13 September 2012

UKSIF
UK Sustainable Investment and Finance Association

Cabinet Office Red Tape Challenge
Civil Society – Social Investment

Thank you for the opportunity to respond to this Red Tape Challenge.

Introduction
UK Sustainable Investment and Finance Association (UKSIF) is the UK's membership network for sustainable and responsible financial services. We promote and support responsible investment and other forms of finance that advance 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.

Our response consists of some introductory remarks on social investing and its role within modern sustainable and responsible investing followed by comments on the report "Ten Reforms to grow the Social Investment Market". We have commented on the report's preamble and the following proposals:

1. Place a Social Investment Duty on Financial Regulators
2. Tailor the Financial Promotion Rules for Social Offers
4. Ensure Suitability Assessments Consider Social and Philanthropic Goals
5. Introduce a Tax Break for Social Investment and for Community Interest Companies
6. Clarify the Investment Duties of Charitable Trusts
7. Clarify the Investment Duties of Pension Funds
9. Create a Social Investment Fund Structure

We have also highlighted the relevance and importance of the emerging regulatory paradigm proposed by the Kay Review. This recommends that the creation of long-term value by the users of capital and good risk adjusted long-term returns to savers should become the primary public policy objective for investment regulation, replacing objectives related to the efficient operation of the investment chain.

Modern Sustainable and Responsible Investing
Modern sustainable and responsible investing takes into account environmental, social, governance and/or ethical criteria alongside conventional financial criteria when making investment decisions. It may seek purely financial objectives such as improved risk-adjusted returns or it may also aim to achieve social and environmental benefits. It is increasingly regarded as having a long-term focus.

It is practiced across an increasing range of asset classes. These include public equities, private equity, fixed income, infrastructure and property. It incorporates environmental, social, governance and/or ethical considerations using a range of techniques. These include responsible ownership, integrated analysis, best in class selection, thematic selection and exclusion. Exclusion may be based on global norms such as United Nations declarations or a more investor-specific mix of factors. Sustainable and responsible investment does not require the use of any specific technique or group of techniques. In the UK, it is unusual for institutional investors other than churches or charities to use exclusion.

Social Investing
UKSIF sees impact investing or social investing as a sub-set of modern sustainable and responsible investing. We agree that its distinctive characteristic is the **motivation** of seeking a social impact as well as financial returns.

Using this definition, social investing can clearly take place across a range of asset classes. An increasing range of reports are highlighting this. For example, *'Total Portfolio Activation: A Framework for Creating Social and Environmental Impact across Asset Classes'*[1] was produced by Tellus Institute for Trillium Asset Management and Tides, while *'Increasing Impact and Enhancing Returns: Integrating Publicly Traded Water and Agribusiness Equities into Impact Investor Portfolios'*[2] was jointly authored by Jed Emerson from Impact Assets and Steve Falci from Kleinwort Benson Investors.

In addition, a range of investment products and opportunities are now becoming available specifically to address this motivation. In particular, products and opportunities are becoming available that invest in social sector organisations. These products may have risk/return characteristics that do not fit naturally within other asset classes. "Social impact bonds" or other investments using a "payment by results" business model are often cited as examples of products that should be regarded as falling within a new "social investment asset class".

In our view, investments within a social investment **asset class** will tend to have different risk/return characteristics from investments in other asset classes. However, they will not necessarily deliver a lower risk-adjusted return over time. This is both because the returns from other asset classes may vary over time (when, for example, environmental and social factors such as climate change affect returns) and also because social investments may need to adjust the financial returns offered to achieve desired capital flows.

This analysis is somewhat different from that offered by The Boston Consulting Group in its report *'The First Billion: A forecast of social investment demand'*[3]. Using a classification of "the five types of finance", that report identifies "social investments" to include only investments in socially motivated organizations by socially motivated investors.

It differs somewhat also from the "spectrum of capital" identified by Bridges Ventures Research in its report *'Bridges Ventures & Impact Investing: An Overview'*[4].

However, all three analyses bring out the critical distinction between the motivation of the investor and the characteristics of the investment.

We believe that it follows from all three analyses that it is essential that regulators are clear about when they seek to enable investors to exercise their wish to use a social investment motivation – which cuts across asset classes - and when they seek to regulate a specific group or asset class of social investment assets.

Kay Review
We believe that the Kay Review of UK Equity Markets and Long-Term Decision Making, commissioned by the UK government and published in July 2012, creates an important context for effective regulation of social investment. This report has struck a chord around the world and we anticipate that it will have global impact.

