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UKSIF

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Directorate General Internal Market and Services
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UKSIF response to The Social Business Initiative: Promoting Social Investment Funds

Thank you for the opportunity to comment on this consultation paper.

UKSIF, the sustainable investment and finance association, supports the UK finance sector to advance sustainable development through responsible investment and other financial services.

UKSIF warmly welcomes this working paper. It illustrates the growing interest within Europe and internationally in social investment, also called impact investment.

UKSIF has supported the field of social and/or impact investment, alongside other sustainable and responsible financial services, for over twenty years. We initiated and provided the secretariat for the UK Social Investment Task Force (www.socialinvestmenttaskforce.org) in 2000 and subsequently assisted the creation of the Community Development Finance Association (www.cdfa.org.uk) as a specialist trade association for community development finance institutions.

More generally, we support transparency, effective governance and management processes and a healthy market in responsible finance products.

In our response to a recent UK FSA consultation on “Product Intervention” we said:

> *Effective regulation should address:*
> - ***Protecting and growing wealth** by responsible asset ownership and the integration of material environmental, social and governance issues into the design and delivery of financial products*
> - *Delivering **positive outcomes for society**, including socially useful innovation and encouragement of responsible corporate behaviour in areas such as equality, diversity and sustainable development, as well as delivering good outcomes for the direct users of financial products*
> - *Enabling **consumer well-being** by allowing consumers, including diverse consumers, to reflect their values and social priorities as well as more narrow financial aims in their use of financial products.*

And

> *It is important that regulation advances rather than stifles socially useful innovation in financial services.*

UKSIF was formerly known as the UK Social Investment Forum. “Social Investment” was used internationally in 1991 to describe the broad field that is now commonly known as Sustainable and/or Responsible Investment. We changed our name in 2008 to more accurately reflect our breadth of interests and activities.

Our response is informed by:

- Informal meetings that we have facilitated in recent years between UKSIF members and social investment providers.
- Feedback from UKSIF financial adviser members and other members.
- UKSIF research on UK retail investors produced for National Ethical Investment Week and other retail and high net worth investor research.
- The research report “Investor Perspectives on Social Enterprise Financing” (July 2011) produced for the City of London Corporation, City Bridge Trust and the Big Lottery Fund by ClearlySo. UKSIF was a member of the Advisory Committee for this research project.[1]
- Our response to the UK Financial Services Authority (FSA)’s recent consultation on “Product Intervention”.
- Our response to HM Treasury’s recent consultation on “Simple financial products”.
- Our response and those of our members to the UK Charity Commission’s recent consultation on their investment guidance for charities.
- Other publications produced in the UK, including the recent NESTA report “Investing in Civil Society: A framework for a bespoke regulatory regime” (June 2011)[2]

UKSIF’s past public policy responses are available online at www.uksif.org/resources/publications/publications_archive/policy_submissions.

UKSIF welcomes the submission to the UK Social Business Initiative Working Group to this consultation. Our comments have been informed also by the Working Group’s views.

Summary

UKSIF strongly supports access to social investment opportunities for all interested investors, including retail investors. Our financial adviser members report strong interest in social investment opportunities from mass affluent retail investors. In addition, UKSIF research for National Ethical Investment Week, the UK’s “SRI Week”, shows this retail investor interest.

UKSIF sees social investment as motivated by both a social or environmental purpose and a financial objective, ie. a “mixed” motive rather than purely a philanthropic one. Social investment includes but extends wider than investment in social businesses. In addition, demand for investment in social businesses includes but goes beyond equity or equity-like investment.

Feedback and research suggests that increasing numbers of investors will find social investment funds attractive so long as the funds demonstrate their social impact and have acceptable financial characteristics and investors are aware of these investments, have sufficient information and financial literacy or advice to understand them and can access them easily.

There is strong government support for social investment in the UK. In addition, significant recent research into social investment in the UK has taken place funded by the City of London Corporation, NESTA and others.

In our view, the UCITS framework may not be sufficient for funding social business. As the social investment market matures, there may be a need for a bespoke fund framework for social investments. However, it is premature to assume this. We query also whether such a framework should be limited to social businesses.

Today, we believe that a key priority is to support the availability to retail investors of a deeper pool of investable opportunities in social businesses and other vehicles that deliver high social and environmental outcomes. This requires action in areas like:

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[1] http://www.cityoflondon.gov.uk/Corporation/media_centre/news_2011/sip_needs_ii.htm
[2] http://www.nesta.org.uk/publications/policy/assets/features/investing_in_civil_society

- Regulation of financial promotion
- Consumer education
- Access to distribution channels
- Removing the barriers to financial advice about these opportunities
- Competencies and cultures within regulatory bodies
- Measures related to social businesses themselves, eg. their capacity, business environment and investment readiness

A new fund framework has the potential to assist in addressing some of these challenges. However, a range of other solutions are also needed and are a higher priority today.

For example, we believe that action is needed at a national level within the UK to improve the regulation of social investment offers to retail investors, including addressing its current disproportionately high cost. The need for revisions to national regulation in this area have been outlined in the NESTA report "Investing in Civil Society: A framework for a bespoke regulatory regime" (referenced above).

