and commentators think that banking regulators are better equipped to protect the general public from the negative externalities potentially generated by Private Funds.[203]

This perspective must change, and investor status as a retail investor must not remain a primary indicator of publicness in triggering disclosure requirements, particularly in the social impact investing context. There is no single regulatory body that could appropriately mitigate the harms generated by social impact investing's negative externalities. This is because these externalities can result from several classes of products and services, which are created by various categories of legal entities, and which can harm communities on a global scale. Even if there was a single regulatory body that could optimally resolve these issues, affected community members should be entitled to material disclosures regarding any projects that may adversely affect their surrounding communities. As such, the SEC should mandate entities relying on the Social Impact Exemptions to disclose the full extent to which they are maximizing net social welfare. They should also be required to disclose any and all due diligence procedures that they have undergone with respect to the engagement with

200. For the sake of clarity, some private placement exemptions do permit retail investors, but only to a limited extent. For example, Rule 506 under Regulation D allows for up to 35 retail investors as long as they are sufficiently sophisticated as defined under SEC rules. *See* Regulation D, 17 C.F.R. § 230.506(b)(2)(i) & (ii) (2020).

201. *See* Securities Act, 15 U.S.C. §§ 77j–77k (2018); LEMKE ET AL., *supra* note 95, § 5.02 (summarizing the extensive disclosure requirements that apply to registered investment companies).

202. *See, e.g.*, John C. Coffee, Jr. & Hillary A. Sale, *Redesigning the SEC: Does the Treasury Have a Better Idea?*, 95 VA. L. REV. 707, 776 (2009) (arguing in favor of the reallocation of some regulatory power from the SEC to other banking regulators for all financial institutions that could destabilize the financial system).

203. *See, e.g.*, *id.*

targeted communities (or lack thereof) and anticipated effects on surrounding communities.

The general public, affected community members, and even regulators and policymakers could then scrutinize any anticipated negative externalities of a social impact investment. The mere act of disclosing this information may disincentivize bad behavior. More specifically, social impact investors would likely face increased pressure to reduce or mitigate these harms before they occur to avoid public embarrassment. A mandatory disclosure framework could similarly prevent advisers from partaking in impact washing, which conceals the extent to which advisers are generating a measurable impact. Down the line, the SEC should also impose standardized measures of impact, some of which are currently being developed in the private sphere,[204] and evaluate the benefits of mandating ongoing and periodic disclosure obligations for entities relying on these exemptions.

Many researchers may argue that the increased costs of enhanced disclosures could deter advisers and other promoters from investing in socially conscious enterprises. These costs ultimately get passed down to underlying investors, making this regulatory solution even less desirable to a range of interests. Even still, advisers may benefit from a standardized disclosure framework as a tool to enhance their competitive advantage, which may be desirable in an industry that is growing increasingly saturated. Some advisers have even advocated for greater transparency, as a recent study administered by the GIIN found that "[m]ost [investment adviser] respondents highlighted the importance of greater transparency around impact, with 80% agreeing that 'greater transparency from impact investors on their impact strategy and results' would help mitigate the risk of mission drift."[205] Several entities are already voluntarily providing enhanced disclosures as Certified Benefit Corporations—in part, this is likely due to the reputational benefits generated from this designation.[206] From the standpoint of investors, a standardized disclosure framework could prevent negative externalities from occurring *ex ante*. Reducing these costs could help to boost investors' short-term and long-term gains.

2. Access

Recalibrating access restrictions under federal securities laws is a complicated endeavor due to the diversity of underlying portfolio companies of social impact investors. Under standard exemptions, access is divided between retail and elite investors. Since retail investors are theoretically more vulnerable to fraudulent schemes, they are mostly restricted to investments comprised of

204. *Supra* Part II.D.
205. MUDALIAR ET AL., *supra* note 65, at 16.
206. *See Certification Requirements*, B LAB, https://bcorporation.net/certification/meet-the-requirements [https://perma.cc/7U27-ZQN3].

publicly traded equities and bonds, and cash instruments.[207] This significantly narrows the universe of strategies available to the investing public.

