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Social Business Initiative: Promoting social investment funds

The European Commission's public consultation

EuroInvestors' reply

14th September 2011

EuroInvestors (the European Federation of Investors or EFI) was created in the summer of 2009, following the financial crisis which demonstrated the limits of the almost exclusive dialogue between regulators and the financial industry, largely ignoring the user side. EFI aims at representing and defending at the European level the interests of financial services users in order to promote training, research and information on investments, savings, borrowings and Personal Finances of individuals in Europe, by grouping the organisations pursuing the same objectives at a national or international level. Already about 45 national organizations of investors and other financial services users have joined us, and EFI already represents about two million European citizens.

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Executive summary

EuroInvestors welcomes the European Commission's consultation on Social Investment Funds.
As far as retail investors are concerned, similar retail funds already exist throughout Europe, like the "fonds solidaires" in France.
The key challenges to effectively promote retail investments in social businesses will be to:

- Define very clearly and precisely what social businesses are: the EC proposed definition is not precise enough and diverges from other existing definitions.
- Have a neutral control on the reality of the "social" nature of any business claiming it.
- Grant investor information and protection rules as close as possible to those provided by MiFID and by UCITS IV Directives;
- Have an independent and trusted rating of such funds;
- Simplify and clarify the offerings in this field instead of just adding yet another category of retail investments of which there are already too many, creating a lot of confusion in retail investors minds; especially the difference with SRI funds must be very clearly spelled out.

Box 1

Do you agree that the main features of social businesses are as outlined above?

Please consider this from the perspective of ensuring effective private investment flows to these businesses, and include any further detail on how to determine the features. If you disagree, please outline the features that you think are important.

To what extent do you think this initiative should focus solely on those social businesses that do not distribute profits to their investors? (Note that, in contrast with pure philanthropic investments, investors would still be able to redeem their investment, or might be offered small returns through portfolio diversification).

Or shall it also focus on those which distribute profits to their investors (e.g. at least to a limited extent)? If so, how might social businesses be distinguished from other businesses?

Please consider the impact this may have in respect of attracting investors to such businesses.

It is important that consumers can easily recognize, immediately and without any doubt, what social businesses and what private investment funds in supporting social businesses are. Therefore EuroInvestors recommends adopting a very clear definition of what are social businesses and a labeling on private investment funds that support social businesses (see below) in order to increase accountability for consumers.

The definition proposed by the EC (businesses having a **primary** corporate objective on the

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achievement of social, ethical or environmental outcomes) may be too narrow compared to the EMES definition for example.

The EMES Project, during the emergence of social enterprise in Europe (1996-1999), received support from the European Commission and formed a partnership with the European Confederation of Workers' Co-operatives, Social Co-operatives and Participative Enterprises (CECOP). Researchers from the, at the time, fifteen European Union Member States analysed the emergence and growth of "social enterprises", that is, initiatives which combine entrepreneurial dynamics and social objectives in an original way.

The EMES definition distinguishes, on the one hand, criteria that are more economic and, on the other, indicators that are predominantly social. To reflect the economic and entrepreneurial dimensions of initiatives, four criteria have been put forward:

1. **A continuous activity, producing and selling goods and/or services**
   Social enterprises, unlike some traditional non-profit organizations, do not normally have advocacy activities or the redistribution of financial flows (as do, for example, grant-giving foundations) as their major activity, but they are directly involved in the production of goods or the provision of services to people on a continuous basis. The productive activity thus represents the reason, or one of the main reasons, for the existence of social enterprises.
2. **A high degree of autonomy**
   Social enterprises are created by a group of people on the basis of an autonomous project and they are governed by these people. They may depend on public subsidies but they are not managed, directly or indirectly, by public authorities or other organizations (federations, for-profit private firms, etc.). They have the right to take up their own position ('voice') as well as to terminate their activity ('exit').
3. **A significant level of economic risk**
   Those who establish a social enterprise assume – totally or partly – the risk of the initiative. Unlike most public institutions, their financial viability depends on the efforts of their members and workers to secure adequate resources.
4. **A minimum amount of paid work**
   As in the case of most traditional non-profit organizations, social enterprises may combine monetary and non-monetary resources, volunteering and paid workers. However, the activity carried out in social enterprises requires a minimum level of paid work.

