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CONTRACTING FOR IMPACT: EMBEDDING SOCIAL
AND ENVIRONMENTAL IMPACT GOALS
INTO LOAN AGREEMENTS

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INTRODUCTION

The term “impact investing” was coined a decade ago, in 2007, at the Bellagio Center of the Rockefeller Foundation.¹ To some this was merely a new label attached to an old way of investing—namely, making investments with the intention of generating both financial and societal and/or environmental returns.² To others, however, this marked the start of a new asset class with tremendous growth potential. Early champions of impact investing suggested that the impact investing field could grow to \$500 billion of assets under management within five to ten years.³ Others were even more bullish, estimating

1. *Innovative Finance*, ROCKEFELLER FOUNDATION, <https://www.rockefellerfoundation.org/our-work/initiatives/innovative-finance/> (last visited Feb. 3, 2017); see also *What You Need to Know About Impact Investing*, GLOBAL IMPACT INVESTING NETWORK, <https://thegiin.org/impact-investing/need-to-know/#s1> (last visited Apr. 3, 2017) (defining impact investments as “investments made into companies, organizations, and funds with the intention to generate social and environmental impact alongside a financial return”); KEITH A. ALLMAN & XIMENA ESCOBAR DE NOGALES, *IMPACT INVESTMENT, A PRACTICAL GUIDE TO INVESTMENT PROCESS AND SOCIAL IMPACT ANALYSIS* 27 (2015) (finding that “impact” as used in impact investing means making a change in people’s well-being).

2. See US SIF, *REPORT ON US SUSTAINABLE, RESPONSIBLE AND IMPACT INVESTING TRENDS* 19 (11th ed. 2016) [hereinafter 2016 US SRI TRENDS] (finding that forms of investing for impact have existed for centuries as religious investors from Jewish, Christian, and Muslim faiths, as well as many indigenous cultures, aligned financial decisions with their values); see also David Bank, *Rockefeller’s High Impact Investment*, HUFFINGTON POST: THE BLOG (Sept. 19, 2012, 3:37 PM), http://www.huffingtonpost.com/david-bank/impact-investment_b_1891491.html.

3. In 2009, in the midst of the global financial crisis, the Monitor Institute estimated that “[g]iven the size of today’s screened social investments, it is certainly plausible that in the next five to 10 years investing for impact could grow to represent about [one] percent of estimated professionally managed global assets in 2008. That would create a market of about \$500

that within ten years the amount of capital invested in impact investments could range from \$400 billion to nearly \$1 trillion.⁴

Today those early estimates seem wildly optimistic, or, at the very least, premature. Yet, impact investing continues to grow. According to a recent survey of over 200 impact investors undertaken by the Global Impacting Investing Network (the “GIIN”), these investors, as of the end of 2016, managed over \$114 billion impact investments.⁵ Of those surveyed investors that also completed the GIIN’s prior year survey, this represents a 15 percent increase in the amount of capital they invested in 2015 and a 3 percent increase in the number of deals.⁶ So, while the early promise of impact investing may not

billion.” MONITOR INSTITUTE, INVESTING FOR SOCIAL & ENVIRONMENTAL IMPACT: A DESIGN FOR CATALYZING AN EMERGING INDUSTRY 9 (2009), http://www.monitorinstitute.com/downloads/what-we-think/impact-investing/Impact_Investing_Exec_Summary.pdf.

4. In 2010, J.P. Morgan and the Rockefeller Foundation estimated that the amount of capital devoted to impact investments aimed at five business sectors (housing, rural water delivery, maternal health, primary education, and financial services) serving the global population living at base of the economic pyramid (namely those earning less than \$3000 a year) could grow within ten years to as much as \$1 trillion of invested capital. J.P. MORGAN, IMPACT ASSETS: AN EMERGING ASSET CLASS 11 (2010), <https://thegiin.org/assets/documents/Impact%20Investments%20an%20Emerging%20Asset%v20Class2.pdf>.

5. ABHILASH MUDALIAR ET AL., GLOBAL IMPACT INVESTING NETWORK, 2017 ANNUAL IMPACT INVESTOR SURVEY (7th ed. 2017) [hereinafter 2017 IMPACT INVESTOR SURVEY].

6. Since 2011, the GIIN (Global Impact Investing Network) has conducted an annual survey of active impact investors. This Article makes use of the results from the GIIN’s survey undertaken as of the end of 2015. More current data (as of the end of 2016) can be found in the 2017 IMPACT INVESTOR SURVEY, *supra* note 5. The GIIN’s annual survey of active impact investors in 2015 included 158 respondents. These respondents indicated that in 2016 they planned to increase their capital commitments to impact investments by 16 percent and increase the number of deals by 55 percent. ABHILASH MUDALIAR ET AL., GLOBAL IMPACT INVESTING NETWORK, 2016 ANNUAL IMPACT INVESTOR SURVEY at vii, x (6th ed. 2016) [hereinafter 2016 IMPACT INVESTOR SURVEY].

Of these 158 respondents to the 2016 Impact Investor Survey, 61 impact investors fully completed GIIN surveys of their impact investing activities over the last three years—in 2013, 2014, and 2015. From 2013 to 2015, these investors increased the amount of impact assets under management from \$25.4 billion to \$35.5 billion, representing a compound annual growth rate of 18 percent over this three-year period. This growth is attributable to the

have been fully realized over the last decade, doing good by doing deals is a reality that is growing in appeal to investors who are looking to generate more than financial returns.⁷

These so-called “impact investments” can take many forms, including private debt, private equity, equity-like debt, real assets, public debt, public equity, deposits and cash, and pay for performance instruments.⁸ Of these forms of impact investments, private debt and private equity are the most common.⁹ Of the impact assets under management held by investors that responded to the GIIN’s 2016 Impact Investor Survey,

growth in the value of existing impact investments as well as new capital commitments.

With respect to new commitments of capital, the growth trajectory has not been a straight line. The capital committed annually by these investors to impact assets jumped from \$7.1 billion in 2013 to \$9.2 billion in 2014, then flattened at \$9.1 billion in 2015. The number and size of impact investments also fluctuated over the last three years. The number of impact investment deals conducted by these investors increased from 2013 to 2014 by 12 percent, then fell from 2014 to 2015 by 17 percent. At the same time, while fewer deals were being made, the average size of those deals increased from \$2.1 million in 2013 to \$3 million in 2015. *Id.* at 5, 8, 10. The GIIN reports that in 2016 the average size of deals was \$2.8 million. 2017 IMPACT INVESTOR SURVEY, *supra* note 5, at 6. To put these trends in context, impact investing is a subpart of a larger wave of value-based investments that has gained momentum in recent years in the United States. Since 2014, the amount of assets under management in the United States that are characterized as “sustainable, responsible and impact investing” has grown by 33 percent, far outpacing the growth (9.5 percent) of professionally managed assets in the United States. 2016 US SRI TRENDS, *supra* note 2, at 18.

7. As evidence of impact investing’s potential to become a more mainstream asset, *The Economist* recently pointed to the impact investing portfolios of institutional investors such as the world’s largest pension funds, and the recent entry of financial players into impact investing such as BlackRock, Goldman Sachs, and Bain Capital. See *Impacted Wisdom: ‘Impact Investing’ Inches from Niche to Mainstream*, THE ECONOMIST, Jan. 5, 2017, <http://www.economist.com/news/finance-and-economics/21713839-more-and-more-investors-are-looking-beyond-just-financial-returns-impact-investing> [hereinafter *Economist on Mainstreaming Impact Investing*]. The recent entry of large-scale firms into impact investing is generating a mix of reactions among existing impact investors. On the one hand, these new entrants can bring larger amounts of capital (financial and human) while enhancing the credibility of the impact investing market. On the other hand, many existing impact investors worry that the investment activities of these new entrants may pose a risk of mission drift or impact dilution. 2017 IMPACT INVESTOR SURVEY, *supra* note 5, at 15.

8. 2016 IMPACT INVESTOR SURVEY, *supra* note 6, at 19.

9. *Id.*

the largest amount of impact assets, over one-third (35 percent), is in the form of private debt.¹⁰

While definitional issues continue to muddy the waters of impact investing,¹¹ one characteristic shared by impact investors that distinguishes them from their more commercial counterparts is that impact investors *intend* to make investments that generate positive societal or environmental impacts.¹² Another common characteristic of impact investors that differentiates them from other investors is that most impact investors *measure* the impact results of their investments.¹³

10. *Id.* In comparison, as of the end of 2015, impact investments in the form of private equity amounted to 17 percent of assets under management.

11. *See Economist on Mainstreaming Impact Investing, supra* note 7 (“definitional squabbles plague the impact investing field making it difficult to gauge the extent of impact investing”).

12. According to the GIIN, impact investors have the following core characteristics. They:

1. Intend to make a positive social or environmental impact;
2. Expect to generate financial returns;
3. Target a range of return expectations and assets classes; and
4. Commit to measure and report the social and environmental performance of their impact investments.

See What You Need to Know About Impact Investing, supra note 1; *see also IRIS Metrics, IRIS*, <https://iris.thegiin.org/metrics/sets> (last visited Feb. 18, 2017).

13. According to the 2016 Impact Investor Survey, more than 99 percent of the surveyed investors intend to measure the social and environmental performance of their impact investments. HANNAH SCHIFF, RACHEL BASS & ARIELA COHEN, GIIN, *THE BUSINESS VALUE OF IMPACT MEASUREMENT 1* (2016).

This high rate of performance measurement among impact investors can be explained by several factors. First, nearly all GIIN Survey respondents measure impact because that is intrinsic to their mission. *Id.* (95 percent of surveyed investors noted that it is “very important” to measure impact because of their mission). Second, most of the surveyed investors believe that impact data is valuable to understanding and improving the impact performance of their investments. *Id.* (81 percent of surveyed investors noted that measuring impact is “very important” to understanding and improving impact performance). Third, many impact investors also believe that measuring impact improves their decisions about future investments and portfolio allocation. *Id.* (nearly 60 percent of surveyed investors noted that impact measurement is “very important” because there is business value to derive from such measurements). Finally, nearly two-thirds of surveyed investors are obligated contractually to report to others on their investments’ impact performance. *Id.* (65 percent of surveyed investors note that impact measurement is “very important” to meeting their contractual commitments to others).

Setting impact intentions and then measuring impact results are not solely within the provenance of the impact investor, of course. Recipients of impact investments are likely to be drawn into discussions with their impact investors about whose impact intentions matter most when setting the terms and conditions of an impact investment. Similarly, there are likely to be negotiations over which party—the investor or the investee—should bear the cost (financial and otherwise) of collecting and reporting impact data.

At the heart of these discussions between impact investors and their prospective investees is a much larger question with philosophical as well as very practical implications—that is, who, if anyone, should bear the risk (and negative consequences, if any) of impact intentions *not* being realized? This is not an easy question to answer.

In a purely financially-oriented debt transaction, lenders knowingly take the risk that the business models of their borrowers might fail or that externalities might interfere with borrowers' financial performance of loan obligations. Even in those cases, however, all is not lost to the lenders. Pursuant to their loan agreements, lenders will likely have a range of legal remedies that they can pursue against borrowers to attempt to recover their investments. By contrast, if an impact debt investment fails, what legal rights and remedies should a lender have against its struggling borrower?

Some might argue that the nature and scope of an impact lender's rights against a borrower should depend on the nature of the failure at hand. That line of argument makes an assumption that financial failures of an impact investment can be distinguished from impact failures and vice versa. But is that true? Even if so, won't financial failures lead to impact failures? And, couldn't the reverse also occur with an impact failure leading to a financial failure?

Others might argue that the range of remedial actions that an impact lender can take against a defaulting borrower

An additional influence encouraging performance measurement are the Sustainable Development Goals (SDGs) that were adopted in 2015 by the member states of the United Nations. In 2016, just over a quarter of the impact investors surveyed by the GIIN began to track the performance of their impact investments relative to SDGs, and another one-third of investors report that they plan to do so in the future. 2017 IMPACT INVESTOR SURVEY, *supra* note 5, at 42.

should depend on the culpability of the borrower. Again, this presumes that the cause of the failure and the borrower's hand in that failure will be easy to discern. But, short of gross negligence or willful misconduct on the part of the borrower, blame can be hard to assess, particularly where the success of an impact investment can be affected by a mix of factors that are within and outside of the borrower's control.

Still others might counter that the party most able to affect the impact returns generated by an impact investment is the party that should shoulder the burden and costs of ensuring that expected impact returns are indeed generated. One can imagine a creative impact lender saying to a prospective borrower, "Look . . . we all know that it is common practice in loan agreements to place the burden and costs of protecting a loan's financial yields on borrowers (not lenders). Why should the rules of the game be different for the social yields we expect you to generate?"