This proposal does not advocate for a complete removal of the access restrictions under federal securities laws, since many social impact investments are excessively risky, but rather, recommends increasing the number of opportunities available to retail investors in certain categories. Investing in a novel clean energy technology that is still in its early stages of development could expose investors to a complete loss of their investment. Moreover, private equity funds, which are the primary drivers of social impact investments, often prefer larger investments that are locked into the vehicle for extended periods of time.[208] Retail investors may not have the capacity to lock in their investments in this manner. And their bargaining power as shareholders may be severely limited due to their presumably smaller provisions of capital in comparison to wealthy or institutional investors.

Yet, opening the door to at least some categories of social impact investing opportunities to retail investors could mitigate many of the harms discussed herein. As shareholders, affected community members would have a greater voice in terms of how these vehicles are managed in the form of voting rights and perhaps other advocacy measures.[209] Their interests would be more closely aligned with the targeted communities than other types of investors. They would have a heightened understanding of the issues affecting their surrounding environments, related but not limited to infrastructure development, community relations, and the interconnectedness of community needs such as food, housing, education, and climate. Investors attempting to resolve one such need without sufficiently understanding how that attempt might expand other needs could cause irreparable damage that ripples across entire ecosystems.[210] Elite investors

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207. *See supra* Part I.C.

208. *See* Thomas Kostigen, *Impact Investing Is Primed to Become a Bigger Force in 2020*, EQUITIES NEWS (Jan. 2, 2020), https://www.equities.com/news/impact-investing-is-primed-to-become-a-bigger-force-in-2020 [https://perma.cc/RH5N-7SG8] (observing that "many impact investments are private equity securities . . . [and] do not have a readily identifiable exchange of or liquidity mechanism. Investors can therefore find themselves owning a risky investment with no means to cash out").

209. *See e.g.*, Alicia E. Plerhoples, *Nonprofit Displacement and the Pursuit of Charity Through Public Benefit Corporations*, 21 LEWIS & CLARK L. REV. 525, 569 (2017) (proposing that "[a] charitable public benefit corporation could be required to grant or donate a sufficient amount of stock to a stakeholder or group of stakeholders who would, by virtue of being stockholders, have the right to bring a derivative lawsuit against the public benefit corporation for failing to pursue its charitable public benefit").

210. Gayle Peterson described at least one notable example of a seemingly helpful innovation destroying surrounding habitats due to limited input from targeted communities:

> Take, for example, the initial sale and distribution of insecticide-treated malaria nets to fight disease in developing countries. Too often, investors failed to work with target communities before introducing a new product, or they didn't stick around to gather feedback on how the nets were used. As a result, many consumers in developing countries used them as fishing nets, which caused widespread ecological damage.

Peterson, *supra* note 143.

may inadvertently identify these "ripples" as "unforeseen" circumstances irrespective of the resulting harms.

Community member access might be ideal with respect to social impact investments into designated Opportunity Zones. Having the opportunity to profit from developments occurring within the very communities in which they reside could further prevent the wholesale displacement of these targeted community members. Permitting affected community members to equally benefit from these external investments could remove the exploitative component of many of these schemes. These kinds of investments often do not entail the same degree of risk as other start-up ventures, as promoters are able to purchase real estate at lower costs while benefitting from the lower tax rates designated to Opportunity Zones. Under these circumstances, mid-to-low-income community members may significantly benefit from the longer-term investment horizons inherent in these schemes to save for retirement, fund college expenses, and pursue other long-term saving goals. Groups of community shareholders could pool their ownership interests to enhance their bargaining power with respect to negotiating for additional layers of protections on a personal and community level.

