

# Incarceration Investment Fund

## Kellogg - Morgan Stanley Sustainable Investing Challenge

### Investment Proposal

Our “Incarceration Investment Fund” (“IIF”) offers an investment opportunity to individuals about to be incarcerated for at least 10 years. By serving a previously-unserved population with a traditional, investment-grade vehicle, IIF generates market returns upon otherwise-dormant capital, providing returning citizens with a path to financial stability and successful reintegration.<sup>1</sup>

### Challenge

In the state of Illinois, 96% of incarcerated criminal offenders ultimately reenter society.<sup>2</sup> Especially for offenders incarcerated for lengthy sentences, reentry is extremely challenging. Returning citizens encounter a surfeit of basic life challenges upon release and receive almost no support. Common challenges include barriers to housing, transportation, employment, food, necessary documentation, medical care, opportunities for upward mobility, and access to credit that might mitigate other barriers. Unsurprisingly, over 40% reoffend within three years. **These challenges coalesce around one core problem: a lack of accessible working capital.**

### Innovative Solution

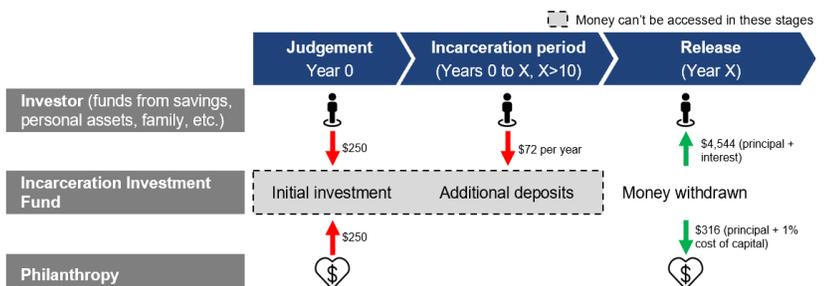
With costs of living largely covered by the state, many incarcerated individuals have limited personal need for capital while incarcerated. Thus, prison sentences reflect an unusual asset: an opportunity for capital appreciation through traditional investment vehicles. **We propose serving this unserved population through an Incarceration Investment Fund (IIF) which will provide traditional investment services to individuals incarcerated for at least 10 years (hereafter “investors”).** Additional philanthropic investments will supplement investors’ own contributions. Appreciated capital will be used for two purposes: providing investors with access to working capital to support personal needs upon prison release; and funding services meant to support successful reintegration.

### The Instrument

IIF will be broadly analogous to a retirement fund - albeit serving a unique, historically-unserved population of investors:

- Prior to incarceration, investors with a sentence of 10+ years deposit capital from personal savings and assets (which would otherwise remain dormant) into IIF.**<sup>3</sup> Additionally, investments in IIF from reintegration-focused philanthropies will increase investable assets.
- During the investor’s incarceration, deposited capital will be invested in a diversified portfolio.** IIF will adjust risk proportionate to release dates of investors, allowing early disbursement solely if investors are released early.<sup>4</sup> Investors may continue to make annual contributions to IIF via familial support or prison labor wages.<sup>5</sup>
- Upon release, investors will receive access to appreciated capital for essential needs.** Investors can use such capital in the short term to mitigate the barriers they will doubtless encounter upon release.<sup>6</sup> Philanthropic dollars will be divided into two pools: a pool of philanthropic dollar principal plus cost of capital appreciation over the term of the investment (to be returned to philanthropists or recycled); and a pool reflecting value accrued from the difference between the IIF’s IRR and the cost of capital (to be spent on holistic wrap-around services to benefit recently-released investors).<sup>7</sup> Fund managers charge a management fee of 1% of total assets. Due diligence needs are limited as IIF will invest in highly liquid assets. Further, philanthropic capital pools can cover all management fees.

Fund overview	
Fund type	Mutual fund
Investment objective	Provide capital appreciation at a 6% y-o-y average in total (after fees)
Asset class	Life-cycle
Asset allocation	On average 70% equities, 30% fixed income
Target investor profile	Incarcerated people with 10y+ sentences with access to more than US\$250
Investment period (average per person)	23 years (derived from reviewing IL 2019 prison records for sentence length)
Minimum investment / Average total deposits (per person)	US\$ 250 / US\$ 2,156 (including philanthropic match)
Proceeds of the investments (on average)	US\$250 initial investment US\$250 match by charity/philanthropist US\$72/year from labor while incarcerated
Target returns	To the investors: 5.0% IRR over ~23 years To charity/philanthropist: 1% IRR over ~23 years
Management fees (% of AUMs)	1.00% (industry average given fund complexity and size)



<sup>1</sup> Returning citizens are defined as people who have been released from incarceration within the last 2 years.

<sup>2</sup> Illinois Department of Corrections Prison Population Data Sets

<sup>3</sup> Initial research suggests that such target investors do have access to limited funds; the proposed model permits an initial deposit of \$250 at minimum. Research to date has included conversations with the [IL Department of Corrections](#), [IL State’s Attorney’s Office](#), [Northern Trust](#), [Revolution Workshop](#), [The Resurrection Project/LiftUp Enterprises](#), [MacArthur Justice Center](#), [First Followers](#), and [Precious Blood Ministry of Reconciliation](#). At several organizations, we have spoken directly with individuals who were incarcerated for 10+ years.

<sup>4</sup> IIF fixed income holding allocation will enable such rapid disbursements.

<sup>5</sup> [Prison Policy Initiative](#). In the state of Illinois, such labor wages range from \$0.09-2.25/hour; current IIF models anticipate an investor monthly contribution of \$6 at minimum.

<sup>6</sup> In the longer term, investors may be able to use such capital to generate a credit history, creating further access to funding and mitigating the likelihood of poverty and recidivism. Further, investors may choose to continue investing using more traditional investment vehicles, creating opportunities for financial gains to interrupt deficits in the intergenerational accumulation of wealth for poor communities.

<sup>7</sup> This might include additional direct cash support, access to social support services, vocational training, financial literacy training, etc. One exciting start-up, [FinLit](#), might be contracted to provide financial literacy services – a huge need for individuals who may never before have managed personal finances successfully.

## Addressable Market and Scalability

- **Target investors:** Prior to the COVID pandemic, 38,140 people were incarcerated in Illinois' state prisons. Of these, 49% (18,692) were initially sentenced to at least 10 years of incarceration, and 29% (11,077) must serve between 75% and 100% of their term.<sup>8</sup> Our initial target population will be some subset of those 11,077 individuals with access to at least \$250 in unencumbered capital.
- **Target philanthropies:** Initial philanthropies targeted include those affiliated with the non-partisan "Coalition for Public Safety," including Arnold Ventures and The Ford Foundation.<sup>9</sup>
- **Scalability:** IIF's initial scope will be specific to Illinois. In time, IIF and investors will benefit from scaling to include neighboring states such as Michigan (40,000 state prison inmates), and larger states such as California (131,000 inmates) and Texas (163,000 inmates).

## Financial Model

### Key assumptions and financial information

#### 1. Additional information on the fund:

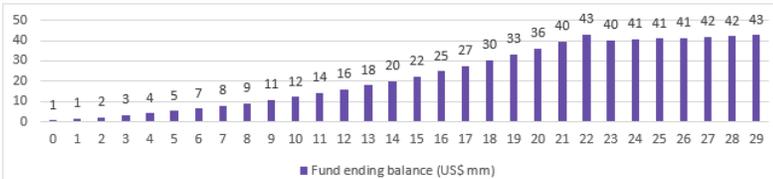
- Fund assumes a population growth of 0.5% and only includes the IL penitentiary system.
- Numbers are built based on average client behavior.
- Fall in AUMs in year 23 caused by first major withdrawal of funds.
- Model assumes a 100% withdrawal of funds by the investor upon release.
- Total withdrawal amount for the investor will range between US\$1,486 and US\$7,602 depending on the initial investment and the annual contributions:

		Initial investment				
		250	375	500	625	750
Annual contribution	0	1,486	1,486	1,486	1,486	1,486
	36	3,015	3,015	3,015	3,015	3,015
	72	4,544	4,544	4,544	4,544	4,544
	108	6,073	6,073	6,073	6,073	6,073
	144	7,602	7,602	7,602	7,602	7,602

#### 2. Financial investor for the managers:

- Revenues will come from a 1.00% management fee.
- Fund assumes US\$75k fixed costs before taxes and 60% variable costs, targeting a pre-tax margin of 25% in the long-run (in line with the industry).
- Fund Manager will receive the proceeds from the fees, plus any additional returns created if they participate as the philanthropist.
- IRR to fund manager expected to be 5.1% assuming an initial investment

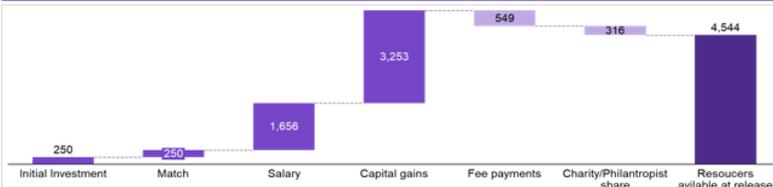
### Fund balance (AUMs)



### Fee payments



### Cash flow of one investor (23 years)



## Impact Metrics

- **First-degree:** Immediate benefits of this project will accrue entirely to investors, whose capital will appreciate at market-level rates of return. Every dollar generated represents a highly-impactful dollar to finance essential needs for returning citizens.
- **Second-degree:** Finances will benefit both investors surmounting barriers to reentry, and their broader communities. For example, we hope to see reductions in unemployment (currently 31% within two years of release), homelessness, healthcare costs, lack of credit, and recidivism (currently 43% within three years of release). A quasi-experimental difference-in-difference study could capture impact, with a macroeconomically-similar state serving as a control population.

### IIF Impact Potential on UN Sustainable Development Goals



Returns upon invested capital will allow investors to avoid immediate capital and credit constraints upon release from prison, which will have a cognizable impact upon social support overreliance, recidivism, and intergenerational poverty



Recidivism and joblessness nourish inequality; this financing tool will break this trend, helping investors and their communities grow



IIF's returns will reduce inequality by supporting basic needs and job-seeking prospects of investors



Fund returns will secure access to basic services for returning citizens, boosting the macroeconomic landscape of their communities

## Assumptions and Risks

- **Initial investment:** To ensure minimum capital investments are met (\$250 from investors, \$250 from philanthropists), we are targeting investors with requisite savings; family members can help them achieve this amount. Current research suggests that such investments are feasible by a large subset of our target population. Philanthropic funds are invested rather than donated, creating a participation incentive for them.
- **Returns:** A 6% annual rate of economic return for IIF investments is feasible, considering the term (23 years on average), the anticipated diversification of the portfolio, and comparable market investments and historical performance.<sup>10</sup>
- **Optics:** Political opposition to supporting incarcerated individuals may arise. To confront this risk, IIF investments will be inaccessible to individuals during the duration of their incarceration, both to ensure stability of the portfolio and to address any moral concern that incarcerated people should not derive benefit from the non-incarcerated world. Careful public messaging about IIF will convey that its aim is to help individuals solely upon release.

<sup>8</sup> Under Illinois' Uniform Code of Corrections, 730 ILCS 5/3-6-3(a)(2), individuals convicted of certain offenses must serve at least 75%, 85%, or 100% of their sentence prior to release (rather than be eligible for early release under a "day for day" scheme that allows a reduction of one day of incarceration for every day of "good time" served).

<sup>9</sup> The Coalition for Public Safety, The Ford Foundation, and Arnold Ventures.

<sup>10</sup> Vanguard's 70% Equity/30% fixed income fund has an average annual return of 9.27% in the period 1926-2019