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EXECUTIVE SUMMARY OF THE IMPACT ASSESSMENT

Accompanying the document

Proposal for a
REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL
on European Social Entrepreneurship Funds

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1. INTRODUCTION

This impact assessment is on social businesses and their financing by private investment funds.

Social businesses are enterprises whose primary objective is to make a social impact. They bring innovative solutions to bear on social or environmental problems. Financial returns are ploughed back into the enterprise: a business form brings access to private finance and a sustainable footing for the enterprise. Social entrepreneurs typically also manage their enterprises in an accountable and transparent way, in particular by involving workers, customers and stakeholders affected by their business activity.

Social businesses are growing significantly; already 10% of EU businesses broadly fall in this category, employing 11 million paid employees. Their focus on social and environmental innovation means these business are by definition key to smart, sustainable and inclusive growth. The vital importance of such growth emerged from the consultation on the Single Market Act, which identified social businesses as one of 12 'key levers' for an effective relaunch of the single market.

While investment funds are a key conduit for the funding of social businesses, since they can widen and deepen available funding, consultations with stakeholders have shown that such funds are not fulfilling their potential. Fragmentation in national rules, and a lack of a clear approach across the EU to such funds, is undermining their emergence, thereby hampering the development of a robust social business sector and allowing this sector to develop in an uneven fashion.

This impact assessment examines therefore options for ensuring such funds can effectively and efficiently fulfil their potential. Given the EU asset management sector currently had more than EUR 8 000 billion of assets under management in 2010, efforts to improve the contributions of this sector to the funding of social businesses could reap strong benefits in the future.

2. WHAT IS THE PROBLEM?

Social businesses are often dependent on grants. Investment funds that can help them address this are however typically small (around EUR 10 to EUR 20 million in size) and thereby stretched, and have developed in a patchy fashion across the EU (thinly spread, while clustering in one or two Member States). Meanwhile, investors seeking to target social businesses or the EU social economy can find it difficult to identify and trust the investment funds available to them: there is a confusing proliferation of competing labels and designations of funds that purport to offer investments into social entrepreneurship. For funds to gain access to investors cross-border is costly due to fragmentary rules: funds are localised, and in smaller markets difficult to get off the ground so as to reach viable sizes. Levels of cross-border fundraising are currently low (one estimated puts them at less than 4%).

These problems are all rooted in the specific qualities of social businesses: their pursuit of social goals through business means raises new challenges for investors, funds and financial services intermediaries, and regulators alike. The impact assessment identified three key drivers for problems.

Key Problem Driver 1: lack of clear and comparable information

Information about social investments and funds targeting social businesses is difficult for investors to use. Understanding and comparing investment propositions is unnecessarily complicated, with competing, contrasting and overlapping terminologies, labels and concepts emerging. The labels which are developing on a self-regulatory basis do not operate across the whole EU, and do not help investors targeting social businesses in particular to identify relevant funds and understand and compare the offerings of these funds.

Key Problem Driver 2: measuring or assessing social returns is difficult

Providing information to investors about social impacts is a key challenge related to the social mission of social businesses. A profusion of tools for assessing and analysing social impacts or performance are emerging. Competing, contrasting and overlapping approaches raise costs for businesses and funds, and make it harder for investors to compare different funds or to track how well the investments they make achieve the social impacts promised.

Key Problem Driver 3: lack of tailoring of fund structures to needs of social businesses

National and EU rules governing the fund structures used for funds targeting social businesses are not always well suited to the needs of these funds, and fragmentation in these rules impedes cross-border activity. This leads to uncertainty for fund managers, a proliferation of different fund forms and approaches across the EU, and thereby a less efficient and effective market for such funds in the EU.

3. WHY EU SHOULD ACT, AND CONSEQUENCES OF NOT TAKING ACTION

If the EU does not act this could forestall the development of social businesses as a trusted model across Europe. Investment funds targeting social businesses would not achieve the scale necessary to make a difference, depriving social businesses of heterogeneous and resilient funding. In addition, funds would remain geographically uneven in dispersal.

National supervisors would have little guidance in how to assess funds that claim to fund social businesses. The Commission's historic experience in the area of investment funds and recent experience gained in the area of venture capital funds is that in the absence of EU coordination, divergent approaches, whether self-regulatory or at the level of national rules, would emerge to address the problems identified. This would notably be in relation to the definition of social investment funds and the transparency measures necessary for these funds.