The SEC, under the advisement of its designated team of experts, should undergo a more detailed analysis on this front to weigh the costs and benefits of allowing access for certain categories of investments. In particular, they should focus on social impact investments that are taking advantage of the lower tax rates for private investment in designated Opportunity Zones. They should similarly assess whether a financial education requirement should accompany any removal of access restrictions. As part of its research process, the SEC should evaluate the extent to which the private sector has successfully created social impact models that are indeed available for community member participation. For instance, the Community Investment Trust in Portland, Oregon created an innovative investment program that is described as follows:

> The CIT shares, which can be purchased through monthly investments of as little as $10 and up to $100 per month, represent a unique real estate investment for neighborhood investors as they are fully liquid through the Letter of Credit issued by the primary mortgage holder, Northwest Bank. As a result, investors are incentivized to invest over the long-term, but they also have the ability to liquidate their investment at any time without a loss of their invested amount. To qualify as a neighborhood investor, individuals must be 18 years-old, live within the designated four zip code area and complete a financial action course called Moving from Owing to Owning. The CIT is designed to provide an on-ramp to personal savings by facilitating investment in a community asset, creating a safety net for those

in asset poverty and, at the same time, spreading the value of appreciating property in a gentrifying neighborhood across the larger community.[211]

Investments of this nature can be an integral first step in removing barriers to access for targeted community members of social impact investments.[212] Lawmakers could further explore how to amend the federal securities laws to allow for additional opportunities of this scope.

While the Department of Labor ("DOL") proposed to make private equity funds more accessible to 401(k) retirement plans in June 2020, this pronouncement does not achieve the access goals advocated in this Article.[213] It simply opens the door for retail investment in the Private Fund universe without the nuanced distinctions amongst underlying strategies in light of the increased risks to the general public. Furthermore, it does not include any additional transparency requirements that would serve to protect investors, as well as broader communities, from these rampant harms. Given that institutional investors (such as pension plans) have historically done a poor job at protecting underlying beneficiaries from excessive fees charged by Private Fund advisers, this increased access is troubling at best.[214]

3. *Accountability*

Regulated parties under federal securities laws are accountable to prospective and existing shareholders, as they are mandated to provide material disclosures related to a range of underlying business activities.[215] Shareholders can bring private causes of action against such regulated parties for material misrepresentations and omissions.[216] Regulated parties are similarly accountable to the SEC and other regulators as they could potentially face significant fines for violating the federal securities laws.[217] However, there are limited

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211. MERCY CORPS, CASE STUDY, THE COMMUNITY INVESTMENT TRUST: A NEW FORM OF REAL ESTATE INVESTMENT CAN HELP LOW-INCOME PEOPLE BUILD ASSETS AND RESILIENCE 11 (2019), https://www.mercycorps.org/sites/default/files/2020-01/EPCIT%20Case%20Study%20MC%20White%20Paper%202019%20120519.pdf [https://perma.cc/7PBP-LBNQ].

212. For additional examples of structures that are accessible to targeted community members, see Dan Wu & Sheila R. Foster, *From Smart Cities to Co-Cities: Emerging Legal and Policy Responses to Urban Vacancy*, 47 FORDHAM URB. L.J. 909 (2020).

213. *See* Press Release, U.S. Dep't of Labor, U.S. Department of Labor Issues Information Letter on Private Equity Investments (June 3, 2020), https://www.dol.gov/newsroom/releases/ebsa/ebsa20200603-0 [https://perma.cc/2AY9-5L9Q] ("The Information Letter addresses private equity investments offered as part of a professionally managed multi-asset class vehicle structured as a target date, target risk, or balanced fund. Adding private equity investments to such professionally managed investment funds would increase the range of investment opportunities available to 401(k)-type plan options.").

214. *See* Cary Martin Shelby, *How Did We Get Here? Dissecting the Hedge Fund Conundrum Through an Institutional Theory Lens*, 74 BUS. LAW. 735, 757–63 (2019).

215. *See supra* Part II.C.

216. *See* Securities Act, 15 U.S.C. §§ 77k, 77l, 77q; Securities Exchange Act of 1934, 15 U.S.C. §§ 78j, 78ff.

217. *See* 15 U.S.C. §§ 77k, 77l, 77q; 15 U.S.C. §§ 78j, 78ff.

accountability measures in place to protect outside stakeholders, such as surrounding community members and industries, who may be adversely impacted by the investments of these regulated parties.