As the above discussion suggests, these are complicated issues. Moreover, the appropriate approach to an impact investment negotiation is likely to vary from deal to deal depending on who is sitting at the negotiating table, as each party is likely to bring different resources, concerns, and experiences to its negotiations.¹⁴

Developing legal documentation that helps to memorialize parties' expectations of each other can help advance the likelihood of successful relationships between impact investors and their investees. On the other hand, as should now be obvious, these are complex relationships and so the documentation used to evince impact investments runs the risk of also becoming complex, perhaps overly so given the relatively small financial stakes at hand.¹⁵

14. The field of impact investing is not static. Nor is it homogenous. As this field grows and moves more mainstream, it is facing the entry of new players from a variety of investment backgrounds. It is likely that these new entrants will draw on investment tools and approaches gleaned from their pasts. This change could have a profound effect on the shape of deal structures and contractual provisions found in impact investing. Additionally, current impact investors and their investees may find that their impact investing experiences have changed their views about what works or does not.

15. See *supra* note 6 for information on the size of the average impact investment.

In sum, “contracting for impact” requires thoughtful consideration by legal counsel as to how best to modify standard contractual provisions or, where needed, create new contractual provisions that can help advance the desired impact as well as financial goals of their clients. Legal counsel also needs to “right-size” the advice it offers so as to not overwhelm the size of the impact investment transaction with undue costs or complexity.

This Article provides a catalogue of trends in embedding social and environmental impact objectives into the loan documentation of impact investments.¹⁶ It explores how key performance indicators (also called “KPIs”) are being used in the debt investments of impact lenders to shape the behavior of borrowers. This Article also analyzes the extent to which new impact investment structures are likely to align lender and borrower interests around agreed-upon impact goals. It considers whether the field of impact investing is ready for standardization of the impact investment provisions included in loan agreements. The Article concludes with a discussion of steps that could be taken in the impact investing field to encourage more contractual innovation and increased adoption of such contractual innovation.

I.

EMBEDDING IMPACT PROVISIONS INTO LOAN AGREEMENTS

As impact investing has grown and evolved so too has the documentation used for these investments. That is not to suggest, however, that the form of funding agreements used in impact investing have moved forward in lockstep. There currently is no “standard” template for an impact investment loan, and, as this Article argues, it is not yet time to standardize loan templates. Instead, there are a variety of approaches to documenting impact investment loans.

At the risk of oversimplifying, over the last decade, the loan agreements used by impact lenders have become increasingly impact performance-oriented and, relatedly, increasingly complex. In contrast, early impact investment loan agreements often were virtually indistinguishable from commercial loan

16. Not addressed in this article, but for future research, is an examination of the extent to which impact performance requirements are being embedded into the documentation evidencing equity investments.

agreements. Their “impact” provisions, if addressed at all, tended to be limited to memorializing the impact intentions of the contracting parties, and possibly stipulating the uses to which loan proceeds could be put.¹⁷ As impact lenders (and those funding impact lenders) became more concerned with understanding whether their impact intentions had been achieved, impact investment loan agreements naturally expanded to include reporting covenants tailored to the impact performance of borrowers.

Now a new generation of impact investment loan agreements is starting to take shape as drafters of impact investment loan agreements are increasingly embedding impact provisions throughout the loan agreement. It is, therefore, timely to take stock of the approaches, challenges, and potential long-term consequences of these new approaches to documenting impact investment loan agreements.

But first, it is worth noting that a decision to embed impact provisions into a loan agreement does *not* mean ignoring the objectives and considerations that lenders and borrowers typically bring to more commercially-oriented loan negotiations. Like commercial lenders, impact lenders are likely to try to negotiate loan agreements that:

1. Set out clear conditions under which the lender is obligated to disburse funds;
2. Enable the lender to monitor the borrower’s financial situation and, when necessary, to take remedial action if the borrower’s financial situation deteriorates; and
3. Provide the lender with a legally enforceable claim to sue or take other remedial actions, if the borrower defaults.¹⁸

17. See, for example, the “Microfinance Institutions’ Commercial Loan Documentation: Form of Annotated Loan Agreement,” which was created with pro bono support from the law firm, Cleary, Gottlieb, Steen & Hamilton, and is based on a compilation of provisions commonly found in loan agreements agreed to by microfinance institutions within two major microfinance networks, FINCA International and Women’s World Banking (in author’s files).

18. CGAP, *COMMERCIAL LOAN AGREEMENTS: A TECHNICAL GUIDE FOR MICROFINANCE INSTITUTIONS 3* (2006), <http://www.cgap.org/sites/default/files/CGAP-Technical-Guide-Commercial-Loan-Agreements-Oct-2006.pdf>.

Impact-seeking borrowers,¹⁹ like more commercially-oriented borrowers, will likely focus on making sure that their loan agreements:

1. Ensure that funds will be available when needed by the borrower on financial terms that are as advantageous to the borrower as possible;
2. Provide for a repayment schedule that does not unduly burden the borrower; and
3. Ensure that the borrower can comply with the terms of the loan agreements without deviating from its ordinary course of business.²⁰

In short, as with more commercial loan agreements, those entering into impact investment loan agreements will likely be focused on protecting expected financial returns while minimizing the transaction costs inherent in instilling such protections.

Unlike lenders making commercial loans, however, many lenders entering into impact investment loan agreements also will focus on protecting and, in some cases, enhancing expected impact returns. Similarly, while lenders in commercial loan agreements typically care about protecting their institutions' reputations, the reputational stakes can be even higher for lenders in impact investment loan agreements, particularly those lenders organized as not-for-profit organizations in the United States that seek to make impact investments in furtherance of their charitable purposes²¹ or those public sector lenders that are funded by taxpayers.

Impact lenders appear to be experimenting with two different approaches to addressing these concerns. As described below, some are simply modifying common contractual provisions to embed impact considerations. Others, however, are

19. "Impact-seeking" behavior, as used in this article, is distinct from what economists often call "rent-seeking" behavior. Rent-seeking behavior involves actions that seek to increase one's share of existing wealth without creating new wealth. By contrast, as used here, impact-seeking behavior describes actions that seek to increase positive societal or environmental impacts that benefit others beyond the transacting parties.

20. CGAP COMMERCIAL LOAN AGREEMENT GUIDE, *supra* note 18, at 3.

21. See, e.g., *infra* note 55 for discussion of requirements imposed by the Internal Revenue Service on private foundations' program-related investment activities; see also *infra* notes 62 and 63 for discussion of provisions some charitable organizations have included in their impact investment loan provisions to ensure that these loans advance the lenders' charitable purposes.

taking a more radical approach and, in addition to modifying contractual provisions, are incorporating impact performance requirements into their loan agreements. These performance-based requirements often are linked to financial events, thereby rewarding or sanctioning, as appropriate, borrowers according to their success (or lack thereof) at meeting specified impact objectives.

A. *Modifying Common Contractual Provisions*

As discussed above, many of the provisions found in an impact investment loan agreement will mirror those provisions found in the loan agreements of more traditional, commercially-oriented parties. Other common contractual provisions that are typically included in commercial loan agreements to protect the lender's financial return also can be used, sometimes with only slight modifications, to protect or enhance a lender's impact return as well.²² Perhaps the most obvious is the addition of impact reporting covenants alongside financial reporting covenants.²³ That is just one of many, however.

Take, for example, covenants that protect the lender against adverse changes taking place with respect to the borrower's management, key assets, or the nature of its business. With relatively small adjustments, these covenants, which typically are included in commercial loan agreements to protect

22. See *infra* Annex A for examples of other common provisions of commercial loan agreements that can be modified relatively easily to reflect impact goals.

23. Below is an example of a redacted term sheet provision from the author's files that combines impact reporting with financial reporting requirements.

The [Borrower] Company will deliver to the [Lender] (i) quarterly (within 30 days), and annual (within 120 days) financial statements and (ii) quarterly updates summarizing the status and results (via agreed-upon metrics) of an implementations of the [XXX] program (including, without limitation, a report detailing the number of [XXX] contracts sold and details around them, as well as the number of [XXX] patients enrolled in the [XXX] program in the United States, the number of [XXX] patients enrolled in the program and the outcomes for all such patients). The financial statements shall be unaudited, unless the [Borrower] Company has elected to have its financial statements audited, in which case the audited financial statements will be provided to [Lender] when completed.

financial yields, also can be used to protect *impact* yields. A covenant that limits a borrower's ability to make material changes in its business can be used by an impact-seeking lender to ensure that the borrower makes no material drift away from its stated mission or target customers.²⁴ A covenant that mitigates against the departure risk of key individuals who are central to the management and leadership of the borrower can be enlarged to include members of the management team responsible for maintaining the mission focus of the borrower.²⁵ In addition, a covenant that requires the borrower to retain and protect its valuable intellectual property can be expanded to cover intellectual property that is intrinsic to the borrower's social or environmental mission.²⁶

Covenants also can be included that limit expenditures by the borrower that are excessive or otherwise inconsistent with the impacts being sought. For example, one impact investor recently included a contractual limitation on the remuneration packages that the borrower can offer to its senior management.²⁷ Presumably, this type of covenant aims to protect both financial and social returns. It limits management claims on company revenues that could otherwise be reinvested in the company or used to meet the company's external financial obligations; and, arguably, by uncoupling financial returns and financial remuneration, it may help to keep the senior management team focused on the company's social as well as financial performance.

24. See ALLMAN & DE NOGALES, *supra* note 1, at 167 (advocating for impact investors to include protections in investment documentation to preserve the impact focus of portfolio companies and avoid the risk of mission drift).

25. See *id.* at 183 (noting that risk that new management may take the borrower in directions that the investor did not intend is particularly important for impact investors).

26. *Id.* at 176 (advocating using a negative covenant to prevent licensing, transferring or encumbering any intellectual property of social enterprises).

27. Below is a term sheet provision from the author's files for management compensation limitation that was used by an impact investor to limit significant compensation hikes in the remuneration packages offered to its borrower's senior management team:

. . . the Borrower shall not (without the prior written consent of the Lender): . . . make any material amendments to senior management remuneration packages, including but not limited to, increases in total compensation of greater than [XX]%. . . .

Similarly, cognizant of the heightened reputational risks that often confront impact investors, some impact-seeking lenders are introducing “do no harm” covenants into their loan agreements. These covenants attempt to discourage borrower behavior that could result in harmful impacts, even if such damaging impact is inadvertent or unintended.²⁸

28. In doing so, the lenders are following the lead of development finance institutions like the Overseas Private Investment Corporation (OPIC) and the International Finance Corporation (IFC), both of which have a long history of imposing “exclusion lists” on organizations that receive their funds. These exclusion lists describe particularly troublesome practices, such as the use of child labor, that should not be funded with the investor’s money. *See* OVERSEAS PRIVATE INVESTMENT CORPORATION, ENVIRONMENTAL AND SOCIAL POLICIES 38 (2017), <https://www.opic.gov/doing-business-us/OPIC-policies/the-environment/environmental-social-policies>; INTERNATIONAL FINANCE CORPORATION, IFC EXCLUSION LIST (2007), http://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/ifc+sustainability/our+approach/risk+management/ifcexclusion-list#2007.

In the microfinance sector, investors have taken a variety of approaches to ensuring that the microfinance institutions in which they have invested do not engage in predatory behaviors when offering microcredit products. For example, several investors such as Aavishkaar Goodwell, Incofin, and KfW (the German Government’s development bank) decided to address this issue in their investment (debt and equity) documentation by contractually requiring microfinance institutions that receive funding from them to assess the repayment capacity of their clients.

KfW has included in its loan agreements with borrowing microfinance institutions the following contract provision, which aims to limit the risk that the microfinance institutions it funds will over-indebt their customers, fail to provide full information to customers about the costs and financial terms of its products, or engage in inappropriate debt collection practices:

The Borrower shall fully comply with all existing and future national laws and regulations on consumer protection especially in the area of financial services. The Borrower shall in particular provide its customers with clear and comprehensive information on the main characteristics of the financial services the customers seek. The Borrower shall, for example, have thoroughly informed its customers in good time before the signing of a loan agreement on the terms and conditions of the loan in a way easily understandable for the customer. These loan agreements shall further contain such information and shall be drafted in a manner the customers are able to understand. Furthermore, the Borrower shall critically review the customer’s repayment capacities before signing a loan agreement and shall refrain from any form of unfair or even harmful debt collection practices.

B. *Introducing Impact Performance Provisions*

A few impact investors are taking still more novel approaches as they adapt and modify standard commercial loan agreements to advance impact goals. Namely, in addition to requiring investees to provide impact reports and tweaking other contract provisions commonly found in loan agreements, they are introducing impact performance requirements into their loan agreements. It should be noted, however, that most of this experimentation and innovation appears to be happening with respect to *direct* impact investments (debt or equity).²⁹ In contrast, less experimentation appears to be taking place in impact investments that are being made *indirectly* through intermediaries or impact investment funds.³⁰

SARAH FORSTER ET AL., IMPLEMENTING THE CLIENT PROTECTION PRINCIPLES: A TECHNICAL GUIDE FOR INVESTORS 10, 15–16 (2d ed. 2010), <http://www.cgap.org/sites/default/files/CGAP-Technical-Guide-Implementing-the-Client-Protection-Principles-A-Technical-Guide-for-Investors-Jan-2011.pdf>.

