THE YOUNG FOUNDATION
THINKING ACTION CHANGE

The Young Foundation response to ESMA Consultation on its Technical Advice to the European Commission on the implementing measures of the Regulations on European Social Entrepreneurship Funds (EuSEF) and European Venture Capital Funds (EuVECA)

The Young Foundation (YF) was born in 2005 from the merger between The Institute for Community Studies - set up by social entrepreneur Michael Young in 1954 – and the Mutual Aid Centre. In both current and previous incarnations, the YF has been instrumental in leading research, driving public debate, and implementing social innovation in the UK and abroad. The YF has created over 60 organisations, including the Open University, the Consumers' Association, the Economic and Social Research Council and the School for Social Entrepreneurs. The Foundation's mission consists in working together with public and private sectors and civil society to build a more equal and just society, where each individual can be fulfilled in their own terms.

The Foundation's work is organized around four pillars: tackling structural inequalities by investigating their nature and forms; supporting young people through venturing, research, practical action and networking; promoting health, well-being and active aging and building knowledge and skills on social innovation and social investment.

Through its Young Academy programme - providing specialist capacity development and risk capital to social enterprises whose work raises the attainment of disadvantaged young people in England – and its Accelerator programme - supporting ventures with skills to secure social investment, contacts or funding and increase their social impact, the YF has supported hundreds of social entrepreneurs and ventures to scale up and deepen their impact.

In 2014, the Young Foundation created EuropeLab, its vehicle to experiment new ways of creating economic and social value across Europe involving citizens and local stakeholders. EuropeLab aims at influencing the policy debate at institutional and political level, but more importantly at supporting concrete initiatives, developing projects which can lead to a systemic transformation of territories and that with time can be part of a more general project of bottom-up transformation of European social economies. EuropeLab has already started one of its experiments with remarkable economies of scale in Portugal, where 150 million of structural funds were allocated to build the first social innovation fund-of-funds, encouraging entrepreneurship and local experimentations and investing in the creation of a new economic model were public and private sector collaborate to create new and better products and services for citizens at large.

Responses

The Young Foundation welcomes ESMA consultative paper on the implementing measures of the Regulations on European Social Entrepreneurship Funds (EuSEF) and European Venture Capital Funds (EuVECA).

We are limiting our responses to the subjects covered that are likely to mostly affect our organization and its stakeholders. Accordingly to our specific expertise in the social impact investing domain, we are only addressing the questions relating to the EuSEF regulation.

1. Types of goods and services or methods of production for goods and services embodying a social objective

Q.1: Do you agree with the identified policy options set out in the cost benefit analysis (Annex III)? Could you identify any other options?

The YF agrees with the 3 options identified, however, for love of clarity we would suggest to put the lists contained in points 3,5 and 6a,b,c in a dedicated Appendix, further highlighting their non-exhaustive and non-binding character. In fact, precedence should be given to the general principles, safeguarding in this way for social enterprises the possibility to address new or emerging categories of people at risk of exclusion as well as to innovate in terms of product/services and organizational model.

Q:2 Do you agree with the proposal set out in the consultation paper? Are there any additional principles or criteria that you would like to propose?

As a first point, we argue that while social enterprises are often active in the field of inclusion of particularly disadvantaged groups, they can also target different categories of beneficiaries and that therefore the definition given in par. 3-6 is too restrictive.
While we understand that the fault lays with the primary legislation, we would like to highlight that limiting the scope of undertakings to those organizations which target vulnerable groups is a serious mistake. EuSEFs should target all the organizations which, irrespectively of their legal form, work to align private and public interest for the common good, building business models which are both economically sustainable and that have a positive impact on the largest possible number of people. We want social businesses to become societal businesses, and we want to attract private investors, not only philanthropists. This is the approach adopted by the Commission in its communication “An investment plan for Europe”, where it is stated that every project to be funded through the new European Fund for Strategic Investments (EFSI) will have to go through an economic as well as a societal assessment, and that only projects with high socio-economic returns will be selected. This is a bold vision, recognizing a “societal” component in every project, including the most traditional “hard infrastructure” projects. In this context, it is our view that the strict definition of social business adopted in the EuSEF legislation will seriously hamper the taking-up of the label by EU investors, including the new EFSI fund, which is meant to invest up to ¾ of available funds in existing funds.
Additionally, it is worth reminding that social enterprises are increasingly active as providers of services falling under the social-investment category, as for instance in-work training or health promotion campaigning or early childhood education and care, which to be effective need to address citizens at large and not just particular segments. The risk is that of excluding a vital sub-sector from the EuSEF qualifying undertakings basin, which would be in flagrant contradiction with the recommendations put forward by the Commission in its 2013 Social Investment Package. Furthermore, many social enterprises active in the cultural and recreational areas would be de-facto excluded.
In this respect, we invite both ESMA and the Commission to consider extending the definition of qualifying portfolio undertakings when revising the regulation in 2017.
In a second place we find the focus on environmental impact (par. 2 and 6) far too accentuated. In particular, point 6b could apply to many enterprises whose social purpose is very vague at best, and particularly given that any reference to legal forms or to the need of securing the undertaking’s social mission in its articles of association has fallen. Businesses active in the green-economy are often in a more mature growth stage compared to more ‘traditional’ social enterprises and social ventures, which could lead to a disproportionate share of EuSEFs being directed towards them (which would certainly compromise the regulation primary scope of promoting the creation and growth of social businesses).
Similarly, it is our opinion that point 6c could lead to a disproportionate amount of funds being directed towards already well-established financial intermediaries, hampering the development of a more diverse social impact investing ecosystem.