A common and uniform frame for the sector across the EU can only be set at the EU level; this would be efficient for bringing clarity and focus at a vital phase of the sector's development. Carefully calibrated measures now are likely to be more efficient than intervention later.

4. OBJECTIVES

In general, the objective is to ensure social businesses and entrepreneurship are able to fully contribute to EU growth goals on jobs, social inclusion and cohesiveness. Social businesses are key drivers for such growth, and supporting them will help ensure a smarter, more inclusive and sustainable EU economy in the future.

More specifically, investors should be able to have confidence in the investment funds that target social businesses, these funds should be able to gather investments from investors

throughout the EU in a cost-efficient manner, while social businesses themselves should be able to efficiently raise capital.

To achieve these specific objectives, three operational objectives can be identified, targeting the problem drivers outlined above:

- improve clarity and comparability of social investment propositions;
- improve tools for assessing and analysing social impacts; and
- ensure regulatory frameworks across EU are proportionate and effective for maximising fundraising opportunities for social entrepreneurship funds.

5. OPTIONS

Options were identified and assessed for each of the operational objectives separately, though these options are cumulative and to a degree dependent on one another. Initial options were also assessed in regards the best way of circumscribing the investors for whom the other options would be tailored.

General – Options on eligible investors

Description of options	
G1	No further action.
G2	Allow investments from certain High Net Worth Investors and other professional investors as under MiFID rules.
G3	Align with MiFID rules on professional investors.
G4	Include mass-market retail investors.

The investment market targeting social businesses currently mostly takes the form of institutional funds, with much funding coming from 'high net worth' individuals and 'business angels', as in the Venture Capital market. This is largely due to the risk profile and liquidity of such investments – they represent a long-term commitment. However, growth in the future could well be strongest from the mass retail market.

In order to ensure effective take-up by existing investors and a proportionate regime, and given the current development of the market, option G2 is preferred at this stage. Future review should however consider possible measures to widen access for retail investors.

A – Options on improving clarity and comparability

Description of options	
A1	No further action.
A2	Develop a non-binding approach on information that should be provided about investments targeting social businesses.

A3	Establishing a EU label or brand for social entrepreneurship funds (EU SEF), with linked transparency measures.
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Options A2 and A3 both could improve the clarity and comparability of information about social investments targeting social businesses. Option A2 would follow non-binding steps to this end, seeking to facilitate coordination in self-regulatory and national steps, while option A3 would establish a EU approach, by introducing a label ('European social entrepreneurship fund') with associated quality standards, which could only be used by funds that comply with common disclosure obligations and a common fund profile (i.e. predominant investment in social businesses). Under A3, a common framework could be established for information on the kinds of social businesses individual funds will invest in and the support offered to the the social businesses targeted. Information would also be provided on possible impacts of the investment.

While a label as under option A3 requires care in making sure it is strongly enforced and not misused, it could stand the best chance of improving the clarity and comparability of information and trust and confidence in investment funds targeting social businesses. It would provide a strong 'seal of approval' to the identified social business sector. Option A3 was thereby preferred.

B – Options on improving tools for assessing and analysing social impacts

Description of options	
B1	No further action.
B2	Establish a forum or group for stakeholders to coordinate development of tools on social impacts.
B3	Launch a study assessing possible approaches to assessment and analysis of social impacts for investment funds.
B4	Set common measurement approach now for social impacts across EU.

Option B4 was discarded because of the risks to the standard setter at this stage. The emerging and evolving nature of tools for assessing and analysing social impacts suggests options directed towards encouraging and facilitating further research and dialogue would be preferable. Options B2 and B3 were both preferred. (They are not mutually exclusive). Note that while option A3 is not dependent on these options, progress on them could in the future feed into further standardisations of disclosures under option A3.

C – Ensure regulatory frameworks across EU are proportionate and effective for maximising fundraising opportunities for social investment funds

Description of options	
C1	No further action.
C2	Encourage development of funds targeting social businesses under existing frameworks.

C3	Develop targeted amendments to existing frameworks.
C4	Create a standalone EU regime including passport for EU SEF.

Options C2 was discarded. