14 March 2016

The Social Investment Team
Strategy and Competition, Policy Division
Financial Conduct Authority
25 The North Colonnade
Canary Wharf
London
E14 5HS

Dear Sir/Madam,

Call for Input: Regulatory Barriers to Social Investments

Thank you for the opportunity to respond to the call for input on regulatory barriers to social investment. We appreciate you taking the time to talk to us and the Ethical Investment Association, UKSIF’s financial adviser chapter, during the course of this consultation. We outline below some of our concerns in relation to regulatory barriers to the acceleration of growth in the social investment market.

The UK Sustainable Investment and Finance Association (UKSIF) is the membership network for sustainable and responsible financial services in the UK. 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 voice for the industry. Our organisation has around 240 members and affiliates which include financial advisers, institutional and retail fund managers, pension funds, banks, research providers, consultants and NGOs. For more information about UKSIF, please visit www.uksif.org.

The FCA’s call for input on regulatory barriers to social investment is timely. Interest from retail clients has so far failed to reach its full potential in accelerating the growth of the social impact investment market. Despite a willingness by retail clients to embrace this new form of investment, the most significant obstacle to market growth is a lack of finance for social enterprises. Regulation is one key barrier which impacts on available finance and we hope to address specific aspects below. It is worth noting however, that unhelpful regulation, while a significant problem in accessing finance, is not the only issue affecting the market. There are wider considerations, outside the scope of this call for input which are just as important in facilitating the growth of the sector. Nonetheless we have heard that the regulatory barriers are too high for retail advisers to support the growth of the social impact market.

We represent members across the full range of UK financial services including financial advisers and organisations who work to raise capital for and invest in social enterprises. Some UKSIF members

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1 Barclays, *The Value of Being Human: A Behavioural Framework for Impact Investing and Philanthropy*, September 2015 survey found that over 50% investors would be interested in impact investment but only 9% had actively engaged.

have raised concerns with us over their ability to do that based on regulatory barriers with regard to financial promotion. Obstacles relating to access to finance ultimately translate into obstacles for the growth of the social investment market in the UK. Therefore we recommend the FCA immediately works to examine these barriers.

Our discussions with members confirm that charities and social enterprises are keen to raise money from the general public for social investment. Big Society Capital\(^3\) recently surveyed financial intermediaries which demonstrated a wide range of motivations for securing investment by the general public. These motivations include diversifying their investor base, raising awareness for the work of the social enterprise or charity, and forging deeper connections with the communities in which they operate. There are clear financial benefits to these organisations by raising capital through the public. Although the UK has seen some useful initiatives to encourage more social investment from the general public, there is more that can be done and it may be useful to look at other international models to understand how the market can be better supported.\(^4\)

We have no doubt that demand for investment in social enterprises is strong. Research commissioned for UKSIF’s Good Money Week 2015\(^5\) shows evidence of a ‘social investor’ with a clear correlation between positive values and age. UKSIF-commissioned polling showed that 54% of people wanted their investments to make a “positive difference” as well as making money. Other research commissioned by Standard Life Investments showed that 58% of 18-24 year olds wanted to invest in companies that achieve positive social outcomes, while 51% of people in the same category wanted to invest in ways that minimise environmental damage. Despite this evidence of the willingness to “supply” capital, the flow of money from the general public to social enterprises and charities has not yet matched the demand from those entities.

Concern has been expressed by UKSIF members with regard to the conflation between social investments and traditional green/ethical investments. The latter are well established forms of investment at both retail and institutional level with different risk profiles, regulation and guidance and consumer protection. The former is a far newer form of investment with its own characteristics and some of our members raised concerns with us that this conflation by the FCA was somewhat misleading and could potentially have a detrimental impact on the ethical and sustainable and responsible investment markets. It would be useful if the FCA would clarify this point in its response to the call for input. Our response seeks to answer questions 3, 4, 5, and 6.