Finally, we notice that "the circumstances in which profits are distributed to shareholders and owners" - which were to be clarified by secondary legislation according to par. 48 of the EuSEF regulation – are not object of ESMA's technical advice. This is an important point and would deserve further debate in order to ensure qualifying portfolio undertakings' social mission, and especially if points 6b and 6c are left in their current phrasing.

Q.3: Is it useful to provide indicative open-ended lists of goods and services provided by the social enterprises, methods of production employed and entities that provide financial support?
It certainly is, but as already mentioned we would suggest to move the lists in appendix, further highlighting their purely indicative character.

Q.4: If so, do you agree with the lists of situations described in the proposed advice? Would you like to suggest any more?
As already mentioned, we are concerned that some services listed in par. 3 and 6b could be misleading. Agricultural productivity, income or productivity growth and energy and fuel efficiency, waste management and sustainable energy are all categories in which the relevance of the social purpose for the enterprise business model call for careful assessment.
As for par. 3 we would add at least the following examples: active inclusion (including through cultural activities and language courses), migrants' integration, employability, food banks, medicine banks, palliative care, work-life balance, early child education and care, human capital (skills update/re-orientation/upgrade). Many of these services should be object of a further point under paragraph 6, as services with a high social impact addressing citizens at large.
Once again, we reiterate the need to extend the target of undertakings' services and products to society at large and not only to vulnerable groups.

2. Conflicts of interest of EuSEF managers

Q.5: Do you agree with the description of the types of conflicts of interest? Would you like to suggest any other type?
Q.6: Do you agree with the standards proposed in terms of the measures that EuSEF managers should adopt in order to identify, prevent, manage, monitor and disclose the conflicts of interest?
Q.9: Do you agree with the proposed approach?

We agree on ESMA approach. It is our opinion that transparency is probably the best defence against potentially negative consequences of (potential) conflicts of interest: in this sense, the obligation to disclose the identity of the manager and of any other service providers together with a description of their duties and remuneration is already a good insurance. More in general, we think that promoting "open organizations" where transparency about retributions, productive processes and the supply chain is total, will put not only investors, but also consumers in the position of taking informed decisions based on social impact.

3. Social impact measurement

Q.11: Do you agree with the general approach on social impact measurement?
We generally agree with ESMA approach. In reference to par. 5 and 8, it must be considered that the funds won't necessarily be traded funds when the investor joins, and that therefore at the time of committing fund managers won't be able to state upfront in which undertakings he will be investing, and hence how social impact will be measured for each investment.