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[1] http://www.trilliuminvest.com/news-articles-category/thinking-capital/new-white-paper-total-portfolio-activation-a-framework-for-creating-social-and-environmental-impact-across-asset-classes [August 2012]
[2] http://www.impactassets.org/files/Issue%20Brief%20%237.pdf [2012]
[3] http://www.bcg.com/documents/file115598.pdf [September 2012]
[4] http://www.bridgesventures.com/sites/bridgesventures.com/files/Impact_Investment_market.pdf [August 2012]

Professor Kay recommended that the core objective of regulators of the investment system should be to support the creation of long-term value by the users of capital and good risk adjusted long-term returns to savers, rather than giving primacy to the operation of the investment chain.

We believe that the regulation of social investing should be built on this philosophy while recognising that social investors seek long-term social impact as well as long-term financial returns.

In addition, Professor Kay specifically recommended that "The Law Commission should be asked to review the legal concept of fiduciary duty as applied to investment to address uncertainties and misunderstandings on the part of trustees and their advisers." We believe that the Red Tape Challenge should support and advance this recommendation in preference to that on pension fund investment duties in the "Ten Reforms" document.

Need for an up-to-date and forward-looking view
The "Ten Reforms" document states on Page 5: "Social investment is to be distinguished from mainstream ethical investment and socially responsible investment, which generally involves the screening out of investments which are regarded as having negative social or environmental impact, such as aerospace, tobacco or heavy industries."

As will be clear from our description of modern sustainable and responsible investment above, this is an outdated perspective. It is akin to starting a report on contactless payment technologies with the statement that they are "to be distinguished from mainstream payment technologies which generally involve the use of cheque books."

Like cheque books as a payment technology, exclusion or negative screening is a traditional technique which is still the preferred solution for a segment of users. However, as with payment technologies, the strategies used to incorporate environmental, social, governance and ethical factors into investment have developed significantly over the last twenty five years and the most popular techniques a quarter century ago are no longer the most innovative or frequently used ones today.

We believe that effective solutions to reducing red tape affecting social investing – or specifically investing into social sector organisations – must be based on a perspective that social investing forms part of the broader field of sustainable and responsible investing. We anticipate that solutions designed on the basis that social investing is distinct and different from sustainable and responsible investing are likely to result in measures that, in time, become future "red tape" inhibiting growth to the scale needed for social and mutual organisations to play a leading role in the delivery of 21st Century public services.

Recommendations in the "Ten Reforms" report

1. Place a Social Investment Duty on Financial Regulators

We support this recommendation.

For more than fifteen years, UKSIF has observed how the framing of regulatory objectives has inhibited the ability of UK financial regulators to take full account of the impact on society and the economy of investment decision making and to regulate effectively in support of investors wishing to combine social and financial objectives and/or to take a long-term perspective.

Relevant experience and competencies have not been put in place at the governance or operational levels. One manifestation has been a lack of understanding or insight by regulators into the development of the sustainable and responsible investment field. It is not surprising that the resulting regulation has not been fit for purpose. It is now clear that this has not been in the public interest.

In contrast, we have observed how the requirement on the Greater London Authority (GLA) to have regard to sustainable development has enabled it to build relevant competencies and take a forward-looking approach.

The proposal for a social investment duty offers an effective strategy to address this imbalance. It is well aligned with the emerging paradigm proposed by the Kay Review of focusing on the interests of providers and users of capital rather than those of the investment chain.

2. Tailor the Financial Promotion Rules for Social Offers

We support this recommendation.

Our members tell us that the cost of meeting financial promotion requirements not designed or appropriate for small-scale social investments inhibits the provision of these opportunities to socially motivated investors.

The FSA consultation paper *'Restrictions on the retail distribution of unregulated collective investment schemes and close substitutes'*[5] is currently out for consultation. While we appreciate the very legitimate concerns that have prompted this paper, we are very disappointed that it makes no mention of social investing or client investment objectives that go beyond financial aims or the potential to introduce a pre-defined cap on investments by ordinary retail investors into non-mainstream pooled investment products with social aims. Instead, the paper states "We would not want to encourage the promotion of non-mainstream pooled investments to any particular groups of retail customers."(Annex 4, Paragraph 24). As a result, its conclusion that "We do not consider that there is any scope to reduce discrimination, promote good relations or to promote equality" (same paragraph) would appear flawed.

We are particularly disappointed after the welcome mention of non-financial investment objectives in the FSA's recent paper *'Assessing suitability: Replacement business and centralised investment propositions'*[6].

4. Ensure Suitability Assessments Consider Social and Philanthropic Goals

We strongly support this recommendation.