3. Have you experienced problems in advising investors who wish to invest in social enterprises, or for whom investment in a social enterprise may be suitable? If so, please provide details of those problems.

Our response to the FCA’s recent review of the financial advice market highlighted some of our concerns, based on feedback from our members, relating to financial advice for retail clients.\(^6\) Many of the issues we have already highlighted will be relevant.


\(^5\) More info available at: [http://www.goodmoneyweek.com](http://www.goodmoneyweek.com)

Following discussions with the Ethical Investment Association, concerns relating specifically to the social investment market include:

- The fact that this is a still-nascent market has been problematic. These types of investments may be considered more risky than traditional investment due to a lack of any track record of successful delivery. We have heard anecdotal evidence that this may be off-putting to financial advisers other than specialists.
- Objective assessment in terms of factors such as diversification, past returns and illiquidity may tend to lead to advice focusing on traditional investment types since the newer can’t demonstrate data in these areas due to their current small size and short-track record. But this is to compare the established apples to the emerging oranges, and a regulatory system that focuses attention on such criteria will cramp potential growth. If the aim is to accelerate such growth some flexibility will need to be introduced into the system.
- Feedback from our members suggests that the cost of compliance for investees is slowing growth in the number of schemes.
- A recurring theme in member feedback is the low level of financial literacy among potential investors. Adviser members report that potential investors with a belief in the relevant social aims have a limited understanding of financial concepts, do not understand their position with regard to e.g. regulated vs unregulated assets, FSCS, liquidity or diversity and thus are hard to advise.
- The Financial Ombudsman Service is not subject to FCA rules and FOS liability is unlimited. A lack of a long-stop means that cases can be brought even by executors. The impact will be compounded on investments which some already consider to be riskier.
- Professional Indemnity insurers do not include these investments as standard; a separate premium is needed which generally requires evidence in advance for underwriters to price the risk.
- As mentioned in our response to FAMR, cost of advice remains an issue. This issue is compounded in social investing where the generally small scale of opportunities means due diligence and research will rise as a proportion of assets invested. RDR also means that commission flow as a means of payment is forbidden.
- We have heard anecdotal evidence that guidance given on compliance with FCA rules on diversification is that a maximum of 5% should be allocated. Typically retail will only want to put a small amount in as a “toe in the water” and £5,000 is a commonly given amount: this gives a minimum portfolio of £100,000, far beyond most retail clients’ investible assets.
- An area which has received some comment is social pensions, for more on this see the Social Mobility Foundation and Big Society Capital report on social pension funds.

Our experience is that innovation is attractive to this investing demographic. We think it may be an area where peer-to-peer (“P2P”) offerings may grow rapidly. Consideration should be given to how the regulatory environment may support both the investment concepts and the P2P delivery route.

A key recommendation we would suggest which would address many of the issues is that advisers be required to ask a question about social motivations or social, environmental and ethical objectives at the fact finding stage. We believe that discussion of this issue will rapidly establish the strength of motivation, and where that is deemed to be high after the relevant aspects of these

investment have been raised (e.g. liquidity, short history) the adviser should be allowed more leeway to recommend social investments. This freedom should be complemented by high disclosure obligation on issuers such that what might be called the “overhead of social investment” is shared by the issuer making disclosures and the investor accepting stated risks.

4. Have you identified barriers to investment in the social sector for retail investors? If yes, please provide details of these barriers, in particular identifying those that may be caused by regulation.

5. What kind of rules do retail investors need to consider when making sound investment? Have you identified any consumer protection concerns in this area? Please explain these concerns and how they might be addressed.

One key regulatory barrier that has been highlighted to us as being responsible for lower market growth is the rules relating to financial promotion, the Financial Promotions Regime (“FPR”). These rules often set minimum investments at levels (per investment) well above the reach of most people and setting such high limits could prevent sufficient diversification.8

A lack of understanding of the social investment market in the regulations has also been cited to us on several occasions as an impediment to growth. Anecdotal and written evidence9 is very clear that the detrimental impacts of this lack of understanding occurs when:

- The size of the investment may be small;
  - The FPR treats large and small investments in the same way. This means reduced risk of losses resulting from smaller investments are not recognised.
- The total amount being raised as part of the offer is small;
  - While social enterprises typically look to raise investments of up to £100,000, the FPR treats investments raises under €5 million the same way. Because the characteristics of social enterprise investment raises are not recognised they are disproportionately disadvantaged under the FPR.
- The investor has significant non-financial goals;
  - FPR still does not expressly recognise non-financial goals as a purpose of investment. This means the rules are still as stringent and there are no exemptions even for investors who are investing primarily with non-financial goals.

The lack of recognition of the nature of social investment is one barrier to the advancement of the market in the UK. It is these types of small investments that taken together could have a huge impact in allowing charities and social enterprises to meet their capital needs that are disproportionately affected. We welcome the news that the Government intends to commission

research to better understand the potential for mass participation in social investment and the extent to which the current rules disproportionately affect social investors.\textsuperscript{10}

We have received other anecdotal evidence of barriers to investment in the social sector for retail investors which should be addressed that relate to:

- Better financial education starting at primary school and continuing throughout state education would achieve a variety of benefits. As well as driving demand for a more sustainable financial system, reducing the amount of people in debt and encouraging a culture of saving, it would help to drive more investment in the social impact sector.
- The cost of advice remains too high for some investors. We have already explained how a ban on commission following RDR is even more relevant in the social investment market.
- There may be some issues around scalability which should be addressed. Although scaling will not be suitable for all social enterprises, some guidance on employing deliberate strategies to scale social innovations would be helpful. Scaling is not the answer to all of society’s problems, but importantly it can mean more impact, lower costs wider reach allowing help sector to meet investor demand.\textsuperscript{11,12}
- Lack of recognition of the importance of \textit{investment readiness}.\textsuperscript{13}

6. Do you have any evidence (e.g. figures, case studies or other practical examples) of the appetite retail investors have for social investments and related products, particularly compared to donations?

- We have already mentioned, but it is worth stating again that UKSIF polling for Good Money Week 2015 showed that 54% of investors want something in addition to a financial return on their investment.
- A recent Barclay’s survey supported UKSIF research and showed that 56% investors want some more than just a return on investment but only 9% of investors have invested in this manner.
- A Standard Life Investments poll for Good Money Week 2015 showed a positive correlation between positive values and youth, with millennials far more likely to want something in addition to a return on investment.
- The SLI poll showed that 58% of 10-24 year olds wanted to invest money in companies that achieve positive social outcomes.
- It also shows that 45% millennials want to gradually increase investment in renewables, while 58% want an annual update from their investors on their environmental and social impact.
- Anecdotal evidence that some investors would rather make a donation than a small social investment because it is far less onerous.

\textsuperscript{11} Nesta, Making it big, July 2014 available at: \url{http://www.nesta.org.uk/sites/default/files/making_it_big_web.pdf}
\textsuperscript{12} UK National advisory board to the social impact investment taskforce, Building a social impact investment market, September 2014 available here \url{http://www.socialimpactinvestment.org/reports/UK%20Advisory%20Board%20to%20the%20Social%20Impact%20Taskforce%20Report%20September%202014.pdf}
\textsuperscript{13} More information available at: \url{https://www.clearlyso.com/big-potential-fund-approved-provider-clearlyso/}
The Ethical Investment Association conferences have seen a reduction in the number of social investments showcased at events. The number of advisers with the requisite PI insurance is low, even amongst the specialists.

We trust the above information is clear, but if you require any information on any of the points raised please do not hesitate to contact me via fergus.moffatt@uksif.org.

Yours faithfully,

Simon Howard
Chief Executive
UK Sustainable Investment and Finance Association (UKSIF)