The government sometimes imposes a wide range of additional accountability measures for its public policies, which are broadly defined as "system[s] of laws, regulatory measures, courses of action, and funding priorities concerning a given topic promulgated by a governmental entity or its representatives."[218] While several models for measuring accountability exist, such measures can include dimensions related to "transparency, liability, controllability, responsibility, and responsiveness."[219] Government entities may, for example, provide advance public notice of their projects, seek local community input, require that their projects first win approval by a community review board, or require compensation for any negative externalities or additional harms generated by these projects. For instance, the Bend City Council in Oregon solicited community input for its law enforcement policies through "online written public comments from the community, a virtual live listening session, and feedback from Bend Police Department employees."[220] The SEC could use comparable models to incorporate heightened accountability mechanisms in the Social Impact Exemptions proposed herein.

While it would be a challenge to define the contours of affected communities in implementing these measures, the SEC could borrow from comparable models that have been developed in the project development context. For example, the IFC now "require[s] that projects financed by the IFC obtain the free, prior, and informed consent ("FPIC") of [I]ndigenous peoples affected by such projects."[221] While many thought that this was a step in the right direction, Professor Shalanda Baker has argued that this informed consent requirement is limited by its narrow interpretation of consent.[222] She further argued that, "[u]nder this narrow interpretation, consent lacks teeth and the ability to affect in any meaningful way the social and environmental risks that often accompany large projects."[223] The SEC—under the advisement of its team of experts—should thoroughly evaluate and respond to these (and other) critiques in exploring existing models of accountability.

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218. Dean G. Kilpatrick, *Definitions of Public Policy and the Law*, NAT'L VIOLENCE AGAINST WOMEN PREVENTION RSCH. CTR. (2000), https://mainweb-v.musc.edu/vawprevention/policy/definition.shtml [https://perma.cc/EKV4-PYWU].

219. Jonathan GS Koppell, *Pathologies of Accountability: ICANN and the Challenge of "Multiple Accountabilities Disorder*,*"* 65 PUB. ADMIN. REV. 94, 96 (2005).

220. *Bend Releases Community Input Report on Policing Policies*, KTVZ NEWS (Dec. 17, 2020), https://ktvz.com/news/bend/2020/12/17/bend-releases-community-input-report-on-policing-policies [https://perma.cc/7AFF-QG5G].

221. Baker, *supra* note 182, at 669.

222. *See id.* at 671.

223. *Id.*

4. Management

Ensuring that affected members from targeted communities are somehow included in managing social impact investments would further help to prevent negative externalities, as "social entrepreneurs who have direct experience with the issues they're tackling often excel in building solutions that are fit-for-purpose."[224] Yet, leadership within the social impact industry faces diversity gaps that are comparable to many related industries.[225] Social entrepreneur Tara Sabre Collier has thus concluded,

> The lack of representation in leadership [of social entrepreneurs] informs misaligned investment decision making, leading to a world where philanthropists under-invest in social entrepreneurs of colour, even as those these [sic] entrepreneurs are more likely to have insights into solving problems in their communities. It leads to a world where 90% of social entrepreneurs funded in east Africa have American or European founders. Equality impact investing would compel impact funders to address these shortcomings within their own leadership and teams, which could ripple out in the form of more representative portfolios over time.[226]

Alexandra Grüber, a public service management consultant and child welfare advocate, has similarly asserted, "if we reimagine how we include people with lived experience in all aspects of child welfare, from policy to technology, we can build a new system built on equity and justice, child protection and family preservation."[227] With much of child welfare services being privatized, it is crucial that the law integrates individuals with lived experiences into the fabric of underlying decision making processes.

In addition to having interests more closely aligned with social impact strategies, targeted community members have first-hand knowledge and exposure to the intricate ways in which their community needs are interconnected. Understanding the interconnectedness between various needs like eradicating racial injustices or improving access to food, water, and shelter

224. Alastair Wilson, *Why Universities Shouldn't Teach Social Entrepreneurship*, STAN. SOC. INNOVATION REV. (Dec. 14, 2016), https://ssir.org/articles/entry/why_universities_shouldnt_teach_social_entrepreneurship [https://perma.cc/76T7-BA4X].