29. Of those direct impact investors that are experimenting with introducing impact performance requirements into their loan agreements, investors that have flexible or lower financial return expectations appear to have more license to innovate. For example, the Global Innovation Fund has found that its flexible approach to financial returns has given it more room to be creative in deal structures and documentation. *See* Letter from Amelie Baudot, General Counsel, Global Innovation Fund, to author (Dec. 23, 2016) (on file with author).

30. These observations are anecdotal. A strong case can be made for the need to conduct further research to examine the documentation being used by a range of intermediaries and impact investment funds. This is particularly important research because of the significant role that intermediaries and impact investment funds play in impact investing. According to the 2016 Annual Impact Investor Survey, 35 percent of the surveyed respondents invest via intermediaries or funds. These respondents explain that the decision to invest through intermediaries or funds is motivated by a variety of factors ranging from sector-specific opportunities to diversification benefits. The most important factor cited, however, is to access the expertise of general partners in investment selection and management. 2016 IMPACT INVESTOR SURVEY, *supra* note 6, at 23.

Whether this trend toward contractual and structural innovation changes over time is likely to turn on whether financial incentives are given to the managers/general partners of impact investment funds to reward them for achieving impact goals as well as financial goals. Several impact investment funds are experimenting with linking compensation to impact returns, but, to date, this is very much the exception. Skeptics question this approach, noting that measuring impact is difficult, and that impact-based compensation strategies could reduce the returns of impact funds signifi-

While not widespread in impact investing, modifying funding agreements to include impact performance requirements is not a new idea. Investors in the microfinance sector have been adapting funding agreements to reflect social impact goals for well over a decade.³¹ These “performance-based” agreements, as they are called by some microfinance commentators,³² are marked by two characteristics. They are “as clear and specific as possible about the expected results and how they will be measured”³³ and they strengthen “incentives for good performance [by borrowers] by defining sanctions or benefits that are tied to the achievement of the expected results.”³⁴

Following in the footsteps of these microfinance pioneers, some impact-seeking lenders are also setting out clear and specific KPIs in their loan agreements. They describe how and when these KPIs will be measured during the term of the loan. Then, they establish strong incentives to encourage impact-seeking behaviors by their borrowers by defining the consequences (positive and negative) of achieving or failing to meet certain agreed-upon KPIs.

Converting a standard loan agreement into a performance-based agreement that advances social or environmental

cantly if fund managers pursue impact at the expense of financial returns. See TRANSFORM FINANCE INVESTOR NETWORK, TYING FUND MANAGER COMPENSATION TO IMPACT OUTCOMES (2016) (noting that, while not an industry practice, three impact investment funds are pioneering linkages between compensation of general partners and impact outcomes); Alex Davidson, *Social Funds Tie Pay to Impact*, WALL ST. J., Dec. 4, 2016 (describing skeptics' responses to linking compensation of fund managers to impact goals).

31. See, e.g., CARLA HENRY, MANOHAR SHARMAN, CECILE LAPENU & MANFRED ZELLER, CGAP, MICROFINANCE POVERTY ASSESSMENT TOOL 1–2 (2003) (“The microfinance industry promotes the dual objectives of sustainability of services and outreach to the very poor.”).

32. MAYADA EL-ZOGHBI, JASMINA GLISOVIC-MEZIERES & ALEXIA LATORTUE, PERFORMANCE-BASED AGREEMENTS: INCORPORATING PERFORMANCE-BASED ELEMENTS INTO STANDARD LOAN AND GRANT AGREEMENTS: A TECHNICAL GUIDE 1–2 (2010) [hereinafter CGAP PERFORMANCE-BASED AGREEMENTS] (noting that standard loan and grant agreements often “fall short on defining expected results and creating positive or negative incentives to achieve those results” advocating for the development of more performance-based agreements within the microfinance sector).

33. *Id.* at 1.

34. *Id.*

impacts, as well as financial returns, will likely require a three-pronged approach that includes the following:

1. Identifying appropriate KPIs;
2. Establishing performance level expectations for these KPIs; and
3. Aligning incentives by creating compliance rewards and noncompliance sanctions that are linked to KPIs.³⁵

But, as the microfinance example has taught us, the story doesn't end here. No matter how tightly drafted a performance-based loan agreement is, the agreement will only be effective if the lender has the capacity to measure and monitor its borrower's performance, as well as the will and resources (legal and otherwise) to exercise its contractual rights as a lender under the loan agreement in the event of noncompliance.³⁶

C. *Selecting and Designing Key Performance Indicators for Loan Agreements*

Context matters a lot in KPI selection and design. Different sectors may require different types of KPIs.³⁷ For example, the KPIs used to measure the poverty alleviation impact of investing in a microfinance institution that provides financial services and products to poor households are likely to differ from those used to measure the health and environmental impacts of investing in a company that sells cook stoves that use clean fuel.

Similarly, borrowers at different stages of development may require different KPIs. A mature borrower may have back-office systems and management that can support significant data collection. By comparison, a start-up may have less capacity and resources to track and monitor the amount or type of data necessary to demonstrate its progress toward certain KPIs.

35. See *id.* at 5–6 (identifying noncompliance measures and linking disbursements to compliance).

36. *Id.* at 7.

37. Moreover, different organizations within a common sector also may require different KPIs because of how much missions can differ from organization to organization. ALLMAN & DE NOGALES, *supra* note 1, at 208 (“One company’s social mission, even in the same industry, might justify different metrics than another.”).

Finally, the duration and type of debt transaction will also shape the choice of KPIs. For example, a short-term bridge loan³⁸ will require very different KPIs from those that are used to measure the impacts of a longer-term trade financing.³⁹

Accordingly, impact investors use a wide range of KPIs—ranging from standardized to customized metrics, or a combination thereof.⁴⁰ Furthermore, the spectrum of KPIs includes indicators that reveal impact *intentions*,⁴¹ indicators that quan-

38. For example, the David and Lucile Packard Foundation typically uses reporting metrics that incorporate both Impact Recording Investment System (IRIS) metrics and a range of other conservation metrics. However, when the Packard Foundation made a short-term bridge loan to The Nature Conservancy (as a program-related investment) to help it acquire and preserve 2325 acres of land surrounding Independence Lake in California, the Packard Foundation abbreviated the environmental metrics to be tracked (acres of land preserved, and water resources preserved). *The Nature Conservancy*, GLOBAL IMPACT INVESTMENT NETWORK, <https://thegiin.org/knowledge/profile/the-nature-conservancy> (last visited Feb. 8, 2017).

39. For example, in a trade financing provided by Root Capital to The Savannah Fruits Company, Savannah used this trade finance (backed by future sales of shea butter) to buy organic-certified shea nuts from rural Ghanaian women who gathered nuts but lacked reliable markets for their product. Savannah then contracted additional Ghanaian women to use traditional methods to hand-process the nuts into shea butter, which Savannah then exported. Root Capital tracked a wide range of social and environmental metrics with respect to this trade financing, including gender of supplier individuals (female), payments to supplier individuals, volume purchased from supplier individuals, financial revenue, permanent employees, units/volume sold, sales from exports, sustainable cultivated land area, access to commercial bank financing, and other sources of financing certifications (social and environmental). *The Savannah Fruits Company*, GLOBAL IMPACT INVESTMENT NETWORK, <https://thegiin.org/knowledge/profile/the-savannah-fruits-company> (last visited Feb. 8, 2017).

40. 2016 IMPACT INVESTOR SURVEY, *supra* note 6, at 36 (stating that 65 percent of survey respondents use metrics that are aligned with IRIS (catalogue of generally accepted performance metrics managed by the GIIN) and 65 percent use proprietary metrics and frameworks).

41. Intention indicators might include the borrower's choice of entity (for profit, not-for-profit, hybrid, or tandem combination of the two), charter provisions, mission statement, business plan, etc.

tify impact *outputs*,⁴² and indicators that measure impact *outcomes*.⁴³

When selecting or designing a KPI, it also is important to consider how and when the KPI is to be used. Certain KPIs will be appropriate for some purposes, yet wholly inadequate for others. For example, is progress toward a KPI merely to be reported to the lender (with little to no significant consequences for the borrower if it fails to meet the KPI), or does the lender intend to create incentives for the borrower to meet desired KPIs? The answers to these questions will help determine what types of KPIs and what levels of KPI performance are most appropriate to expect of a borrower.

Impact reporting can place a significant burden on borrowers. Even simply creating and delivering progress reports on KPIs to lenders (with no consequences accruing to the reporting borrower) can present challenges to borrowers. This is particularly true if the KPIs are not customarily tracked by the borrower, and the costs (financial, time, or otherwise) of collecting and reporting on the KPIs are high.⁴⁴ These costs can

42. According to the GIIN's 2017 Impact Investor Survey, just over two-thirds (67%) of survey respondents track outputs associated with their investments. 2017 IMPACT INVESTOR SURVEY, *supra* note 5, at 42.

Output indicators are the most common form of KPI. IRIS provides industry stakeholders with a common language to describe output indicators. Sometimes output indicators serve as proxies for outcomes that are hard or expensive to measure. For example, the gender and geographic location of target customers are output indicators that are often used by impact investors that hope to alleviate poverty.

43. According to the GIIN's 2017 Impact Investor Survey, more than half (57%) of survey respondents track outcomes associated with their investments. And 46 percent of the surveyed investors track *both* outputs and outcomes. *Id.*

Outcome indicators are the holy grail of KPIs, elusive and hard to nail down, yet of extraordinary value. Examples of outcome indicators include reductions in ex-offenders' recidivism rates, reductions in CO² emissions, or improvements in life expectancies of infants.

44. ALLMAN & DE NOGALES, *supra* note 1, at 208 (stating that onerous reporting requirements can distract companies from their focus on core financial and social missions and that "a balance between meaningful, timely data and limited burden on reporting company needs to be agreed upon" among the parties); *see also* CGAP PERFORMANCE-BASED AGREEMENTS, *supra* note 32, at 3 (stating that funders should not overburden financial service providers with tracking obligations that are not useful for operations management or decision-making because collecting and reporting information has costs).

be compounded if the borrower has different reporting requirements imposed by its lenders and other stakeholders (such as other investors, donors, and government regulators). In a best case scenario, the KPI reporting required of a borrower by an impact-seeking lender should be consistent with that required by other funders of the borrower, and should provide substantive information that is also useful for the borrower—informing the borrower’s decision making processes about operations and strategy.

If a borrower’s failure or success in meeting a KPI (or series of KPIs) will have significant financial consequences for the borrower, it is important to consider what level of impact performance should be expected of the borrower. Should the performance level set for a KPI be a relatively high target, or should it be set at a minimum performance threshold?⁴⁵ The answer to this question will turn on the borrower’s circumstances, the data being measured, and, of course, the lender’s own impact goals. As a general matter, however, minimum performance levels may be more appropriate for KPIs that trigger penalties or sanctions against borrowers, while ambitious targets may be more appropriate for KPIs that trigger incentives.

For instance, if a minimum performance threshold is set for a KPI as opposed to a higher target, the lender may effectively be setting a floor for the borrower’s impact-seeking behavior. This, in turn, can have consequences for which contractual rights a lender may wish to exert, or threaten to exert, if its borrower fails to perform at even a minimum threshold. In such a case, the lender may want to ensure that it has a contractual right to take actions to sanction such underperformance by its borrower.⁴⁶ In contrast, a lender may be less focused on its ability to exert contractual rights against a borrower if the borrower fails to reach a KPI that has a high (perhaps even aspirational) target of performance.

45. See CGAP PERFORMANCE-BASED AGREEMENTS, *supra* note 32, at 4 (explaining that when minimum performance thresholds are set, they typically are intended to be the “minimum result necessary” to justify the investment).

46. *Id.* at 5 (explaining that past experiences of a borrower with other types of funders, such as donors, can shape how seriously the borrower takes the threat of performance-based sanctions).

In each case, when setting KPIs—either as targets or as minimum performance thresholds—there is the risk that a single-minded pursuit of agreed-upon KPIs may wreak havoc on the borrower, and on the customer-base it serves.⁴⁷ To take an example from microfinance, a microfinance institution that focuses on targeting a high number of active borrowing clients might achieve a growth rate that is faster than its management information systems can support. Or, this same microfinance institution may be so focused on growing its client base that its credit officers act inappropriately in securing clients and end up saddling those clients with unsustainable levels of debt. To avoid perverse results like these, it is important to make sure that financial incentives and impact goals are appropriately aligned.

