

# POSITION PAPER



## **ESBG Response to the European Commission Consultation concerning the Social Business Initiative and the Promotion of Social Investment Funds**

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ESBG Register ID 8765978796-80

**14 September 2011**



### **Introductory Remarks**

The European Savings Bank Group (ESBG) would like to convey our thanks to the European Commission (Directorate General for Internal Market and Services) for this opportunity to provide input and comments concerning the upcoming Social Business Initiative and the Promotion of Social Investment Funds.

### **ESBG replies to the Commission's specific questions**

#### **Box 1**

**Defining social business: 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?**

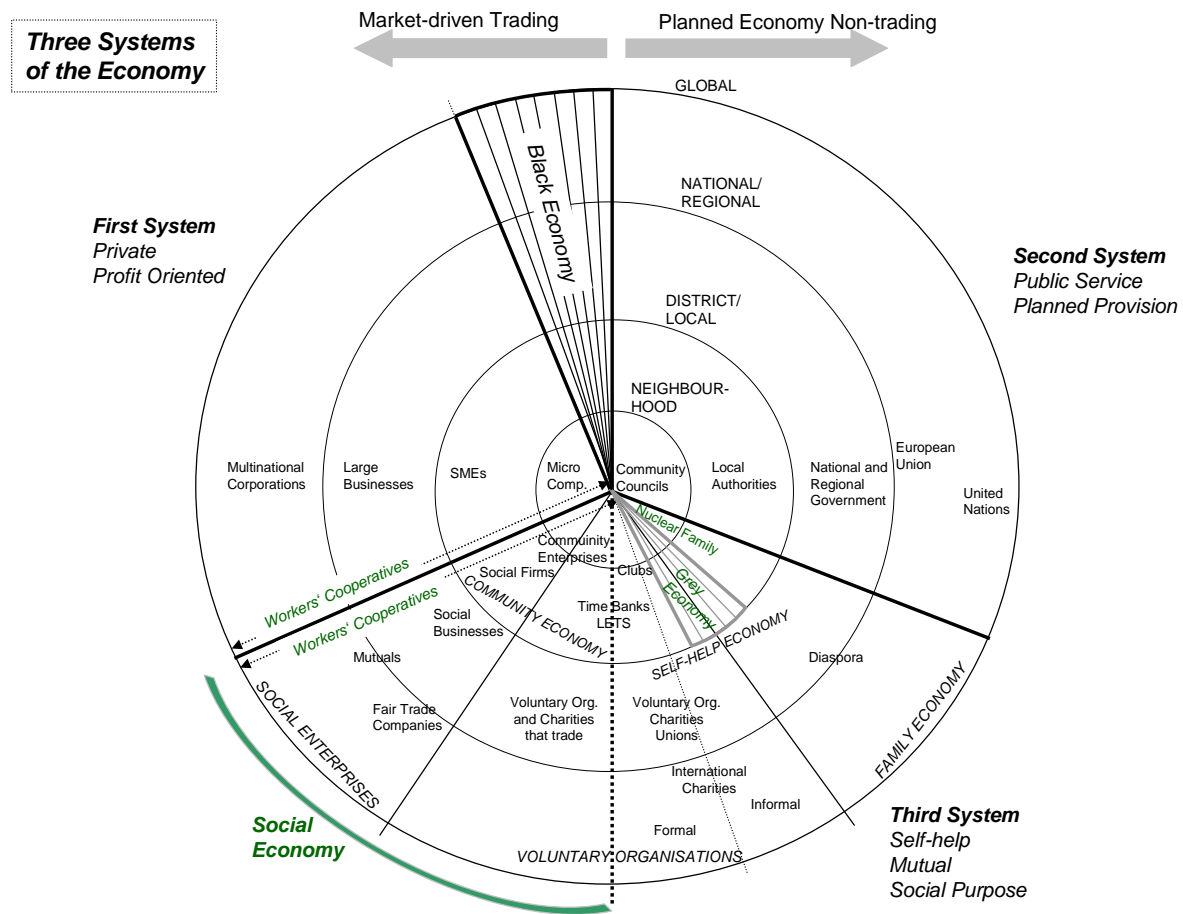
**Please consider the impact this may have in respect of attracting investors to such businesses.**

#### **ESBG response:**

Social enterprises are part of the economy's third sector. They are neither part of the private nor to the public sector (see Fig. 1). Comparing the social and the private sector, there appear to be similarities and differences. Similarities would include the fact that they are both profit and personality-driven and have a stakeholder model behind them. Differences would include the distribution of profits, stakeholder expectations and the ownership structure.



Figure 1: Three Systems of the Economy



A lot of corporations in the 'first system' – the private sector – have nowadays been increasingly acting in a socially responsible way. The trend of CSR (Corporate Social Responsibility) in companies is, however, different from the nature of a social enterprise. Social enterprises are also different from charity organisations in the way that part of the charity system is not involved in trading-business. The 'third sector' or 'citizen sector' has shown tremendous growth over the last years. It has become an important part of the paradigm of the 'three systems of the economy' (see Fig. 1). The worldwide mobilisation of citizens shows a lot of new aspects recently, like growth on an unprecedented scale and global dispersion. Systematic approaches have replaced stop-and-go solutions. The new organisation type is less encumbered by church and state and often able to put pressure on governments. Furthermore, third sector organisations are increasingly forging



partnerships with businesses, academic institutions, and governments. The sector is experiencing the beneficial effects of entrepreneurialism, increased competition and collaboration, and a heightened attention to performance.

A social enterprise has six defining characteristics. It has a social purpose, it achieves that social purpose by - at least in part - engaging in trade in the marketplace, it is not distributing profits to individuals, it holds assets and wealth in trust for community benefit, it is democratically involving members of its constituency in the governance of the organisation and it is an independent organisation accountable to a defined constituency and to the wider community.

