SQUIRE PATTON BOGGS

# Family Office Insights
## Sustainable and Impact Investing: An Increasing Focus for Family Offices

As highlighted in our previous "Family Office Insights" piece, the last few years have witnessed a growing number of family offices undertaking direct investments and developing their human and technical resources as enablers for such investments. While not without its challenges, such a strategy can deliver economic benefits by way of reduced fund management fees while giving investors a greater level of engagement and influence within the underlying businesses.

At the same time, we are seeing mounting evidence to suggest that more and more family offices are turning their focus and capital allocations toward businesses and assets that satisfy certain environmental, social and corporate governance (ESG) criteria and/or that seek to achieve positive social or environmental "returns" or "impact" alongside financial performance.

This is, of course, not a trend that is exclusive to family offices and should not come as a surprise. We live in a world of increasing interest in the environmental and social consequences of business and trade, where the behavior of corporations is scrutinized more and more rigorously, and so the impetus for making investments in and supporting organizations that have a positive impact on society will surely continue to strengthen. As social awareness and pressure increases, it seems inevitable that the whole gamut of investors, across the private and public sectors, will look to increase their exposure to, or use of, products or assets that satisfy certain ESG, "green" or "impact" criteria in one way or another.

Nor is this a recent phenomenon; the idea of investing to align with ethical standards or to incentivize or disincentivize certain types of environmental or social behavior is long established.

What has perhaps been a catalyst for the more recent trend, however, is a realization by many investors that companies (and the instruments deriving from them) operating ESG-sensitive business practices are capable of matching, if not outperforming, their peers and comparable investments from a financial perspective.

### Converging Trends

There could be said, to be some degree, of correlation between the growing trend of direct investments by family offices and the increase in capital being allocated by family offices to businesses or investments that operate with ESG considerations at their core, especially those that can truly be said to be "impact investments."

The Millennial generation is undoubtedly more influenced by and in tune with ESG concerns than their forebears, and with a large number of 30-40-year olds now starting to assume greater decision-making responsibility within their own family organizations, greater proportions of the capital at their disposal is now being aimed in this direction. The emergence of a new cohort of global entrepreneurs with strong social and ecological consciences and loud social media-enabled voices no doubt adds further support to the momentum of a generation who want to put their money to work in a socially productive and beneficial way, while still generating acceptable investment returns.

More particularly, while liquid assets in this space such as ESG-oriented equity funds become increasingly prevalent and investable and will continue to attract a meaningful share of available capital, alternative assets such as direct investments can offer a much more "hands-on" approach to ESG investing, by removing intermediaries and often giving investors a role in the operation or governance of a business, enabling them to make an "impact." Reputational benefits by association may also accrue to families that are seen to be actively involved with ESG businesses and investments, which can add to the appeal for some family organizations. For the right asset and assuming financial performance targets are achievable, there can then be a compelling investment rationale at the confluence of these developing trends.

### What Are the Challenges?

In the case of direct investments, identifying and gaining access to the right investment opportunities and then executing them will present the sort of challenges with which family offices are increasingly familiar.

As well as the typical hurdles of sourcing deal flow and identifying investment opportunities, there is the more fundamental question of how to measure performance as far as ESG or "impact" is concerned. This is essentially an emerging asset class that is still in its infancy; there is no such thing as standardized criteria with which to measure "impact" against, and while corporate governance (the "G" of ESG) has received considerable attention and is some way toward more global or regional standardization, the other limbs of this commonly used acronym remain difficult to quantify or verify. In the US and in other jurisdictions, including the UK, the development of the "benefit corporation" model, aimed at addressing ESG concerns and social investing more generally, does, however, show signs of providing one form of verifiable framework in which to join a for-profit enterprise with a social investment goal.

While the general trend seems, therefore, to be one of ever-increasing development, transparency and disclosure (other examples of which include the "comply or explain" regimes for public companies, requirements for regulated funds and the proliferation of ESG-oriented indices in the public equity and debt markets), which will help with the evolution of best practice and benchmarks for many investors, an assessment of performance from an ESG or "impact" perspective will often be to a large extent subjective.

Balancing what can, therefore, be a rather imprecise notion of ESG performance or "impact" and the asset's financial performance within the decision-making and constitutional framework of a family office may not be without its complications and some will take to this approach more readily than others.

## How Advisers Can Help

There will be a range of areas in which external advisers can help, depending on the asset in question and what the investment aims and objectives are.

A thorough understanding of the business model and particularly the supply and distribution chains will be critical and, accordingly, a more bespoke and possibly more intrusive approach to due diligence might be necessary. Likewise, a familiarity with the markets the business operates in and the local public policy landscape may be more valuable than it might otherwise be. Negotiating and obtaining appropriate governance and information rights, giving an ability to direct or monitor specific aspects of its investment, can also become a crucial aspect of the deal terms and may go beyond what is typically sought by a minority investor. Where direct investments are made in real estate, analyzing and agreeing to the terms and conditions applicable to tenants and potential service providers can also be a means of shaping the performance and credentials of the asset. In the case of funds and listed entities, where the opportunity for direct "impact" will be more limited, investors may wish to consider how they can influence performance or behavior by way of shareholder activism or softer, more diplomatic means such as raising concerns with directors and fund managers directly. With such a variety of approaches and considerations, there will, therefore, be numerous ways in which advisors should be able to add value to the process throughout the life cycle of the investment.

Please contact your principal lawyer or lawyers listed in this publication for additional information or for help on these matters from our global Family Office Services team.

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