D. *Aligning Incentives: Compliance Rewards and Noncompliance Sanctions*

When impact goals are inextricably linked to the financial success of an enterprise, a kind of virtuous circle can be created whereby social returns generate greater financial returns, and financial returns generate greater social returns. A cautionary note should be sounded here, however. Sometimes the degree to which impact goals are inseparable from the financial success of a business model can be determined only with hindsight.⁴⁸ Consequently, some impact investors are reluctant

47. *Id.* at 5–6.

48. Commercial success (and the type of investors that commercial success attracts) can seriously test an enterprise's continued commitment to societal or environmental goals. Take for example, Movirtu, a company that was created to provide mobile cloud technology to wireless telecommunication providers servicing rural poor communities in Sub-Saharan Africa and South Asia. By enabling multiple phone numbers to be active on a single SIM card, Movirtu's innovative technology allowed the rural poor to share access to basic mobile phone services while retaining their own private telephone numbers. *See generally* *Movirtu*, WILLIAM DAVIDSON INSTITUTE AT THE UNIVERSITY OF MICHIGAN, <http://wdi.umich.edu/programs-projects/movirtu> (last visited Feb. 7, 2017); *Movirtu*, BUSINESS CALL TO ACTION, <http://www.businesscalltoaction.org/member/movirtu> (last visited Feb. 7, 2017).

In 2014, Movirtu was acquired by Blackberry. *See* Press Release, *Movirtu, BlackBerry Acquires Movirtu to Improve Adoption of BYOD and COPE* (Sept. 11, 2014), <http://www.movirtu.com/091014-blackberry-acquires-movirtu>. Movirtu now describes its vision as redefining “the mobile experience by introducing virtual identities, enabling innovative solutions which help our mobile operator customers to differentiate with valuable service

to rely solely on a perceived integration of impact goals into business models. Rather, as described in greater detail below, these investors are including contractual provisions in their funding agreements that are aimed at helping to align (or reinforce an alignment of) financial and social interests.

Impact investors are by no means the first to attempt to design contractual arrangements that are intended to align the interests of contracting parties in order to fully realize the gains that can come from cooperation.⁴⁹ Nor are they first to provide contractual incentives and disincentives aimed at encouraging an alignment of interests among contracting parties.⁵⁰ Accordingly, it should not be surprising to learn that, like the many that have come before them, impact lenders are wrestling with the challenge of developing loan agreements that specify appropriate performance indicators *ex ante*, and also address the parties' ability to measure and verify that performance *ex post*.⁵¹

offerings." *The Movirtu Vision*, MOVIRTU, www.movirtu.com/about (last visited Apr. 15, 2017). Prior to the acquisition, Movirtu's technology had been deployed to build "services aimed at extending market share where device ownership is limited," but it "now extends the use of this core technology to new markets with the introduction of the Movirtu WorkLife and ManyMe solutions and our latest innovation, Movirtu CloudPhone.?" *Id.*

49. As economic historians have pointed out, Adam Smith recognized in the 1700s that sharecropping contracts often did not provide tenants with sufficient incentives to improve the land that they tilled. *See generally* JEAN-JACQUES LAFFONT & DAVID MARTIMORT, *THE THEORY OF INCENTIVES: THE PRINCIPAL-AGENT MODEL* (2002) (describing the history of economic incentives).

50. One common example in the commercial context is where a company offers a compensation package to its managers that links managers' compensation to the company's stock performance. *See generally* Michael Faulkender et al., *Executive Compensation: An Overview of Research on Corporate Practices and Proposed Reforms*, J. APPLIED CORP. FIN., Winter 2010, at 107; *see also* Tamara C. Belinfanti, *Beyond Economics in Pay for Performance*, 41 HOFSTRA L. REV. 91 (2014). Another example drawn from the social services context is where performance measures are applied to the evaluation of prisons. *See generally* Alexander Volokh, *Prison Accountability and Performance Measures*, 63 EMORY L.J. 339 (2013).

51. It is in situations like these that some contract theorists, such as Nobel laureate Oliver Hart, suggest an alternative approach and look to align interests through contractual arrangements that allocate decision rights between agent and principal, rather than provide financial rewards linked to express performance objectives. *See generally* THE COMMITTEE FOR THE PRIZE IN ECONOMIC SCIENCES IN MEMORY OF ALFRED NOBEL, THE ROYAL

Creating effective alignments of financial and non-financial interests in impact loan agreements can be tricky. Expanding a standard loan agreement so that it advances impact and financial goals requires paying close attention to the incentives and disincentives that are likely to shape both borrower and lender behavior.⁵² As described in greater detail below, some impact investors are experimenting with offering financial incentives to investees to promote impact-seeking behavior. Naturally, impact-seeking lenders will aim to structure financial incentives that encourage, rather than discourage, borrowers to achieve agreed-upon financial and impact objectives. Consequently, borrowers that perform well should benefit financially from such good performance, and borrowers that underperform should receive fewer financial benefits.

This may be easier said than done, however, as impact investors also have multiple financial and impact goals, the pursuit of which can lead to skewed or even perverse incentives for the borrower.⁵³ For example, an impact-seeking lender may want to reward borrowers financially for meeting impact objectives, but the lender also may be unwilling (or, given the lender's sources of funding, unable) to reduce the financial

SWEDISH ACADEMY OF SCIENCES, OLIVER HART AND BENGT HOLMSTROM: CONTRACT THEORY (2016), https://www.nobelprize.org/nobel_prizes/economic-sciences/laureates/2016/advanced-economicsciences2016.pdf (describing the contributions of Hart and Holmstrom to the design of optimal contracts). The application of incomplete contracting and contract theory to impact investing is an area for future research.

52. ALLMAN & DE NOGALES, *supra* note 1, at 225 (explaining that poor alignment of interests can take place with respect to investor behavior too when investors have insufficient "skin in the game" and, therefore, are less motivated to offer additional support to their investees).

53. Some grant-making impact investors are experimenting with reimbursable grants, whereby the impact investor will convert its grants into debt claims on a grantee if the grantee reaches commercial viability. The rationale is that the grantee's commercial success should now be shared with its early stage grantors so that the grantors can benefit too. On the opposite end of the spectrum, some impact investors are creating convertible debt instruments that convert into grants if the borrower is having trouble meeting its financial or impact performance obligations.

While the motivations behind these two structures are understandable, they run the risk of misaligning incentives. In the first case, the grantee may seek to hide or understate its commercial viability to avoid incurring a burdensome debt obligation. In the second case, the borrower may deliberately fail to meet its performance obligations in order to be excused from its existing debt obligations.

returns it expects of borrowers.⁵⁴ Conversely, an impact-seeking lender may want to (or be tempted to) share in the commercial success of its borrowers, irrespective of the borrowers' level of impact performance, since a financial windfall could provide the lender with more capital to reinvest in the future.

To provide a strong financial incentive to borrowers to meet impact goals, some impact-seeking lenders have started to use KPIs to trigger significant financial events. The financial events triggered by KPIs can include, but are not limited to, determining (i) the timing and amount of advances to be disbursed to the borrower; (ii) the interest rate applied to disbursed advances; (iii) the repayment schedule (amount and timing) of such advances; (iv) the conversion of the nature of the investor's legal claims on a borrower such as converting debt obligations into equity, or converting grant obligations into loans (thus shifting the relative seniority of the investment in the borrower's capital structure); and (v) the provision of additional investment rights to the lender (such as warrants or rights to participate in future financings of the borrower).

1. *Loan Disbursements*

Lenders often limit the use of loan proceeds to purposes that are defined in the loan agreement. Typically, in more commercially-oriented loan agreements, the "use of proceeds" provisions relate to those business activities of the borrower that are expected to generate revenues that will eventually be used to repay the loan. Some impact-seeking lenders, however, are narrowing such provisions of their loan agreements still further to reflect the impact goals of the loan transaction.⁵⁵ The narrower the permitted uses to which loan proceeds can

54. Impact investors have a wide range of financial return expectations. *See, e.g.*, 2016 IMPACT INVESTOR SURVEY, *supra* note 6, at 40 (59 percent of surveyed respondents primarily targeted a risk-adjusted, market rate of return; 25 percent of surveyed respondents targeted a below market rate of return that was close to market rates; and 16 percent of surveyed respondents targeted a below market rate of returns that would preserve their capital investment).

55. Here is a redacted example from the author's files of a term sheet's "use of proceeds" provision that reflects the impact goals of the transaction:

Use of Proceeds: The proceeds of the Loan will be used by the Borrower solely for the purpose of providing microfinance loans to entrepreneurs in [BORROWER'S JURISDICTION] and will not be used to fund any activities on the Exclusion List.

be put, the more challenging it may become for a borrower to comply. This will be of particular concern to a borrower if (as may be the case with some impact objectives) the enumerated permissible uses are unlikely to generate sufficient earnings for the borrower to repay the loan.⁵⁶

In addition to limiting the uses of loan proceeds, some impact-seeking lenders also use impact measurements to de-

In some cases, the purposes to which loan proceeds can be put are defined with respect to the impact objectives of the lender as well as the borrower. This often is the case where a U.S.-based lender (typically a private foundation) is making a program-related investment (PRI). The lender of a PRI will be required by the Internal Revenue Service to understand and limit how its funds are being spent in order for the debt investment to qualify for treatment under U.S. tax laws as a PRI. *See* 26 I.R.C. § 4944(c) (LEXIS through Pub. L. No. 115-22) (providing an exception for qualifying PRIs from provision that otherwise imposes taxes on investments that jeopardize charitable purpose of private foundations). *See generally Program Related Investments*, INTERNAL REVENUE SERVICE (Oct. 14, 2016), <https://www.irs.gov/charities-non-profits/private-foundations/program-related-investments>. So, for example, it is not unusual to see a PRI-related provision included in the recitals of a loan agreement that reads as the following example from the author's files:

The purpose of the loan is to [INSERT IMPACT GOALS] . . . all in furtherance of the exempt purposes of the Borrower *and the Foundation* [*emphasis added*] described in section 170(c)(2)(B) of the [Internal Revenue] Code.

See generally LUCIA BENABENTOS, JUSTIN STORMS, CARLOS TEUSCHER & JON VAN LOO, STRATEGIES TO MAXIMIZE YOUR PHILANTHROPIC CAPITAL: A GUIDE TO PROGRAM RELATED INVESTMENTS 5 (2012) (listing the three requirements for an investment to qualify as a “program-related investment” as:

1. The primary purpose of the investment must be to accomplish one or more of the charitable, religious, scientific, literary, educational, and other exempt purposes described in Section 170(c)(2)(B) of the Internal Revenue Code (the “Code”);
2. No significant purpose of the investment is the production of income or the appreciation of property; and
3. No purpose of the investment is to lobby, support, or oppose candidates for public office or to accomplish any of the other political purposes forbidden to private foundations by section 170(c)(2)(D) of the Code.).

56. Some borrowers, as a consequence, are demanding (and at times getting) a lower interest rate where the use of proceeds is more narrowly defined (e.g., limiting the purposes to which the loan proceeds can be put as opposed to a more general working capital loan). Interview with Edward Marshall, General Counsel and Partner, Developing World Markets, in New York, N.Y. (Nov. 3, 2016).

termine how much money they will lend to a borrower.⁵⁷ More specifically, the lenders may decide to disburse additional loan amounts to a borrower only if and when certain agreed-upon KPIs are achieved. This approach requires a careful balancing of the borrower's funding needs against the impact goals and disbursement pressures facing the lender. Practically, it also means that the KPIs being used to trigger future loan disbursements must be measurable within the disbursement period of the loan.

2. *Interest Rate Adjustments*

Impact investors also may use KPIs to provide interest rate relief (or increases) depending on the progress made toward agreed-upon impact objectives. For example, an impact-seeking lender may agree to give a borrower a lower interest rate if the borrower generates significant demonstrable, positive impacts as defined within a KPI.⁵⁸ Conversely, an impact-seeking lender may impose a higher interest rate on a borrower if the borrower fails to meet agreed-upon KPIs within a specified time period.⁵⁹ Impact investors that agree to these types of interest rate provisions must be comfortable making a contrac-

57. See SCHIFF, BASS & COHEN, *supra* note 13, at 25–26.

58. The following are draft term sheet provisions from the author's files that reduce interest rates upon the borrower's achievement of certain KPIs.

If the Borrower achieves the Social Impact Targets . . . on or before the Final Repayment Date and the Borrower and Lender receive a certification from the Third Party Evaluator, then: . . . the interest rate on the Facility shall be reduced to [X]% for the period commencing on the date after the First Repayment Date until the Final Repayment Date. . . .

The Impact Terms Project also provides sample language on its website:

A variable interest rate initially set at X percent (the 'Initial Rate'). The interest rate shall be adjusted [quarterly] OR [annually] pursuant to the Impact Performance Adjustment. Impact Performance Adjustment: [For every] OR [Upon completion of] [specify impact target], the interest rate shall be reduced by X percent [, provided that the rate shall not be reduced below the Initial Rate less Y percent.]”