To encapsulate the social dimensions of the initiative, five criteria have been proposed:

1. **An explicit aim to benefit the community**

One of the principal aims of social enterprises is to serve the community or a specific group of people. In the same perspective, a feature of social enterprises is their desire to promote a sense of social responsibility at local level.

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2. An initiative launched by a group of citizens

Social enterprises are the result of collective dynamics involving people belonging to a community or to a group that shares a well-defined need or aim; this collective dimension must be maintained over time in one way or another, even though the importance of leadership – often embodied in an individual or a small group of leaders – must not be neglected.

3. Decision-making power not based on capital ownership

This generally refers to the principle of 'one member, one vote' or at least to a decision-making process in which the voting power in the governing body with the ultimate decision-making rights is not distributed according to capital shares. Moreover, although the owners of the capital are important, decision-making rights are generally shared with the other stakeholders.

4. A participatory nature, which involves the various parties affected by the activity

Representation and participation of users or customers, stakeholder influence on decision-making and participative management are often important characteristics of social enterprises. In many cases, one of the aims of social enterprises is to further democracy at local level through economic activity.

5. Limited profit distribution

Social enterprises not only include organizations that are characterized by a total non-distribution constraint, but also organizations which – like co-operatives in some countries – may distribute profits, but only to a limited extent, thus avoiding profit maximizing behaviour. [1]

As one can read, the EMES definition is quite different and quite broader than the one proposed by the Commission in this consultation. For example, what about cooperative and mutual banks? Credit unions? Cooperatives and mutual do happen to distribute profits. For example, in France, they even issue "mutual" or "cooperative" shares to their affiliates that bear interest and are considered as the business's own funds for accounting purposes. FSUG believes it is an important feature to attract retail investors. If there is no profit or any yield, then gifts and donations are a preferable tool than "investments".
Also, experience has shown that some businesses, even labelled as mutual or cooperatives have acted in very corporate profit oriented manner, or totally escaping the control of their natural members. How to distinguish between genuine mutual and coops versus the others?

Finally, the EC must clearly distinguish "social business" from other fashionable concepts that are also used to design investment vehicles in order to avoid a probable confusion in the mind of retail investors:

- Socially Responsible Investment (SRI): there is already a very large and diverse offering of retail "SRI" funds.
- "ESG"
- Solidarity businesses or funds like those in place in France ("fonds solidaires" that invest 5 to 10% of their assets in businesses helping the poor, or employing handicapped people, etc.; these businesses usually do not have any profit goals)

1 Marthe NYSSENS, Social Enterprise. At the crossroads of market, public policies and civil society, ed. (2006), Routledge, Londres and New York.

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Box 2
What are the main difficulties social businesses face, in your experience, in getting access to finance? (Please provide any data or evidence you have to show the scale and relative importance of the difficulties you identify).

Do different kinds of social businesses face different barriers? (Please include details about how these differences might impact on the access of these social businesses to finance, including over their lifecycle where appropriate.)

To what extent do you think barriers to access to finance are limiting the growth of social businesses across the EU? (Please provide any data or evidence you have to illustrate the scale and nature of these limitations).
Do you agree that there is a need to tackle any such barriers at the EU level?

This question is obviously more targeted towards the social businesses themselves rather than to retail financial services users.

Given the specific characteristics of social enterprises, other forms of financial instruments are to be expected, for example combining grants, loans, investments and other favourable conditions suitable for social enterprises and their development. However, it is important that the diversity of financial instruments used by social economy enterprises (SMEs, employment aid and / or training, environmental aid, loans ...) does not unduly complicate the management of these enterprises. This requires a degree of complementarity between the public, private and third sectors.

Firstly, the European Commission should ensure that all types of players, including SMEs, have the opportunity to benefit from the European support and encourage various forms of partnerships, particularly at local level. Support should be accessible to all types of businesses, not just to a single model of capital companies.

On the other hand, it is essential to adjust the definition of SMEs. The mid-term review of Modern SME policy published in the Commission Communication on the role of small and medium enterprises in boosting growth and employment states that the Commission "will **take into account the diversity** of the SME community: craft and small businesses, social economy enterprises and family-run SMEs all show potential for strengthening European growth and acting as a driving force for innovation, local development, training and employment, while sometimes displaying special problems and needs.. ".[2] Therefore, it would be interesting to segment companies in different categories according to their size (e.g. micro-enterprises), activities (e.g. social integration) or their legal status (for example, cooperatives companies).