225. *See* Lisa M. Fairfax, *Some Reflections on the Diversity of Corporate Boards: Women, People of Color, and the Unique Issues Associated with Women of Color*, 79 ST. JOHN'S L. REV. 1105, 1105 (2005) (determining that "people of color appear to have experienced more significant barriers [to accessing board of director positions] than women, while women of color appear to be experiencing the most formidable of such barriers"); Post Reporters, *Social Investment Sector Still Plagued by Lack of Diversity*, PIONEERS POST (Jan. 9, 2019), https://www.pioneerspost.com/news-views/20190109/social-investment-sector-still-plagued-lack-of-diversity [https://perma.cc/57G7-2ZV8].

226. Tara Sabre Collier, *A Global Moment of Reckoning: Covid-19, Inequality and Impact Investing*, PIONEERS POST (July 7, 2020), https://www.pioneerspost.com/news-views/20200707/global-moment-of-reckoning-covid-19-inequality-and-impact-investing [https://perma.cc/UAC4-966Q].

227. Lexie Grüber, *Child Welfare Policymakers Need to Learn User Centered Design*, IMPRINT NEWS (May 27, 2020), https://imprintnews.org/opinion/child-welfare-policymakers-need-to-learn-user-centered-design [https://perma.cc/KG29-8WXY].

is essential in preventing negative externalities from occurring *ex ante.* Well-intentioned attempts at resolving one social ill can fail when private actors do not consider how their solutions could hamper progress towards resolving other social ills, or even create new ones. These unresolved blind spots could cause irreparable damage to entire populations of already-vulnerable communities. Advisers of exempt entities, who may have a limited interest or understanding of these nuanced issues, might inadvertently identify these blind spots as "unforeseen" circumstances irrespective of how obvious they may have been to affected community members. Lived experience provides invaluable layers of expertise that advisers seem to severely discount in structuring their management and decision-making processes.

Moreover, scholars have found that increasing diversity can enhance the effectiveness of complicated systems and structures and serve to improve investment decision-making.[228] The social ills that have afflicted our communities arise from a complex array of intertwining factors, making them that much harder to resolve. Racism, sexism, and elitism are often primary drivers of these complexities. Enhancing diversity can be a cost-effective mechanism to digest these complexities and produce effective solutions that actually serve to increase net social welfare. Appointing community members as leaders in any capacity likewise has a ripple effect, as community members who rise to leadership roles frequently motivate others to do the same, potentially adding an additional increase to net social welfare.[229] Since affected community members may encounter financial hurdles in accessing social impact investments as investors—even if the law changes to enhance accessibility—including them within the management structure is a crucial alternative to consider.

There are some legislative measures in place that attempt to improve diversity in management of corporate and governmental entities. From a regulatory perspective, several states have adopted mandatory diversity measures for corporate boards where a certain percentage of board members have to be minorities, women, or a combination of both.[230] Section 342 of the Dodd-Frank Act also "generally obligates a number of federal agencies to create Offices of Minority and Women Inclusion, [which] are charged with ensuring the fair inclusion and utilization of minorities and women in all business and activities of their respective agencies."[231] Section 342 further instructed these offices to create diversity standards for assessing the policies of its regulated

228. *See generally, e.g.*, SCOTT E. PAGE, DIVERSITY AND COMPLEXITY (2011) (analyzing the role that diversity plays in enhancing the effectiveness of complex systems).

229. Wilson, *supra* note 224.

230. *See, e.g.*, S.1007, 189th Leg. (Mass. 2015); H.R. 0439, 99th Gen. Assemb. (Ill. 2015); S. Con. Res. 62, 2013–14 Reg. Sess. (Cal. 2013).