See *Creating Impact Performance Incentives: Reduce Interest Rate*, IMPACT TERMS PROJECT, <http://impactterms.org/2016/04/reward-reduce-interest-rate/> (last visited Feb. 10, 2017).

59. The following is a draft term sheet provision that increases interest rates if the borrower fails to meet certain agreed-upon KPIs (described below as milestones) by a target date.

tual trade-off between financial returns and impact returns. Other impact investors may not be as willing to make such an express trade, and, therefore, are unlikely to adopt interest rate provisions that are linked to the borrower's impact performance.⁶⁰

3. *Repayment Schedule/Amounts*

Like more commercially-oriented lenders, impact-seeking lenders are likely to use the threat of suspending disbursements or accelerating loan repayment obligations as sanctions to ensure that their borrowers meet their financial obligations.⁶¹ Some impact-seeking lenders are also expanding the "events of default" provisions of their loan agreements to expressly address both the financial and impact behaviors of their borrowers.⁶² Similarly, some impact-seeking lenders have

During the term of the Loan, the interest rate shall be increased by the amount shown in the table below if the [Borrower] Company fails to achieve the corresponding milestone by the target date. In the aggregate, the interest rate shall not be increased above the Initial Rate plus X percent.

See Sample Language for Interest Rate Increase Based on Failure to Achieve Multiple Milestones, IMPACT TERMS PROJECT, <http://impactterms.org/2016/04/penalty-interest-rate-increase/> (open the tab entitled "Sample Language For Interest Rate Increase Based On Failure To Achieve Multiple Milestones," last visited Feb. 10, 2017).

60. *See* 2016 IMPACT INVESTOR SURVEY, *supra* note 6, at 40–41 (discussing the range of financial returns expected by impact investors).

61. Typically, lenders will impose affirmative or negative covenants that, if the borrower fails to meet or violates such covenants, will ripen into events of default, thereby giving the lender the right to accelerate all or part of the outstanding loan (or, if advances are still being disbursed under the loan, to halt any future advances to the noncompliant borrower).

62. The following is taken from a term sheet that includes events of default that are triggered by social performance failures by the borrower.

Events of Default:

“. . . (vi) [Borrower] Company ceases using reasonable commercial efforts to develop or commercialize the "Prevent" and other prevention program initiatives; (vii) the [Borrower] Company does not have any clients in [SPECIFIC TARGET GEOGRAPHIES] and is not actively pursuing any clients in these geographies; (viii) a failure to meet the Social Investment Purpose Covenant [set forth below];

Social Investment Purpose Covenant:

The social purpose of the purchase of the Note by [FOUNDATION] (the "Investment") is to improve access to and delivery

included in their loan agreements the contractual right (called a “mandatory prepayment”) to require a borrower to prepay some or all of the outstanding principal amount of the loan. This prepayment right can be exercised if the borrower fails to accomplish or satisfy important impact goals within a specified time period, poses considerable reputational risk to the lender, or acts in ways that could jeopardize the lender’s mission and legal status as a charitable organization.⁶³

A decision by a lender to assert its rights and suspend disbursements and/or require repayment based on a missed KPI can be highly destabilizing for the borrower. Accordingly, a decision to introduce or exercise an impact-related KPI trigger

of quality, affordable healthcare for low-income and other underserved people and communities across the United States, by accelerating the development and implementation of on-line programs for disease prevention and management for patients primarily serviced by federally qualified health centers (FQHCs) and other safety net organizations that provide medical services to underserved people.

See IMPACT TERMS PROJECT, PROMISSORY NOTE FINANCING: SUMMARY OF PROPOSED TERMS (June 30, 2016) (sample terms sheet), <http://www.impactterms.org/wp-content/uploads/2016/06/Loan-with-Impact-Triggered-Default-US-foundation-health-tech-startup-final.pdf>.

63. The following is a redacted example from the author’s files of term sheet provisions from a PRI that include a mandatory prepayment requirement that is linked to the borrower’s nonperformance of impact objectives:

In the event that as of the third anniversary of the closing date, the Borrower does not have a minimum of \$[XXX] of the Loan invested to support the [XXX], then, at the option of the Foundation, exercised in its sole discretion, the difference between the Loan outstanding and the amount of the Loan invested to support the [XXX], shall be due and payable as a mandatory prepayment on the Loan.

In the event that as of the first anniversary of the closing date, the Borrower does not have qualified loans outstanding or committed equal to or greater than [XX]% of the Loan outstanding, or as of the second anniversary of the closing, the Borrower does not have qualified loans outstanding or committed equal to or greater than [XX]% of the Loan outstanding, or as of the third anniversary of the closing, the Borrower does not have qualified loans outstanding or committed equal to or greater than [XX]% of the Loan outstanding, then, at the option of the Foundation, exercised in its sole discretion, the difference between the Loan outstanding and qualified loans outstanding or committed shall be due and payable as a mandatory prepayment on the loan.

that gives a lender the right to require immediate repayment should not be taken lightly.⁶⁴ Moreover, the exercise of a KPI trigger that trips an event of default or mandatory prepayment requirement has the potential to threaten not only the financial viability of the borrower, but also to cause long-lasting damage to the borrower's reputation.

Lenders also are likely to have reputational concerns. They may worry about developing a reputation in the marketplace for having a hair-trigger response to events of default. Such a reputation can cast a long shadow over the lender's possible future transactions, damaging relations with both prospective borrowers and potential co-lenders. So, not surprisingly, when there are breaches of financial covenants or non-financial covenants (as opposed to payment), lenders often choose not to accelerate repayment.⁶⁵

Moreover, a KPI trigger need not be exercised to have a chilling effect on the borrower's ability to raise capital from other sources. The very fact of the KPI trigger's existence may

64. The introduction of broad cross-default provisions into impact investment loan agreements can have a similar destabilizing effect on borrowers. When the cross-default clause is drafted broadly, the occurrence of an event of default in one of the borrower's debt obligations can trigger events of default in a domino-like effect across other loan agreements of the borrower.

In a commercially-oriented loan agreement, there is a plausible (although negotiable) argument that a lender can make about why it needs such a broad cross-default clause, although such a clause may not be enforceable in some jurisdictions—particularly if the triggering default is unrelated to the breach of a payment obligation. In contrast, it is much harder to make a convincing argument about why a lender would need to include broad cross-default provisions in its impact investment loan agreement.

Accordingly, the borrower in an impact investment loan agreement could argue that the cross-default provisions used in impact investment loan agreements should be limited to only payment defaults. Or, if that is unacceptable to the lender, the borrower should at least try to exclude impact-related events of default from the reach of cross-default provisions.

65. See INT'L ASS'N OF MICROFINANCE INV'RS (IAMFI), CHARTING THE COURSE: BEST PRACTICES AND TOOLS FOR VOLUNTARY DEBT RESTRUCTURINGS IN MICROFINANCE 6 (2011), <http://www.morganstanley.com/globalcitizen/pdf/IAMFI.pdf>. For example, when several microfinance institutions first breached financial covenants in the wake of the broader financial crisis of 2008, many of their lenders chose not to accelerate their loans. Instead, these lenders focused on increasing the frequency of financial reporting and taking other actions to enhance information flows between the borrower and its lenders. *Id.*

be sufficient to scare off other funding sources, particularly more commercially-oriented investors. This is because, while more commercially-oriented investors will be familiar with covenant default provisions and mandatory prepayment provisions, they may not be as familiar with the notion that such provisions can be triggered by the borrower's impact performance (as opposed to financial performance). Furthermore, in addition to being novel, KPI triggers also can introduce an unacceptable level of uncertainty about the financial stability and capital structure of the borrower.⁶⁶

On the other hand, one might argue that the chilling effect of KPIs on future funding could be a good thing for both the borrower and the lender. The existence of such KPIs could perform a valuable screening function, filtering out investors that are not sufficiently mission-aligned with the borrower and its other impact-seeking lenders. If a potential investor backs off from making an investment because KPIs are included in the borrower's existing loan agreements, then perhaps that investor was not an appropriate fit for the borrower in the first place.

In addition to covenant defaults or mandatory prepayments, impact-seeking lenders are also developing creative amortization schedules that relax or delay repayments of loans if specified KPIs are achieved. In some cases, this is as simple as offering extended grace periods or repayment "holidays." In other cases, the principal payments required of the borrower are variable, both as to the timing of a payment and the amount to be repaid.

While the KPIs used in variable payment options of an impact investment are typically financial in character, they often still relate to the broader mission of the borrower. For example, variable payment options can instill much needed flexibility into the repayment structures of loans to borrowers that are engaged in businesses that generate seasonal or otherwise fluctuating revenues.

Variable payment options can take several forms. Some lenders structure payment triggers around the amount of

66. New potential funders will be understandably concerned about any contractual provisions that can change the nature and/or size of existing lenders' claims on a borrower. They will be particularly concerned about those provisions that permit a lender to improve its claim on a borrower.

gross or net revenues generated by the borrower.⁶⁷ Other lenders require payments only when the cash flows of the borrower reach certain agreed-upon amounts.⁶⁸ Like the con-

67. The following term sheet provisions were used in a royalty payment convertible note.

Royalty: 2.5% of Borrower's Gross Revenues from all sources, minus Permittable Offsets outlined below, delivered to [XXX] in quarterly repayments

Initial Payment: Initial payment begins within 45 days of the earlier of: (a) the end of the first quarter in which the Borrower generates Gross Revenue of \$50,000

(b) 12 months from the investment date

Offsets: Proceeds from: loans from commercial lenders, sales of securities, insurance claims, litigation settlements, customer refunds or reimbursements, write-off, and non-cash revenue from partners or joint ventures.

Payment Schedule: Borrower shall make the Royalty Payments commencing [X] months from Initial Payment until such time as Lender has received Royalty Payments in the aggregate of Seventy-Five Thousand Dollars (\$75,000), which term shall be no longer than five (5) years from the Closing Date.

See IMPACT TERMS PROJECT, ROYALTY PAYMENT CONVERTIBLE NOTE (Oct. 6, 2016) (sample royalty payment convertible note), <http://www.impactterms.org/wp-content/uploads/2016/06/Royalty-Payment-Convertible-Note-model-term-sheet.pdf> [hereinafter Royalty Payment Convertible Note].

68. The following draft provisions are taken from the term sheet for a subordinated variable payment arrangement (also called a Demand Dividend). Under this structure, the lender requires payment only when operating profits are generated by the borrower.

Repayment Holiday: Repayment obligations under the Demand Dividend will not commence until [_____] months after the Closing Date. Interest [will/will not] accrue during the Repayment Holiday.

Payment Provisions: The Company shall be obligated to repay principal and interest on a variable payment schedule depending on Free Cash Flow (as defined below) of the Company, and shall continue to pay a fixed portion of its Free Cash Flow to the Holders until the amounts paid have reached the Total Obligation. There shall be no pre-payment penalty.

Business Plan Extension: If the Total Obligation is not repaid within the Debt Term, the Company and Investors will make best efforts to agree on a business plan extension. The extension should cover a term sufficient to allow repayment of the Total Obligation. If the Company and Investors cannot mutually agree on a plan, the default Plan will be for a minimum annual Free Cash Flow equal to four (4) times the average free cash flow of the preceding eight (8)

cerns expressed above with respect to KPI default triggers and KPI mandatory prepayment triggers, even these more “borrower-friendly” variable payment structures can introduce a level of uncertainty into a borrower’s balance sheet that may be troubling to future funders.⁶⁹

4. *Conversion/Additional Lender Rights*

Impact-seeking lenders are also experimenting with changing the legal nature of their claims on borrowers if certain KPIs are met (or missed). In some cases, impact-seeking lenders are taking a page from venture capital investors⁷⁰ by converting their loans into equity upon the occurrence of cer-

quarters. The annual cash flow shall be allocated quarterly in equal proportion to the prior year’s quarters.

During the Business Plan Extension term all Default Provisions (below) will apply.

If the Total Obligation is not paid off by the end of the Business Plan Extension the Investors shall have the right to demand full payment of the remaining Total Obligation.

Calculation of Free Cash Flow: Specific elements of the calculation for the purposes of this Financing shall be negotiated between the parties and included in the Business Plan. In general, Free Cash Flow shall be calculated as gross sales, less discounts, cost of goods sold, operating expenses approved under the Business Plan, and periodic payments of prior outstanding debt due within the reporting period (current quarter).

After the completion of the Repayment Holiday the Holders shall receive [__%] of the Free Cash Flow of the Company on a quarterly basis. Such payments shall apply first to accrued interest due up to the reporting period, then to principal remaining under the Financing, and finally to payment of the Total Obligation.