The social enterprise sector is incredibly diverse encompassing mutual organisations such as co-operatives, but also social firms, development trusts, community enterprises, housing associations, football supporter's trusts, Social Firms and leisure trusts, among others. As a result social enterprises use a wide variety of legal forms; some incorporate as companies while others take the form of industrial and provident societies. The social enterprise tries to maximise the value of its activities and therefore has to optimise the combination of social and economic benefit. Accordingly, the maximisation of the social enterprise's value would be closer to the 'social benefit' than to the 'economic benefit' dimension.

The primary motivation of the social entrepreneur is social and not financial. His objective is to create 'social value.' A social value is a value that 'creates', 'sustains', 'measures' and 'replicates'.

Microfinance might be a case study for a social enterprise. Microfinance is a term used to refer to the activity of provision of financial services to clients who are excluded from the traditional financial system on account of their lower economic status. These financial services will most commonly take the form of loans and micro-savings. The primary differentiator between microfinance and the conventional credit disbursement mechanism lies in the 'joint liability' concept. A group of individuals, almost always women, form an association to apply for loans.

#### **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?**



**ESBG response:**

One should differentiate between investments in a classical sense and philanthropy. Investors, be it short-term or long term oriented, long for returns. However, as mentioned above, the primary motivation of the social entrepreneur is social and not financial. Microfinance stands somewhere in between return-driven and non-profit concepts. Those microfinance investments that focus (also) on returns are an alternative for the long-term investor.

A greater awareness of social return for social investors, like trusts or foundations, is a big challenge. A fiscal incentive could be supportive. Any regulation barrier that limits the growth potential of social business needs to be tackled.

**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).**

With regards to microfinance investments, we have the opinion that a fund framework is beneficial. (There are no additional legislative requirements on top of the status quo.) Generally we see a very restrictive framework for alternative and social investments like microfinance in Europe. In many cases there is no access for private investors to these instruments.

**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?**

**ESBG response:**

As long as liquid products in the field of microfinance are concerned, we think that social investment funds are an alternative for retail investors. Social investment funds should be open to retail investors. Requirements are a regulative framework and guidelines for the fund as well as transparency, risk management and a certain level of liquidity.

**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.)**

According to liquidity restraints, ESBG thinks that the appropriate time frame for redemption of units in a microfinance product (as an example for a social investment fund) should be monthly or at least quarterly. For large and professional investors lock in periods make sense on a case to case basis. Social investment manager need a medium/long term horizon for their investment decisions.

**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% highly liquid transferable securities).**



**ESBG response:**

Diversification is key for any investment type. A number of at least ten investments in a fund should be required. However, we don't think that a diversification across asset classes different from social business makes sense. There should be a clear definition of each investible area a social investment fund can invest.

**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)?**

**ESBG response:**

Microfinance is an example of assets a social investment fund should be able to invest in.

By way of example, goodbee, an initiative of Erste Bank Stiftung (Foundation) is running a project for launching a social investment fund with its exposure to the EU.

**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?**

Valuations should be available twice a month. Tradeable prices to ensure some level of liquidity should be available on a monthly or at least on a quarterly basis.



**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.**

ESBG thinks that social return could be addressed to investors and other stakeholders in an annual specific report where all collectable social achievements are described.

**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.**

ESBG does not think that investor participation in the investment process will contribute to the success of the fund, a kind of investment board for questions of social background etc. might be helpful. We expect the participation in such investment boards to elevate the knowledge of the work of the social investment fund and that members of such a board can act as a multiplier.

**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.**



It is the liquidity of the investments that is the first and foremost risk to be tackled by risk management. Besides that, general requirements for social and financial risk management have to be covered.

**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.**

ESBG does not see much difference in the duties of a depositary between controversial investment funds and social investment funds. Certainly they might have to face diverging challenges in administrating such investment 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)?**

The sustainability and profitability of a social investment fund regime has to be ensured by fund management and – if available – an investment board for socially related questions. In our opinion the management of a social investment fund and incentives like performance fees are contradictory.

**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?**

**Please consider how to balance burdens on social businesses against effectiveness in ensuring their 'investment readiness'.**



Transparency should be available to an extent like for any other investment fund vehicle.

**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.**

The rating and labelling of social funds seem to make sense to confirm the achievements of the fund. Initiatives like CGAP of the Worldbank or the Luxflag-Label for Microfinance Investments might be also supportive for the establishment of social investment funds.

**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 is the contents rather than the packaging (label) that matters in the first place. Once the discussion on the contents is done, a label might be helpful.

**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 regulative framework seems to be a key issue for social investment funds.

**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?**

ESBG is not familiar with any tax incentives that fit for social investment funds. We regard the measures described above as the key for a potential success for European social business funds.



## About ESBG (European Savings Banks Group)

### ESBG – The European Voice of Savings and Retail Banking

ESBG (European Savings Banks Group) is an international banking association that represents one of the largest European retail banking networks, comprising about one third of the retail banking market in Europe, with total assets of over € 6.000 billion, non-bank deposits of € 3.100 billion and non-bank loans of € 3.300 billion (all figures on 1 January 2009). It represents the interests of its members vis-à-vis the EU Institutions and generates, facilitates and manages high quality cross-border banking projects.

ESBG members are typically savings and retail banks or associations thereof. They are often organised in decentralised networks and offer their services throughout their region. ESBG member banks have reinvested responsibly in their region for many decades and are a distinct benchmark for corporate social responsibility activities throughout Europe and the world.



ESBG - Association internationale sans but lucratif/Internationale vereniging zonder instoogmerk/  
International not-for-profit association

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Published by the ESBG, July 2011