2 Small and medium-sized enterprises - Key for delivering more growth and jobs. A mid-term review of Modern SME policy, 4.10.2007, COM(2007) 592 final.

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Box 3
If you operate a social investment fund, or are aware of the (national) legislative requirements that apply currently in practice, could you please provide broad detail on these requirements.
How do you think funding through investment funds might effectively compliment other sources of funding, e.g. philanthropic funding? Are there any challenges here?
Do you think that the UCITS framework is sufficient for funding social business without change?
Do you think a bespoke fund framework tailored to the needs of social business might be better suited to channel funds toward social businesses?
(If you think the UCITS framework is not suited, please outline the features of the UCITS framework that you think are mostly responsible for this).

Social enterprises, like all others, refer to various sources to finance their activities. However, and given the specificities of the sector, a specific fund could be created that would affect a significant portion of its capital to ethical investments. The remaining part of its assets could be used to finance the social economy. The fund would aim to support the development of social entrepreneurship through equity and loans to companies in this sector that meet the basic principles listed above.

The national requirements for social businesses investment tools are highly dependent on the definition one gives to "social business": see our reply to Box 1.
For example in France, there are numerous existing investment tools:

- For cooperatives and mutuals: "titres participatifs", "parts sociales";
- For "solidarity" businesses (not for profit specializing in helping the poor get jobs, housing, microcredit etc., or employing handicapped people): all corporate savings and retirement plans in France must offer at least one "fonds solidaire". These funds must invest 5 to 10 % of their assets into "solidarity businesses"[3]

and their numbers are constantly increasing.[4]

Box 4
Do you believe that social investment funds should be open to retail investors? Please give reasons for your answer.
What features of a social investment fund do you think are most important for retail/professional investors?
What specific pre-contractual information do you think would need to be provided to retail investors?
Should the framework encompass funds that explicitly forego greater financial returns for the benefit of the social impact of their investment, or that expose investors to greater risks, or both?

Social investment funds are already open to retail investors. For example, as mentioned above,

[3] French law n° 2008-776 of 4 August 2008 de modernisation de l'économie
4 Dr. Roland Benedikter , European Answers to the Financial Crisis: Social Banking and Social Finance , http://spice.stanford.edu/docs/european_answers_to_the_financial_crisis_social_banking_and_social_finance/.

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"fonds solidaires" offerings in France are mandatory for all corporate defined contribution savings ("PEE") and retirement ("PERCO") plans. These plans have millions of employee participants.
In France as well, the "solidarity" businesses have to be agreed by the Government. There is also a private labeling by the NGO FINANSOL. FSUG believes there must be a neutral control on who ever labels itself as social or solidarity business not to mislead retail investors.
Also, as mentioned above, there must be some kind of financial return. Otherwise gifts and donations are a more appropriate funding tool for social businesses.
Specific risks if any must be disclosed as for any other retail fund.
UCITS investor protection rules must fully apply to avoid any damaging scandal that could arise from the misuse of social investments.

Box 5
What do you think would be the appropriate time frame for redemption of units in a social investment fund, e.g. monthly? Please give reasons for your answer.
Do you think there are other options for balancing the liquidity that small retail clients might be seeking with a focus on a long-term time horizon? (For instance, requirements on holding certain levels of liquid assets, lock in periods, etc.)

It all depends on the asset components of the funds and on the narrower or wider definition of social business (see our replies above). If one designs them like the above-mentioned French ones, then with only 5 to 10 % invested in pure "solidarity" businesses, it is certainly possible to have at least monthly redemption time frame. Any heavy timing constraint may be badly perceived and push retail investors to give up or to consider gifts instead.

Box 6
Do you think that social investment funds should be subject to diversification rules?
To what extent do you think investors might expect a fund focused on social businesses to only invest in social businesses?
Should social investment funds be required to invest into different types or numbers of social business? (How many separate businesses might be required?).
Should there also be diversification across asset classes different from social business? (What limits might be appropriate? For instance, 40% social businesses, 60% highlyliquid transferable securities).

See our reply to Box 5. Also, the social investment fund offering should remain simple and should replace any existing ones. The diversity of retail funds offerings is already much too large, as recognized by the industry as well. If one adds a new variety on top of "fonds solidaires", SRI funds, etc., one risks toad to the confusion of retail investors.