See SANTA CLARA UNIVERSITY, TERM SHEET FOR SUBORDINATED VARIABLE PAYMENT DEBT (Apr. 23, 2013) (sample term sheet), <http://cms.scu.edu/socialbenefit/impact-capital/loader.cfm?csModule=security/getfile&pageid=10422177>.

69. This issue is not limited to debt financings. Equity transactions that include redemption rights or put options that are linked to impact metrics can also have a similar chilling effect on the investee’s ability to raise additional financing.

70. *See* *Venture Capital Education Center: Convertible Debt (aka Convertible Notes)*, MICROVENTURES, <https://microventures.com/convertible-debt> (last visited Feb. 6, 2017) (describing why venture capital investors use hybrid financing structures like convertible debt for early-stage companies).

tain KPIs.⁷¹ There are several possible motivations that might

71. Factor(E) Ventures, a venture development firm that is intent on improving lives in the developing world by increasing sustainable energy and related services, has posted online an annotated term sheet that describes the general terms of its convertible note financings. The KPIs used by Factor(E) to trigger conversions are focused on financial events, such as relatively large, equity raises (commonly defined as “Qualified Financings”). See *Deal Docs*, FACTOR(E), http://www.factor.com/wp-content/uploads/2016/04/FACTORE_Deal_Docs.pdf (last visited Apr. 15, 2017). See generally *Blending Impact into Traditional Debt and Equity Instruments: A Guide for Investors*, MORRISON FOERSTER, <https://www.mofo.com/special-content/impact-investing/blending-impact.html> (last visited Feb. 6, 2017) (discussing the use by investors of traditional debt and equity instruments to keep impact-focused companies committed to their missions).

Echoing Green also has posted online a form of convertible note for use by seed stage social enterprises. As described by Echoing Green, this form of convertible note is designed to be used for “investment into an early-stage social enterprise by institutions and individuals who are principally concerned with assisting the social or environmental mission of the company and not with earning a speculative financial return on their investment.” Min Pease, *The Seed Impact Investment Template Note Developed by and for Entrepreneurs*, ECHOING GREEN (Jun. 1, 2016), <http://www.echoinggreen.org/blog/seed-impact-investment-template-note-developed-and-entrepreneurs>.

One unusual provision in the Echoing Green convertible note is that, in addition to providing for an annual impact report that is provided to holders of such notes, the conversion rights of the holder can be terminated unilaterally by the issuer of the note if the holder has a change in control. Presumably this feature was added to ensure that all holders of equity in the issuer have the same motivations and impact-oriented expectations as do those that bought the convertible notes. Relatedly, the assignment provisions of the notes are subject to this same provision:

(e) Upon any Change in Control of the Holder, the Company shall have the right to unilaterally cause this Section 4 [specifies conversion rights of Holder] to terminate and have no subsequent binding effect on either the Company or the Holder. This right of the Company must be exercised no later than [thirty (30)] days after the later of (x) the consummation of the Change in Control of the Holder and (y) receipt by the Company of written notice of such Change in Control from the Holder. For the purposes of this provision, “Change in Control” means (i) a sale, transfer, lease or other disposition of all or substantially all assets; (ii) an acquisition by any person, entity, or “group” (within the meaning of Rule 13d-5 under the Securities Exchange Act of 1934, as amended from time to time) (the “Exchange Act”), of “beneficial ownership” (as defined in Rule 13d-3 under the Exchange Act as in effect on the Date of Issuance of this Note) of more than fifty percent (50%) of outstanding voting securities; or (iii) a reorganization, consolidation or merger in which the holders of outstanding voting securities prior to the closing of such reorganization, consolidation or

cause a lender to offer a convertible instrument. Perhaps the lender might have preferred to make an equity investment in the first place, but then decided to opt for debt because of concerns about the relative illiquidity of an equity investment. Or, the lender might aim to catalyze new funding for its impact investment. Such a lender might be willing to convert its initial debt investment into equity in order to provide its investee with a larger equity base from which to attract additional debt investments.

Lenders also might ask for an option to participate in the upside of the borrower's business through the exercise of a warrant that allows them to purchase equity from the borrower at a later date.⁷² The pricing of this conversion option might be linked to how well the borrower is performing with respect to agreed-upon KPIs.⁷³ Alternatively, lenders might ask for a

merger do not retain voting securities representing a majority of the voting power of the surviving entity (or a holding company of the surviving entity).

ECHOING GREEN, SEED IMPACT INVESTMENT TEMPLATE NOTE (May 2016) (sample investment template note), <http://www.echoinggreen.org/pubs/Echoing-Green-SeedIIT-Note-6%202016.docx>; *see also Case Study: Convertible Revenue Loan For Green Cleaning Products Co.*, IMPACT TERMS PROJECT (June 2016), <http://impactterms.org/2016/06/case-study-convertible-revenue-loan/> (discussing a case study of a convertible loan that was provided to a Latin American company that produces and distributes green household cleaning products).

72. Early stage or start-up companies often have trouble securing debt financing on reasonable financial terms because their cash flow may not yet be positive and they may have few, if any, valuable assets to pledge as collateral. This same problem makes it challenging for start-up social enterprises to secure debt financing.

Like more commercially-oriented early stage or start-up companies, some new social enterprises (and their investors) also are starting to experiment with "venture debt." Venture debt is a form of venture capital that fills this capital vacuum, not with equity, but with debt that has equity-like features. For example, one feature common to venture debt is the use of warrants that are issued by the borrowing company. These warrants give the holder a right to purchase shares of the company at a later date for a set price. So, if a borrowing company is acquired or goes public (or some other liquidity event occurs with respect to the company), the warrant holder can convert her warrants into equity and participate in that liquidity event, thereby enjoying equity-like returns. *See ALLMAN & DE NOGALES, supra* note 1, at 258–59.

73. The following redacted sample term sheet provision from the author's files links the pricing of conversion rights to the borrower's perform-

more general contractual option to participate in future financings—debt or equity—of the borrower.⁷⁴

In other cases, through a reimbursable grant instrument, grantors are converting grants into loans based on an agreed-upon KPI (or series of KPIs) trigger.⁷⁵ Unless great care is taken, however, reimbursable grants can cause incentives to

ance against defined social impact targets such that the lender will pay *more* for the borrower's equity if agreed-upon social impacts are achieved:

If the Borrower achieves the Social Impact Targets . . . on or before the Final Repayment Date and the Borrower and Lender receive a certification to that effect from the Third Party Evaluator, then: . . . the Borrower shall issue an option (in form and substance satisfactory to the Fund) conferring on the Fund certain rights to subscribe for equity in the Borrower in an amount equal to the principal and accrued interest (at the [X]% rate) of the Facility repaid by the Borrower on the Final Repayment Date.

If the Borrower does not achieve the Social Impact Targets . . . as of the Final Repayment Date: . . .

the Borrower shall issue an option (in form and substance satisfactory to the Fund) conferring on the Fund certain rights to subscribe for equity in the Borrower in an amount equal to principal and accrued interest with a [XX]% discount to the price per share.

74. This sample term sheet provides the lender with a right of first refusal to participate in future financings, specifying:

Right of First Refusal: [Lender] Investor shall have the right to participate in future financings of the [Borrower] Company (whether debt or equity) on a pro rata basis.

See supra note 67 and accompanying text.

75. From a documentation point of view, the difference between a loan and a reimbursable (also sometimes called “recoverable”) grant can be quite blurry as many of the provisions found in a loan also can be built into a reimbursable grant (such as conditions precedent to disbursement, reporting, and covenants). As a result, no matter what an instrument is called by contracting parties, the instrument may be characterized quite differently by local courts and regulators. Tax and accounting treatment of these convertible instruments also can vary, causing the instruments to have different financial implications for the issuers and holders from what the contracting parties originally intended (or expected).

The legal consequences of how these types of claims are treated can be substantial. In some jurisdictions, the enforceability of a reimbursable payment obligation may be called into question. Similarly, there may be questions about how bankruptcy regimes will treat the convertible instrument. As a general rule, in a bankruptcy proceeding, the holder of a grant will not have equal standing with other creditors of the borrower; whereas the holder of a debt obligation, unless deeply subordinated, should be able to assert claims similar to like creditors. Accordingly, it is important to work

become vastly misaligned. For example, if a grant converts into a loan because a borrower *misses* a desired KPI, there is a risk that the borrower may not have the financial resources to meet its repayment obligations under the loan and the grantor/lender will end up with neither the desired impact nor financial returns. On the other hand, if a grant converts into a loan because a borrower *meets* a desired KPI, the borrower could have a perverse incentive to avoid reaching that desired KPI.⁷⁶

5. *Measuring and Monitoring Key Performance Indicators*

To measure and monitor KPIs effectively puts demands on the resources of the borrower and the lender. In some cases, these measurement and monitoring functions can be outsourced, but such outsourcing is not without costs. Accordingly, when determining how best to measure and monitor KPIs, there are at least two threshold questions to address. First, who should be charged with measuring and reporting on progress toward a KPI? Second, what are the data collection requirements (type, amount, timing) for measuring progress toward a KPI?

The first question relates to how easy or hard it is to manipulate a KPI. Is the KPI within the borrower's power to affect? Put differently, does the borrower possess the means, tools, and skills to achieve the KPI, or is achievement of the KPI vulnerable to (or dependent on) external factors outside of the borrower's control? While an impact-seeking lender may try to choose KPIs whose achievement are within the borrower's control, there is a downside to this borrower control. Simply put, today's control can morph into tomorrow's manipulation. Where there is a risk that the borrower will try to ma-

with local counsel, tax advisors, and accountants when structuring reimbursable grants.

76. It should be noted that this moral hazard issue is present in many social impact bonds. In those structures, financial and impact returns typically are positively correlated so that the financial returns owed to investors increases as the impact returns generated by the investment also increases. *See generally* SOCIAL FINANCE, A NEW TOOL FOR SCALING IMPACT: HOW SOCIAL IMPACT BONDS CAN MOBILIZE PRIVATE CAPITAL TO ADVANCE SOCIAL GOOD 12, 16–17 (2012), <http://www.socialfinance.org.uk/wp-content/uploads/2014/05/small.Social.Finance.WPSingleFINAL.pdf> (describing social impact bond mechanics and actors).

nipulate attainment of the KPI, it may be wise to use an external validator to measure performance of the KPI.⁷⁷ Use of an external validator, however, raises its own issues. For example,

77. Here are three draft term sheet provisions that could be used for reporting on impact goals: self-reported, mandatory external validation, and optional external validation.

Self-Reported by Borrower:

The Company and the Investors have defined a set of metrics to assess the Company's performance in [describe impact goals], which metrics are described in [Exhibit X]. [As long as the Investors hold at least X percent of the Shares purchased] OR [During the term of the Loan], the Company shall deliver to the Investors, within X days following the end of each [reporting period], a report setting forth [the metrics] OR [the Company's progress toward each impact milestone] described in Exhibit X.

Establishing Specific Impact Metrics: Sample Impact Metric Language, IMPACT TERMS PROJECT, <http://impactterms.org/2016/04/impact-metrics/> (open the tab entitled "Sample impact metrics language," last visited Apr. 2, 2017).

External Validator – Mandatory:

[As long as the Investors hold at least X percent of the Shares purchased] OR [During the term of the Loan], each Impact Report described in the preceding paragraph shall be audited by a third party organization with relevant expertise, [selected by the Investors and reasonably acceptable to the Company] OR [agreed upon by the Investors and the Company]. Costs of the audit shall be borne by the Company. If mutually agreed, the findings of the audit may be publicized by the Investors and the Company.

Auditing Impact Reports: Sample Mandatory Audit Language, IMPACT TERMS PROJECT, <http://impactterms.org/2016/04/impact-auditing/> (open the tab entitled "Sample mandatory audit language," last visited Apr. 2, 2017).

External Validator – Optional:

[As long as the Investors hold at least X percent of the Shares purchased] OR [During the term of the Loan], the Investors may require that the Impact Report described in the preceding paragraph be audited by a third party organization with relevant expertise, [selected by the Investors and reasonably acceptable to the Company] OR [agreed upon by the Investors and the Company]. If an audit is requested more frequently than once every [three] years, then the Investors shall pay for the audit, unless the audit reveals substantial reporting errors. If mutually agreed, the findings of the audit may be publicized by the Investors and the Company.

Id.

finding an appropriate external validator and then securing sufficient financial resources to pay for such an external validator's services could overwhelm the size of the transaction at hand.