In addition, more needs to be done to raise awareness about social investment as a concept and about those social investments which are available today. To address this, the European Commission might, for example, support the development of the "SRI Awareness Weeks" that are already run in Belgium, France and the UK to promote sustainable investment and finance, including social investment, and encourage their expansion to further EU countries.

We have addressed the following areas of the consultation paper:

Box 1: Defining social business
Box 2: The funding challenge
Box 3: The role of investment funds
Box 4: The role of investors
Box 10: Investor participation
Box 14-16: Transparency and labeling
Box 17: Intermediation and distribution
Box 18: Tax incentives and other incentives

Box 1: Defining social business

According to Social Enterprise UK, the UK government defines social enterprises (or social businesses) as "businesses with primarily social objectives whose surpluses are principally reinvested for that purpose in the business or in the community, rather than being driven by the need to maximise profit for shareholders and owners."

However, there is not a consensus on definitions within the UK. In particular, some commentators see social businesses or social enterprises as defined primarily by their social purpose and/or positive social impact rather than by whether or not their surpluses (ie. profits) are distributed, eg. it is possible for a profit distributing business, such a small or medium sized enterprise (SME) with socially concerned shareholders, to be regarded as a social business.

It is noteworthy that the UK government definition states that surpluses are <u>principally</u> reinvested ie. it does not rule out a financial return made to investors in addition to redeeming their capital.

Please see also our response to Box 4 on the need for financial characteristics that attract investors in addition to social characteristics.

Box 2: The funding challenge

Social businesses face a range of challenges in getting access to funding. One barrier of particular concern to us as an investment association is the regulation of social investment offers. We believe that action is needed at a national level within the UK to improve the regulation of social investment offers to retail investors, including addressing its current disproportionately high cost. The need for revisions to national regulation in this area have been outlined in the NESTA report "Investing in Civil Society: A framework for a bespoke regulatory regime" (referenced above).

Box 3: The role of investment funds

Based on UKSIF member feedback, we anticipate that the UCITS framework may not be sufficient for funding social businesses. Over the last decade or so, some socially responsible funds which are otherwise invested mainly in equities have made a small number of social investments and sought to make others. This experience has informed their feedback to us. For example, asset valuation frequency has been an issue of concern.

In addition, marketing issues may make it difficult to include significant exposure to social investments within funds which are primarily invested in other assets. On the one hand, anecdotal evidence suggests that a limited exposure to social investments may give marketing advantages because social investments are attractive to retail investors. In addition, the fund may benefit from financial characteristics of social investments such as financial returns that are not correlated with other assets in the fund. On the other hand, retail funds, including sustainable and responsible investment funds, compete on their financial performance. This means that their attractiveness is likely to be reduced if their level of exposure to social investments materially impacts their financial performance. This restricts the investment likely to flow to social business through this route.

A bespoke fund framework may offer a desirable alternative. Ideally, this should enable both "pure play" social investment funds and funds that are mainly invested in social investments but can combine these with other appropriate investments.

Feedback from our members suggests that it would desirable for UCITS funds and other retail funds to be able to invest in funds managed under any new social investment fund framework.

Box 4: The role of investors

According to feedback from our financial adviser members and other members, there is retail appetite for social investments. In addition, UKSIF research for National Ethical Investment Week 2010, the UK's "SRI Week", has found strong retail investor interest. Over half (52%) of investors would consider investing in renewable energy to help the sector receive greater funding and almost a third (32%) of all British adults with savings and investments would consider supporting initiatives that assisted their local community to help them receive greater funding, the research discovered.[3]

Retail investors should therefore be offered access to social investments, rather than this being limited to professional investors.

It is reasonable to assume that retail investors will generally seek exposure to social investment funds only for a relatively limited part of their portfolio rather than for their core assets. As the report "Investing in Civil Society: A framework for a bespoke regulatory regime" highlights, this introduces differences from mainstream financial regulation in the drivers for an appropriate and proportionate approach to the protection of retail consumers.

UKSIF sees social investment as motivated by both a social or environmental purpose and a financial objective, ie. a "mixed" motive rather than purely a philanthropic one. Investors will be seeking financial characteristics, with a range of financial return expectations, as well as a social return. This indicates that the volume of capital available from retail investors is likely to be influenced by the financial return available and that constraints on the delivery of financial returns will restrict the size of the social investment market.

In addition to financial returns, other financial characteristics that investors may be seeking or may find attractive include:

- low risk of capital loss
- low volatility
- investment returns that are not correlated with other asset classes used

Our research for National Ethical Investment Week 2010 found that, overall, more than half (54%) of all British adults with investments want to make money *and* make a difference with their savings and investments.[4] However, the proportion motivated by social impact ahead of financial return is lower.