231. Steven A. Ramirez, Kristin Johnson & Cary Martin Shelby, *Diversifying to Mitigate Risk: Can Dodd-Frank Section 342 Help Stabilize the Financial Sector?*, 73 WASH. & LEE L. REV. 1795, 1841 (2016) (discussing the limited impact that section 342 will have on achieving its stated goal of increasing diversity within the financial sector).

entities.[232] However, these requirements do not do enough in the context of social impact investing because board diversity statutes vary by state (many do not have any), and the diversity assessments imposed by section 342 are voluntary in nature.[233] Private Funds may also be excluded from each of these categories of mandates. Section 342's definition of "diversity" likewise does not include affected community members in the context of enterprises engaged in social impact investing.

Even still, these frameworks provide useful starting points for integrating a "diversity" requirement into entities relying on the Social Impact Exemptions. A provision of this nature would necessarily require that managers of social impact enterprises be sufficiently diversified with a percentage of community members that are the targeted beneficiaries of these projects. Hurdles to this proposal include defining who belongs to a particular community and ensuring that truly representative voices are included. The limited educational opportunities that are available to targeted community members may also hinder their participation. Pervasive inequities, financial constraints, systemic racism, and other roadblocks could admittedly be prohibitively expensive hurdles to overcome. As such, researchers should further explore both government and privately funded educational programs that target such affected communities. Although these challenges are legitimate, the potential benefits of enhanced diversity in management necessitate further exploration of this component.

CONCLUSION

Social impact investing has the power to produce astounding results for communities on an international scale. It can successfully connect distressed communities to vital resources such as safe drinking water, low-cost business loans, clean energy sources, and even high-quality educational opportunities. Government and philanthropist resources will likely be insufficient in resolving these growing needs in coming decades. However, well-intentioned social impact investors can create devastating harms that can annihilate the very communities that they are trying to serve. Many such investments have generated negative externalities that have decreased net social welfare, thereby creating even more crises for the already underfunded governments and philanthropists to try to resolve.

The regulatory framework in which social impact investors operate does little to address these harms or prevent them from occurring *ex ante*. Since they operate mostly as privately held entities, most investors are exempt from the arduous regulation under the federal securities laws. This exempt status deepens many of the problems associated with private actors performing functions that were historically designated to the public sector. Exemptions under federal

232. *See id.* at 1840–51.
233. *See id.* at 1841, 1848–51.

securities laws limit the disclosure that social impact investors provide to the general public, and they exclude access to affected community members as investors. Affected community members therefore have no ability to examine the extent to which such investors are maximizing net social welfare. Even if such entities were subject to SEC oversight, there would be limited opportunities for direct accountability to affected communities for investments gone awry, and there is no mandate that managers of such enterprises be sufficiently diversified to include a percentage of affected community members. These regulatory loopholes reveal a deeper problem in that the law has not been sufficiently updated to account for the increasing publicness of private entities.

Reconceptualizing notions of publicness in the context of social impact investing would necessarily require merging previous indicators of public and private, while creating new protections for the increasing publicness of these private entities. Creating a new series of Social Impact Exemptions, which are specifically tailored to this industry, can achieve this goal. These exemptions could include detailed and customized rules related to disclosure, access, accountability, and management. In exchange for complying with these exemptions, social impact investors would receive any remaining regulatory flexibilities under federal securities laws, such as the power to invest in illiquid instruments. Much research is still required before this proposal can be successfully implemented to ensure that social impact investors can actually achieve their stated goals of *doing well, while doing good.* As new and existing crises continue to unfold, this will become an even more pressing matter. Innovations related to the COVID-19 pandemic may seek to do well, but without the proper regulatory framework, can result in even more harm to affected communities. In a similar vein, social impact investors may seize opportunities to create privately developed solutions to resolve the racial injustices unveiled by the Black Lives Matter movement, to the exclusion and detriment of those they are proffered to benefit. Scholars across disciplines must continuously investigate solutions to the myriad of problems created by the blurred distinctions between public and private entities, which often leaves the most vulnerable of communities at risk for unintended harms, while commodifying those harms for elite investors to continuously profit from our pain.