Another set of issues relate to the type, amount, and timing of data being collected and measured. If the KPI requires a baseline of data against which progress toward the KPI will be measured, then several questions must be addressed. Who owns that baseline data? Can that type of baseline data and performance data be shared? For example, if the data involves personal data, have the people whose data is being collected provided adequate consents? When the population from which data is being collected is relatively unsophisticated, or even illiterate, informed consent may be particularly difficult to demonstrate.⁷⁸ Furthermore, when the impact investment takes place internationally, there may be additional legal complications in transferring personal data across national borders.⁷⁹

78. CGAP and First Access, a data analytics company that works with lenders to use mobile data to predict credit risk of “base of the pyramid” (BoP) financial consumers, conducted field tests to determine appropriate methods for informing BoP borrowers in Tanzania how their data will be used by First Access. Key findings included: (1) consumers expressed strong interest in how their data would be used (and indicated that need for a loan would supersede privacy concerns), (2) basic understanding of data privacy and credit scoring can be communicated and understood through simple messages, (3) more than a single message is needed, however, to help consumers fully understand how their data will be used, and (4) data usage and privacy are interlinked and so may need to be presented in a single message. RAFAEL MAZER, JESSICA CARTA & MICHELLE KAFFENBERGER, CGAP, INFORMED CONSENT: HOW DO WE MAKE IT WORK FOR MOBILE CREDIT SCORING (2014), <https://www.cgap.org/sites/default/files/Working-Paper-Informed-Consent-in-Mobile-Credit-Scoring-Aug-2014.pdf>.

79. See, for example, the recently agreed E.U.–U.S. Privacy Shield Framework's legal protections that seek to improve commercial oversight and enhance privacy protections when U.S. based organizations transfer personal data of E.U. nationals across E.U. national borders. It is voluntary for U.S. based organizations to comply with the Framework. However, once an eligible, U.S. based organization self-certifies under the Framework, its commitment is enforceable under U.S. law. On August 1, 2016, the US Department of Commerce began accepting self-certifications by U.S. organizations under the Framework. Organizations that self-certify under the Framework commit to requirements based on privacy principles such as notice, access, and accountability for onward transfer of data to third parties. *See generally*

There are also issues of scale. An issue that plagues those attempting to measure impact outcomes (not just impact outputs) is the question of whether the underlying impact investment transaction is likely to provide sufficient new data so that it is possible to measure progress from the existing baseline data with statistical certainty. For example, “pay for success” arrangements (such as social impact bonds), which typically rely on impact outcome measurements to determine the amount, if any, of financial returns to be provided to investors, require a critical mass of data to ensure that the impact outcomes can be statistically validated or invalidated.⁸⁰

PRIVACY SHIELD FRAMEWORK, <https://www.privacyshield.gov> (last visited Apr. 2, 2017).

About half of impact investment assets are in developed markets and half in emerging markets. See 2016 ANNUAL IMPACT INVESTOR SURVEY, *supra* note 6, at 13. Accordingly, a number of countries’ data privacy laws and related regulatory regimes may need to be considered. There may be religious or cultural considerations to be alert to as well.

80. The first social impact bond (SIB), launched in 2010 in Peterborough, England to reduce prisoner recidivism, confronted this risk of a statistical sampling error because it involved a relatively small number (3000 expected, 2000 actual) of short-sentenced ex-offenders. As a result, the term of this Peterborough SIB was extended so that there would be sufficient time to demonstrate the statistical validity of the targeted performance outcomes. Deborah Burand, *Globalizing Social Finance: How Social Impact Bonds and Social Impact Performance Guarantees Can Scale Development*, 9 N.Y.U. J.L. & BUS. 447, at 456 (2013).

As originally structured, the Peterborough SIB was intended to cover three cohorts of prisoners and run until 2017, but the Peterborough SIB was suspended by the UK government after the second cohort. The reason for this suspension was due to the government’s adoption of a new policy called “Transforming Rehabilitation,” which applies a pay for results contract across all prisons. See PETER RAMSDEN ET AL., OECD, SOCIAL IMPACT BONDS: STATE OF PLAY & LESSONS LEARNT (2016), <http://www.oecd.org/cfe/leed/SIBs-State-Play-Lessons-Final.pdf>; STATISTICS BULLETIN, U.K. MINISTRY OF JUSTICE, PETERBOROUGH SOCIAL IMPACT BOND AND HMP DONCASTER: PAYMENT BY RESULTS PILOTS FINAL RE-CONVICTION RESULTS FOR COHORTS 1 (2014), https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/341682/pbr-pilots-cohort-1-results.pdf (explaining that Peterborough SIB will be suspended after second cohort due to wider reforms to probation).

On July 27, 2017, the manager of the Peterborough SIB announced that the target outcome for the first and second cohorts had been met. Consequently, the 17 investors in the Peterborough SIB will receive a payment equal to their invested capital plus a return of just more than three percent per annum for the investment period. Press Release, Social Finance and One Service, World’s 1st Social Impact Bond Shown to Cut Reoffending and to

Another data-related issue concerns the timeframe during which data will be collected. Impact measurements can take place throughout the life cycle of an investment—from cradle⁸¹ to grave.⁸² Can the KPI be measured within the timeframe of the impact investment transaction? KPIs that take a long time to demonstrate may be an inappropriate fit for impact investment transactions of relatively shorter durations.

II.

STANDARDIZING IMPACT INVESTMENT PROVISIONS IN LOAN AGREEMENTS

Over time, standardization of the impact provisions being embedded in loan agreements is likely to generate efficiencies that can lower both the financial expense and time involved in consummating impact investment transactions.⁸³ Similarly, standardization can lead to the development of a common vocabulary, thereby reducing the risk of misunderstandings and resulting disputes among parties to impact investments. Reaching a consensus on standardized loan provisions and developing a common language around key terms should help minimize the staff time required of impact-seeking lenders and borrowers when designing, negotiating, and documenting per-

Make Impact Investors a Return (July 27, 2017) <http://www.socialfinance.org.uk/wp-content/uploads/2017/07/Final-press-release-PB-July-2017.pdf> (SIB reduced recidivism of short-sentenced offenders by nine percent compared to the national control group, exceeding the target of 7.5% set by the Ministry of Justice).

81. The most common use of impact data is in the pre-screening or due diligence stage. One hundred and one GIIN survey respondents, which accounts for 80 percent of those respondents that reported that they use impact data, indicated that they use performance measurements at the pre-screening or due diligence stage. 2016 ANNUAL IMPACT INVESTOR SURVEY, *supra* note 6, at 37.

82. Fifty GIIN survey respondents (approximately 45 percent of those survey respondents that use impact data) indicated that they use performance measurements when deciding whether to exit an investment. *Id.*

83. See generally Mark R. Patterson, *Standardization of Standard-Form Contracts: Competition and Contract Implications*, 52 WM. & MARY L. REV. 327, 331–333 (2010) (describing key advantages and disadvantages of standard-form contracts). Advantages can include reduced transaction costs, greater certainty as to meaning of contract terms, and reduced agency costs; disadvantages can include decreased competition on standardized terms, thereby making for an uneven bargaining power among contracting parties. *Id.*

formance-based loan agreements. And, given the relatively small size of these loans, it should help to ensure that transaction costs do not overwhelm the deals. Standardization can also help to reduce the undue complexity of some impact investments. Finally, standardization may attract more funding to impact investing and diversify funding sources.⁸⁴

On the other hand, as this Article has attempted to catalogue, there is still a good deal of experimentation and innovation taking place in structuring and documenting impact investments, particularly with respect to the introduction of performance-based provisions. Standardizing and replicating contract provisions that are relatively untested runs the risk of “baking in” incentives and sanctions that may turn out later to be flawed or misaligned with the overall goals of the impact investment. Similarly, significant standardization at this time risks continuing to perpetuate a playing field that currently favors lenders over borrowers.⁸⁵

This is not to say that it is too early to undertake any type of standardization or harmonization with respect to the loan agreements that are being used in impact investing. It may be more appropriate to start with standardizing or harmonizing contractual provisions by individual lenders and borrowers, rather than across the entire impact investing field. For example, a borrower is likely to have an interest in standardizing the formats by which it reports on impact performance to its lenders. As noted previously, borrowers shoulder a heavy load when required to report to multiple lenders in multiple formats at multiple times. One way to lighten this reporting burden is for all of one borrower’s lenders to agree, formally or

84. If impact investment loans begin to become more standardized, there may be an opportunity to transform what are relatively illiquid corporate loans into more liquid securities that could be traded in secondary markets. Securitization analysis and draft agreements already exist in the microfinance sector. *See* CGAP & GRAMEEN FOUND., *SECURITIZATION: A TECHNICAL GUIDE 4* (2010), <http://www.cgap.org/sites/default/files/CGAP-Technical-Guide-Securitization-Oct-2010.pdf> (explaining that securitizations require some degree of homogeneity among the assets to be pooled).

85. In part this imbalance is due to the fact that the lenders are more experienced than the borrowers in negotiating loan agreements simply because they are doing (and thus seeing) more deals. But also in part this skew is likely due to the fact that currently there are more opportunities in impact investing for investors to convene and share experiences than there are opportunities for borrowers to do the same.

informally, to a common reporting format. Additionally, if a borrower experiences weakness and is forced into a voluntary workout situation, the intercreditor process might also open both the borrower's and lenders' eyes to the benefits of developing common reporting requirements so that all lenders receive the same borrower information at the same time.⁸⁶

Lenders that are making a significant number of impact investments also have an interest in standardizing or harmonizing reporting requirements across their impact investment portfolio so that they can ease the administrative challenges of managing multiple investments with varying terms and reporting requirements. Furthermore, such lenders might want to standardize the “plumbing” of their agreements. For example, a lender could find it useful to standardize the mechanics by which KPIs act as triggers to financial events under its loan agreements, even if the actual KPIs vary from deal to deal.⁸⁷

86. A key recommendation arising from the voluntary debt restructurings in microfinance that took place between 2008 and 2011 is to have documentation evidencing loans to microfinance institutions be improved by incorporating universal terms and metrics. Variations in the definitions and calculation methods of common covenant items needlessly complicated restructuring negotiations and added to the reporting burden imposed on already struggling microfinance institutions. As a result, it also was recommended that loan covenants be harmonized when a microfinance institution becomes distressed so as to facilitate the microfinance institution's compliance with multiple creditors' requirements. There were two covenants in particular that could benefit from modification and harmonization across creditors when a borrower is in financial stress—standardizing timing and content of borrower reports and notifications to lenders, and prohibiting early redemptions or voluntary prepayments by borrowers. See IAMFI CHARTING THE COURSE, *supra* note 65, at 9, 13, 39.

87. For example, a lender could develop a standardized approach for how to address the following questions:

1. What constitutes a KPI trigger? Which types of financial events should be triggered by missing a minimum performance threshold versus missing a higher target? Is this a binary (yes/no) question? Or do a series of KPIs need to occur before a financial event is triggered?
2. What happens if a KPI trigger is partially, not wholly, met? Would partial performance result in a partial financial event?
3. Is there a defined period within which a KPI trigger can be exercised?
4. Is the exercise of a KPI trigger mandatory or optional? If optional, who decides whether to exercise the trigger?
5. Is consultation or notice required before the exercise of a KPI trigger? If so, with whom and how much notice?

The challenge, of course, comes when a borrower and its lender are both trying to standardize or harmonize their respective contractual terms. In this case, it is useful to note a precedent recently developed in the microfinance sector. In 2014, a group of socially responsible investors developed guidelines for developing covenants for use in their loan agreements to microfinance institutions (and other financial institutions disbursing microcredits).⁸⁸ The guidelines were revised in late 2016. These socially responsible investors focused on harmonizing the covenants used in their loan agreements because they saw covenants as “tools to encourage good practices.”⁸⁹ They also aimed to “ease monitoring and reporting constraints” for their borrowers.⁹⁰ While the covenant guidelines are not prescriptive, and may need to be adapted to specific borrowers or market conditions, lenders were encouraged to harmonize financial covenant definitions and calculations so as to reduce the monitoring and reporting burden on borrowers.⁹¹ These guidelines also include five social undertakings by the borrower: (1) endorsement of the SMART Campaign on Client Protection Principles and progressive implementation of those principles within a reasonable timeframe,⁹² (2) annual reporting of relevant social performance indicators to social data collection platforms,⁹³ (3) commitment to develop a Social Performance Management system to implement social and environmental activities and monitor performance in line with industry standards on social performance manage-

88. See *Lenders’ Guidelines for Setting Covenants in Support of Responsible Finance, Version 2.0*, SOCIAL PERFORMANCE TASK FORCE (October 2016), <https://sptf.info/images/SIWG-Reasonable-Covenants-Updated-Dec2016.pdf> (providing an indicative set of ten financial covenants and five social undertakings, together with a framework for guiding the behavior of both lenders and borrowers in the event of a covenant breach).

89. *Id.* at 1.

90. *Id.*

91. *Id.*

92. By “reasonable,” the guidelines explain, they mean a timeframe that is aligned with the business plan and level of maturity of the borrower. *Id.* at 7.

93. By “relevant,” the guidelines explain, they mean the borrower is expected to report only on those social indicators defined by the Universal Standards for Social Performance Management’s SP14 that are (i) in line with the borrower’s social mission, and (ii) possible for the borrower to provide given possible technological constraints linked to its management information system. *Id.*

ment, (4) commitment to obtain a social rating or other external social performance management assessment within a specific timeline, and (5) commitment to maintain an average annual return on assets level *below* 7.5 percent (net of donor subsidies) during the life of the loan.⁹⁴ Importantly, the guidelines indicate that these social undertakings are “typically not binding on the Borrower but including them in the loan documentation can raise the [Borrower’s] awareness and underscore their importance to the Lender.”⁹⁵

CONCLUSION

As impact investing evolves, the approaches currently being taken by impact investors that make debt investments are also evolving. Impact investors that are making direct debt investments into companies are experimenting with a variety of approaches. Some impact-seeking lenders are requiring borrowers to do much more than simply file reports on their progress, or lack thereof, toward agreed-upon impact goals. These lenders are providing borrowers with financial incentives to achieve desired impact goals and avoid poor impact performances.

As noted earlier in this Article, impact-seeking lenders and borrowers share many of the same goals as their more commercial counterparts when negotiating a loan agreement.⁹⁶ Yet, there are additional impact goals and considerations that are likely to shape the contractual provisions found in an “impact loan agreement.”

One can imagine that, in the not too distance future, some impact-seeking lenders will aim to negotiate loan agreements that:

1. Set out clear conditions under which the lender is obligated to disburse funds, which may include conditions precedent to disbursement that are impact-ori-

94. In the event that the borrower’s return on assets exceeds 7.5 percent, the guidelines suggest that an investigation should be triggered wherein the borrower would be required to explain to the lender the drivers of such a high profitability level. The goal of this dialogue between borrower and lender is to allow the lender to determine whether these drivers are due to irresponsible lending by the borrower or due to efficiencies in the borrower’s business operations. *Id.* at 7.

95. *Id.*

96. *See supra* text accompanying notes 18–20.

ented such as meeting agreed-upon impact milestones in addition to the satisfaction of specified financial and legal conditions;

2. Enable the lender to monitor the borrower's financial situation and, when necessary, to take remedial action in the event the borrower's financial situation deteriorates;
3. Enable the lender to measure and monitor the borrower's impact performance and, possibly, to take remedial action if the borrower underperforms or performs in ways that would adversely affect the lender's reputation or legal status; and
4. Provide the lender with a legally enforceable claim to sue or take other remedial actions to recover its investment, in the event the borrower defaults on its financial obligations.

And impact-seeking borrowers will focus on making sure that their loan agreements:

1. Ensure that funds will be available when needed by the borrower on financial terms that are as advantageous to the borrower as possible and that support (and possibly reward the borrower for) high impact performance;
2. Provide for a repayment schedule that does not place an undue burden on the borrower and reflects the impact performance objectives of the borrower; and
3. Ensure that the borrower can comply with the terms of the loan agreements without needing to deviate from its ordinary course of business or its pursuit of agreed-upon impact performance goals.

Moving to more standardized, or, failing that, more harmonized contract provisions and terms could help create a more efficient impact investment process. In this author's opinion, however, it is too early to move toward comprehensive standardization of loan agreements and term sheets. Much more experimentation and innovation needs to take place first. For example, before wholesale adoption, KPI triggers need to be tested to ensure that they align the financial and impact interests of lenders and borrowers as intended, and that the presence of such KPI triggers does not destabilize the capital structures of borrowers. Similarly, more thought should be given to other forms of performance-oriented con-

tracts that look beyond financial rewards and sanctions to promote cooperation across contracting parties.

On the other hand, so long as the costs of experimenting with contractual innovations are solely born by individual impact investors and their respective investees, the impact investing field faces the risk that under-innovation and under-adoption of contractual innovations may occur. Accordingly, current initiatives to develop libraries of impact investment documentation (such as model term sheets, sample contractual provisions, actual deal documentation) are extremely useful to help spread the costs of experimentation and facilitate the transfer of knowledge within the impact investing field.⁹⁷ The willingness of impact investors to share their forms of documentation publicly is to be commended.

Simply archiving impact investment documentation, however, is not enough. Additional work needs to be done to continue to curate this growing body of knowledge so that lessons learned from the implementation of innovative contractual provisions and funding structures can be shared more broadly within the impact investment community.

Furthermore, there is a risk that less sophisticated or less experienced borrowing institutions will not understand the implications of the innovative contractual provisions and funding structures being introduced by impact investors. Building “impact investment-ready” borrowers is in the interest of not only the broader impact investing arena, but of impact-seeking

97. As noted previously, the Impact Terms Project is developing an online library of impact investment terms and documentation. See IMPACT TERMS PROJECT, <http://impactterms.org> (last visited April 2, 2017) (describing itself as “a library of innovative practices . . . explor[ing] a library of new ideas based on the experience of more than 1000 pioneering impact investors and entrepreneurs”). Currently, the “Terms Library” covers the following topics: defining mission, protecting mission over time, investing in alternative entities, creating impact performance incentives, enforcing mission-related agreements, measuring impact performance, and finding alternative exits for impact investments. *Id.* The Nonprofit Finance Fund has also created an online library to house contracts and legislation underpinning pay for success (SIB) transactions taking place in the United States. See *Pay for Success Learning Hub*, NONPROFIT FINANCE FUND, <https://web.archive.org/web/20160319193214/http://www.payforsuccess.org/provider-toolkit/contract-issues> (last visited April 2, 2017).

And some individual impact investors, like Factor(E) and Echoing Green, *supra* note 71, are posting forms of documentation on their websites.

lenders (who stand to benefit from having more knowledgeable borrowers) as well.

A similar challenge was confronted by the microfinance sector when more commercial sources of funding (as opposed to donor funding) began to flow into the sector in significant amounts.⁹⁸ Accordingly, a number of technical guides were created, often under the leadership of the Consultative Group to Assist the Poor (CGAP), to help level the playing field between microfinance institutions and their prospective lenders and investors.⁹⁹ Many of these guides not only introduced deal documentation, but also provided plain language annotations of contractual provisions and offered general negotiating guidance.¹⁰⁰

98. CGAP has surveyed funding trends in microfinance since 2008, and, as of December 31, 2014, funding for financial inclusion held steady at \$31 billion after increasing in prior years. MATTHEW SOURSOURIAN ET AL., CGAP, CURRENT TRENDS IN INTERNATIONAL FUNDING FOR FINANCIAL INCLUSION I (2015), <http://www.cgap.org/sites/default/files/Brief-Current-Trends-in-International-Funding-Dec-2015.pdf>; *see also*, XAVIER REILLE & SARAH FORSTER, CGAP, FOREIGN CAPITAL INVESTMENT IN MICROFINANCE: BALANCING SOCIAL AND FINANCIAL RETURNS I (2008), <http://www.cgap.org/sites/default/files/CGAP-Focus-Note-Foreign-Capital-Investment-in-Microfinance-Balancing-Social-and-Financial>Returns-Feb-2008.pdf> (stating that stock of foreign capital, debt and equity, invested in microfinance investments globally tripled to \$4 billion between 2004 and 2006).

99. The following are some of the publications that were commissioned by CGAP to provide explanatory and technical guidance to microfinance institutions on the documentation used for a variety of forms of financing: CGAP & GRAMEEN FOUND., *supra* note 84; DAVID A. CARPENTER, CGAP, NEGOTIATING AN EQUITY CAPITAL INFUSION FROM OUTSIDE INVESTORS (2010), <http://www.cgap.org/sites/default/files/CGAP-Technical-Guide-Negotiating-an-Equity-Capital-Infusion-from-Outside-Investors-Oct-2010.pdf>; SANDRA M. ROCKS, CGAP, PROVISIONS OF STANDARD COMMERCIAL AGREEMENTS: TECHNICAL GUIDE (2010), <http://www.cgap.org/sites/default/files/CGAP-Technical-Guide-Provisions-of-Standard-Commercial-Guarantee-Agreements-Oct-2010.pdf>; CGAP PERFORMANCE-BASED AGREEMENTS, *supra* note 32; CGAP, FOREIGN EXCHANGE RISK MITIGATION TECHNIQUES: STRUCTURE AND DOCUMENTATION: A TECHNICAL GUIDE FOR MICROFINANCE INSTITUTIONS (2006), <http://www.cgap.org/sites/default/files/CGAP-Technical-Guide-Foreign-Exchange-Risk-Mitigation-Techniques-Structure-and-Documentation-Oct-2006.pdf>; CGAP COMMERCIAL LOAN AGREEMENT GUIDE, *supra* note 18.

100. *See* CGAP & GRAMEEN FOUND., *supra* note 84; CARPENTER, *supra* note 99; ROCKS, *supra* note 99; CGAP PERFORMANCE-BASED AGREEMENTS, *supra* note 32; FOREIGN EXCHANGE RISK MITIGATION TECHNIQUES, *supra* note 99; CGAP COMMERCIAL LOAN AGREEMENT GUIDE, *supra* note 18.

The value of creating such tools, however, is limited if not also accompanied by trainings aimed at engaging these companies and their counsel. Accordingly, an initiative in the impact investing field similar to that which occurred in the microfinance sector could be useful. This initiative could include training aimed at companies (particularly less sophisticated companies) that are seeking funding from impact investors.

As the spectrum of approaches taken in documenting impact debt financings expands from simply focusing on impact reporting requirements to developing financial incentives and disincentives aimed at aligning lender and borrower interests around impact goals, there are also opportunities to expand the knowledge of the parties entering into these transactions. These opportunities, in turn, will shed light on how training and research can advance the contractual innovations that are taking place, and, eventually, promote adoption of the most promising of these innovations.

ANNEX A

IMPACT-ORIENTED MODIFICATIONS TO STANDARD
LOAN AGREEMENT PROVISIONS

The following is a list of relatively standard provisions in a loan agreement that can be modified or expanded to address the impact goals of a loan. This list is not intended to be exhaustive but rather to serve as a starting point for drafters of a loan agreement between an impact-seeking lender and borrower.

Introductory Provisions

- Recitals (*can include impact purpose of loan; where PRI is being conducted, it is usual to include PRI language in the recitals*)
- Definitions (*insert terminology used in impact metrics/KPIs; where industry has agreed to standardized metrics, use those terms*)

Financial Terms

- Commitment to lend: Conditions Precedent to Effectiveness and Lending; Disbursements (*can include KPI triggers for disbursement to take place*)
- Repayment structure
 - Principal (*can provide for repayment structures that reflect borrower's business—extended grace periods or payment holidays, and variable payment structures based on revenues or cashflows of borrower*)
 - Mandatory prepayment (*can link to KPI triggers, or used to protect lender's reputation/legal form against adverse impacts caused by nonconforming behavior of borrower*)
 - Interest (*can link to KPIs to trigger interest increases/relief*)

Performance Commitments

- Representations and warranties
 - Organization—legal form (*can refer to choice of entity/charter provisions of borrower that address mission*)

- Government authorizations (*where applicable, can include legal authority to conduct borrower's social/environmental business*)
- Financial statements/impact statements (*can have borrower provide historic impact statements as well as financial statements*)
- Material adverse change (*can require representation and warranty by borrower that no material adverse change impacting the social or environmental aspects of borrower's business has occurred since due diligence took place*)
- Covenants
 - Reporting (*describe metric/KPI, data type and source, frequency of reports, external validator (if any)*)
 - Use of proceeds (*can link to impact goals of financing*)
 - Inspection rights (*can expand to provide lender with right to inspect social/environmental activities/operations as well as financial records*)
 - Asset disposal (*can expand to limit borrower's right to dispose of assets that relate to impact goals*)
 - Key person risk (*can expand to include those members of borrower's management team that are responsible for ensuring adherence to borrower's mission*)
 - No license, transfer, or encumbrance of any intellectual property (*can expand to ensure that intellectual property relevant to social/environmental mission of borrower is protected and retained*)
 - Material change of business/limitation on fundamental changes (*can expand to prohibit material changes in legal form, mission drift, shifts from target customer base, or other business decisions and strategies that otherwise would advance mission/impact performance of borrower*)

Events of Default

- Grace period and opportunity to cure (*can expand to include KPI-related covenants*)

Enforcement

- *Dispute resolution (can include stepped dispute resolution such as requiring mediation to occur before resorting to more formal proceedings; may want to consider whether arbitration would be appropriate given size of disputed amount/complexity (or lack thereof) of transaction (if so, consider identifying appropriate impact-related skills/experience for arbitrators)).*¹⁰¹
- *Assignment (consider how data transfer issues can arise if loan is assigned to lenders located in jurisdictions other than the location of the original lender(s)).*

101. For a discussion of the issues that can arise in resolving impact investment disputes and that can inform a decision about whether to choose arbitration as a dispute resolution mechanism, see Deborah Burand, *Resolving Impact Investment Disputes: When Doing Good Goes Bad*, 48 WASH. U. J.L. & POL'Y 55 (2015).