For over fifteen years, UKSIF has highlighted that many potentially interested private investors fail to receive advice and investment recommendations that take their social goals fully into account. Legal and regulatory barriers are a key factor in this long-standing failure.

In taking forward this recommendation, it is important that regulators ensure that advisers take a holistic view of client non-financial goals within suitability assessments rather than a narrow or restrictive interpretation of social goals. For example, clients may have environmental or "green growth" goals or their social goals may include the encouragement of corporate responsibility and/or the avoidance of activities that they consider harmful to society as well as or instead of an interest in providing investment support to social sector organisations.

We welcome the focus on understanding each client's specific needs and objectives in the recent FSA guidance consultation paper *'Assessing suitability: Replacement business and centralised investment*

[5] CP12/19 http://www.fsa.gov.uk/library/policy/cp/2012/12-19.shtml [August 2012]
[6] FG12/16 http://www.fsa.gov.uk/static/pubs/guidance/fg12-16.pdf [July 2012]

propositions'[7]. In particular, it was a welcome and significant milestone that the guidance highlighted that some clients may have other investment objectives in addition to their financial aims.

However, there is little benefit in assessing suitability if insufficient appropriate products can be recommended. For this reason, we were very disappointed by the lack of reference to social investing in the current FSA consultation paper *'Restrictions on the retail distribution of unregulated collective investment schemes and close substitutes'*[8] as described above.

5. Introduce a Tax Break for Social Investment and for Community Interest Companies

We support this recommendation.

It is perverse that tax breaks should be available for investment in listed companies and in early stage venture capital but not in social investments.

Indeed, in response to the initial consultation in the 1990s on the design of ISAs, UKSIF proposed that Industrial and Provident Societies should be eligible for ISA investment but the government did not take this proposal forward.

As the secretariat for the Social Investment Task Force, we then supported the introduction of Community Investment Tax Relief (CITR).

UKSIF also called for and welcomed the government's decision last year to ensure that community-based renewable energy projects established as social enterprises were not excluded from Enterprise Investment Scheme (EIS) and Venture Capital Trusts (VCT) tax reliefs.

We believe that there are important lessons to be learned for the effective design of tax relief for social investment from the community development finance sector's experience of using CITR.

6. Clarify the Investment Duties of Charitable Trusts

We support this recommendation and welcome the comments of Lord Hodgson on social investment in his recent report.

We believe that the Law Commission review of fiduciary responsibility proposed by the Kay Review should take into account Lord Hodgson's recommendations on charitable trusts but should not delay the separate consideration of issues specific to charitable investors.

7. Clarify the Investment Duties of Pension Funds

Please see our comments under "Kay Review" above.

9. Create a Social Investment Fund Structure

We support the recommendation that a high level working group should be established to consider a suitable structure.

The working group should take into account the current European Union consultation document *'Undertakings for Collective Investment in Transferable Securities (UCITS) - Product Rules, Liquidity*

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[7]FG12/16 http://www.fsa.gov.uk/static/pubs/guidance/fg12-16.pdf [July 2012]
[8]CP12/19 http://www.fsa.gov.uk/library/policy/cp/2012/12-19.shtml [August 2012]

Management, Depositary, Money Market Funds, Long-term Investments’[9], particularly the section on long-term investments. This highlights the potential for long-term investment funds open to retail investors.

It should consider also that it would be desirable that:

- UCITS funds should be permitted to invest in this fund structure, thereby enabling retail investors to gain access through conventionally structured and professionally managed collective investment funds.
- The fund structure should be designed to enable rather than inhibit positive innovation within social investment and in combining social investments with other investment approaches.

About UK Sustainable Investment and Finance Association (UKSIF)

UK Sustainable Investment and Finance Association supports the UK finance sector to be a global leader in advancing sustainable development through financial services. We promote and support responsible investment and other forms of finance that advance 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.

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 260+ members and affiliates include pension funds, institutional and retail fund managers, investment banks, financial advisers, research providers, consultants, banks and non-governmental organisations.

UKSIF members with a particular interest in social investing include Big Issue Invest, Bridges Ventures, CCLA Investment Management, CDFA, Charity Finance Group, The Co-operative Banking Group, Social Finance, The Social Investment Business, Triodos Bank, Worthstone and over 50 financial advisers committed to increasing access to green and ethical investment advice and to improving their own professional knowledge.

For more information about UKSIF, please visit www.uksif.org.

Yours sincerely

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[9] http://ec.europa.eu/internal_market/consultations/docs/2012/ucits/ucits_consultation_en.pdf [July 2012]