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[3] http://www.neiw.org/about/media-centre/government-urged-introduce-green-deal

[4] http://www.neiw.org/about/media-centre/greed-good-green-good-2010s-set-become-decade-financial-responsibility

The paper appears to address primarily equity and equity-like investments. However, social businesses may offer financial returns to investors by means other than profit distribution. For example, they may issue bonds. There is a long history in the UK of bond investment in mutual, co-operative and non-profit distributing businesses, including the use of bond finance in social housing.

Box 10: Investor participation

Investor participation should not be required as part of a social investment fund framework.

Investor interest in the choice of investments does not necessarily imply a desire to participate in determining the investment strategy or in choosing particular investments. For many investors, this interest will be satisfied by transparency about the investment strategy adopted and the social investments held.

Feedback and research suggests that investors are seeking financial characteristics as well as social returns from social investment funds. Compulsory investor participation may reduce the ability of fund managers to deliver such financial characteristics.

Box 14-16: Transparency and labeling

UKSIF supports transparency and appropriate labeling. We believe that a flexible and principles-based approach to the implementation of fund transparency and labeling, led by the social investment industry, is most appropriate to deliver positive outcomes for retail investors. Such an approach is more likely to enable innovation and appropriate cost compared with the use of EU law. The response of the UK's Financial Reporting Council to the recent consultation on the EU Corporate Governance Green Paper describes the benefits of a flexible "comply or explain" approach.

While there may be merits in a common pan-European logo for social investment funds, it will be important to establish through consumer research whether there is sufficient commonality at this level as to what is appealing to investors. In the UK, we anticipate that investors will look to a logo to demonstrate a positive level of social and/or environmental outcomes from the investment rather than being focused on the organizational form, ie. a social impact logo rather than a social business logo. We anticipate that a logo would also be expected to indicate quality in managing the financial characteristics of the investments.

Further consideration of transparency and labeling should consider also the relationship to standards for social investment offers as proposed in the report "Investing in Civil Society: A framework for a bespoke regulatory regime".

Box 17: Intermediation and distribution

It is a significant challenge to grow the social investment market to scale. The UK government has published and is implementing a strategy to support this.

UKSIF's financial adviser members report a number of barriers today to them advising interested clients on social investment funds. In particular:

- **Due diligence requirements:** The adviser may not have access to the due diligence support needed to enable them to assess the suitability of the fund for a client. This may be due to issues of availability, skills or cost.
- **Regulatory support and professional indemnity insurance:** The adviser's regulatory support provider or their professional indemnity insurance provider may veto or discourage advising on social investment funds.
- **Business model:** A critical mass of interested clients is needed to justify the development of the required general expertise. This runs the risk that such advice is available only from specialist practitioners until the market reaches greater scale.

Some smaller sustainable investment funds in the UK have experienced challenges in accessing unadvised and platform distribution channels. It is reasonable to assume that both individual social investments and social investment funds would experience similar challenges.

Indeed, the challenges of distribution potentially introduce opportunities for new social businesses to offer specialized distribution channels for social investments and social investment funds. Online platforms such as Kiva and Lendwithcare offer inspiration for this.

"SRI Awareness Weeks" as described below also offer opportunities to address distribution challenges.

Box 18: Tax incentives and other incentives

Following the recommendations of the Social Investment Task Force, the UK government introduced Community Investment Task Relief (CITR) for investments in qualifying Community Development Finance Institutions (CDFIs). We recommend that the CITR experience should be studied as its achievements and challenges should offer lessons for the design and implementation of social investment fund incentives.

UKSIF research for National Ethical Investment Week 2010, the UK's "SRI Week", found strong consumer interest in tax incentives for green and social investment. In particular, the research found that over a quarter (27%) of British adults would be likely to invest in a "Green ISA" over the following twelve months if such a tax allowance was introduced[5].

Greater awareness of social investments and better consumer financial literacy are both needed. Measures to address awareness and understanding include:

- Use of social investment examples within financial literacy education both for adults and in schools
- Support for promotional measures to raise awareness. Following the introduction of the world's first National Ethical Investment Week in the UK in 2008, "SRI Awareness Weeks" are now also held in Belgium and France to promote sustainable investment and finance. In addition, Finansol runs a "solidarity finance" week in France.

The European Commission might support the development of these "SRI Awareness Weeks" in Belgium, France and the UK, including deepening their coverage of both social investment as a concept and the social investments available today, and encourage their introduction in those EU countries where they do not yet exist.

UKSIF – the Sustainable Investment and Finance Association

UKSIF, the sustainable investment and finance association, promotes responsible investment and other forms of finance that support sustainable economic development, enhance quality of life and safeguard the environment. We also seek to ensure that individual and institutional investors can reflect their values in their investments. We aim to support the UK finance sector to lead the world in advancing sustainable development through financial services.

UKSIF was created in 1991 to bring together the different strands of sustainable and responsible finance nationally and to act as a focus and a voice for the industry. UKSIF's 250+ members and affiliates include pension funds, institutional and retail investment managers, banks, financial advisers, research providers, consultants and non-governmental organisations. For more information about UKSIF, please visit www.uksif.org.

With best wishes

Penny Shepherd

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[5] http://www.neiw.org/about/media-centre/government-urged-introduce-green-deal