Q.12: Could you help us estimate the costs to which the proposed approach would give rise for the EuSEF manager and the social enterprises?
Following EVPA survey of VP/SI organisations based in Europe, the average annual budget for measuring social impact in 2011 was just over €63,000 with a median spend of €15,000.
As for social enterprises it is difficult to estimate the incurred costs, but they are likely to be quite high given that social enterprises will have to adjust their reporting guidelines to the fund managers criteria. While the importance of flexibility in setting parameters allowing for a balanced measurement of social impact achieved by organizations that can operate in very different fields is important, it is also true that practitioners from the third sector across Europe are often complaining about the multiplying of impact evaluation methodologies, and of the consequent need to adapt data-collection and presentation methodology following the different potential sources of funding. In fact, it may be argued that costs would be lower for both social enterprises and fund managers if social enterprises were in charge of social impact measurement. Potential EuSEF managers who can't already rely on extensive previous experience in the social finance domain, could be turned away by the costs of putting in place such a specific impact evaluation framework, and the absence of a methodological level playing-field could be further discouraging. Trusting the social mission of the undertakings (based on their statutes, articles of association, organizational structure and business models/plans) and focusing instead in assessing their credit worthiness also based on qualitative parameters taking into account the peculiarity of social businesses (for instance their fund-raising capacity and stakeholders network) could be in the long term a more effective way of providing funding to economically viable social enterprises. Non specialist financial intermediaries could be more motivated in taking-up the challenge of investing into social businesses, also because reporting costs would be dramatically reduced. At the same time investors could be informed about the social impact achieved through their investments tanks to annual reports assembled by social enterprises: most social enterprises already provide their stakeholders with increasingly detailed reports, and costs to put in place social impact evaluation procedures wouldn't probably be particularly higher than those implied by the collection of the data necessary to EuSEFs managers in order to prepare their report. Furthermore, the recent adoption of the new EU directive on public procurement will be a further stimulus for putting in place more sophisticated social impact measurement indicators. In this respect, it would be important for EuSEF managers to considers criteria adopted by public procurers for evaluating social impact when they set-up their evaluation models.

Q.13: Which option would you favour? Why?
We agree in principle with ESMA choice, even with the already mentioned concerns on the excessive reporting obligations for both social entrepreneurs and fund managers. Additionally it is unclear if the procedural steps set out by ESMA will be sufficient to allow investors to easily compare information about different EuSEFs.

Q.14: Could you please quantify the costs for the EuSEF manager of your preferred option?

See answer 12

Q.15: Do you have any alternative proposals? If so, please quantify the costs involved.

We believe that constant monitoring and comparative study of funds impact evaluation practices should aim at building a broad archive of impact measurement best practices which could be easily adopted by future fund managers, while contributing to the validation of the indicators which are more commonly used to assess certain initiatives' social impact. In the medium to long term, this efforts should lead to an harmonization of social impact evaluations methods, which in turn will lead to the creation of an authentic European single market for social investment. For this reason, we believe that data deriving from the social impact evaluation of projects and organizations funded by EuSEFs should be made publicly available for academic purpose.

4. Information to EuSEF investors

Q.16: Do you agree with the proposed approach with regard to the information on the different items of the investment strategy and objectives required under Article 14(1)(c) of the EuSEF Regulation?

Q.17: Do you agree with the proposed approach with regard to the information on the positive social impact expected, the projections and the past performance and the methodologies for measuring the social impact (Article 14(1)(d) and (e))?
Q.18: Do you agree with the proposed approach on the non-qualifying assets held by the EuSEF and the process and the criteria used for selecting these assets (Article 14(1)(f))?

We generally agree with ESMA approach.

Q.19: Do you agree with the proposed approach with regard to the description of the support services, as required by Article 14(1)(l)? Do you think that the manager should provide information about the cost of the support services?

We tend to disagree. Given the importance of helping social enterprises to become investment ready for the development of a social investment market, ESMA's choice not to ask EuSEF managers to provide an explanation on the reasons behind the choice not to provide capacity building services seems somewhat contradictory. In fact, given that all the burden of putting in place a social impact measurement and reporting framework is left to EuSEF managers, and considering that the regulation asks managers to work closely with social undertakings in order to set-up the best possible impact measurement model, "increased reporting costs" do not seem to be a reasonable explanation for this choice, all the more so considering that ESMA declined to develop a common template for the provision of the information directed to investors (which of course would have saved a considerable amount of time and money to EuSEF managers).
Not providing social undertakings with advisory, consultancy and training services means that either the enterprises are already in a very mature stage and therefore they don't need these services, or that they will have to totally rely on financial intermediaries concerning impact assessment and won't probably be in the position of survive their start-up phase for lack of assistance other than financial.
In both cases, the regulation principal objective of sustaining social enterprises across Europe could be seriously compromised.
We also argue that, in order to attract investors (and not only philanthropists), grant funding should be made available to fund managers in order to set up capacity building programmes and services. Structural funds could be used for this scope.

Q.20: Do you consider that it is advisable to develop an indicative model or a template for the pre-contractual information that EuSEF has to provide to the investors under Article 14 of the EuSEF Regulation?
Yes, this would be very useful in order to attract fund managers, and especially if they do not have a long acquaintance with social impact investment.

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