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Box 7
What types of assets should a social investment fund be able to invest in? Please give examples.
Should the funds be limited to certain kinds of strategies (for instance, aimed at maximising their attractiveness for retail investors)? If so, which?
What rules or limits might be necessary to prevent firms using a new framework to circumvent restrictions in other frameworks (e.g. UCITS)?

As mentioned before, it depends on the scope of the social business definition. In our view, it would also be dangerous to have significantly lower valuation and investor protection requirements compared to UCITS.

Box 8
Do you agree that it would be impractical for social investment funds to have frequent valuations of assets? Please give reasons for your answer.
If so, for the purposes of investor protection what frequency might be appropriate? Please give examples.
Do you think that any non-social business assets that might be permitted should be subject to different valuation requirements? Might different kinds of assets require different approaches?

Again, it depends on the fund's asset components. The French "solidar" funds invest only 5 to 10 ù in social businesses (but these being rather) narrowly defined). In that case, frequent valuations of assets are easier.

Box 9
How do you think 'social returns' might be best addressed and measured?
How might this build on other existing work, for instance on non-financial company reporting, social accounting, socially responsible investing, etc.?
What information do you think needs to be disclosed to investors, and how might this best be presented?
If you have experience in this area please provide examples, data, and as much detail as possible.
Please consider that prospective investors might need different information compared with already existing investors.

« Social » objectives and returns should be quantified and disclosed in the fund « KID », if it is to be sold to retail investors.

Box 10
Do you agree that investor participation will contribute to the success of these funds?
Please give reasons for your answer.
If so, please outline how this might work in practice, and whether this can or should be required as part of the social investment fund framework itself.

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Yes, but this is part of the broader issue of investment funds governance: see our reply to the corporate governance consultation from last year.

Box 11
Which particular features of social investments might require specific risk management requirements?
When considering this question, please also consider issues of non-financial outcomes and risks.

Better answered by social businesses' themselves.

Box 12
What should be the duties of a depositary (e.g. tracking the funds' assets, reconciling units or shares issued with subscription proceeds received)? Please give reasons for your answer.
Please take into account the specific kinds of assets that might be held by a social investment fund.

We believe the duties of the depositary should be no less than the ones he has for UCITS funds.

Box 13
How might the sustainability and profitability of a social investment fund regime be ensured?
Are there any particular factors in your experience that might determine the commercial success of the fund?
In your view, what kinds of incentive structures might be appropriate or inappropriate for the managers of the funds (e.g. performance fees versus flat management fees)?

As for mainstream funds, performance fees (that go both ways, not only when the performance is positive) are certainly more aligned to investors' interests than the existing asset-based fees.

Box 14
What steps do you think should be taken to improve transparency for investors in relation to funds targeting social businesses?
What steps do you think should be taken to improve transparency for fund managers about the social businesses which they target?

Box 15
How do you think common criteria for defining, labelling and rating social funds and social businesses might be most effectively established?
Who should establish them and develop them over time?
How might they be verified, to ensure they are appropriately used in practice?
Please set out views on the pros and cons of different approaches.

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Box 16
Do you think a strong new EU label (e.g. supported by a common logo) would help social investment funds succeed? Please give reasons for your answer.
How might the appropriate use of such a brand be ensured in practice, and potential for confusion with other brands or labels diminished?

It might, but only if the EU defined « social investment funds replace exiting national ones instead of creating just another new variety of retail funds, of which there are already too many.

Box 17
What steps do you think might be taken at the European level to facilitate better intermediation between funds and social businesses? Are there particular responsibilities that you think fund managers should take on?
Do you think there are any possible actions at the European level that might ensure effective distribution of social investment funds?

A neutral control of who can label itself as a "social business" is a key to generate retail investor confidence. An equally neutral rating of the social investment funds by an independent NGO (see the French example of FINANSOL) would help as well.

Box 18
How might tax incentives be made useful? Please provide data on any existing such incentives you are aware of.
Are there any other measures you think might be possible to maximise investor's access to social investment funds, or the attractiveness of these for investors?
Thank you for taking the time to respond to this consultation.

We refer for example to the tax rules for the French "fonds solidaires ». Contrary to the "fonds de partage" (funds which do not have to invest in social businesses[5] but where all returns are given to charities); they do not benefit from specific tax advantages. But, if subscribed through corporate savings or retirement plans, they enjoy the significant tax benefits of these plans.
Again, any new tax incentive should replace existing ones if it is to be clearly understood by retail investors.

[5] This is why we did not focus on these « fonds de partage » in this consultation reply.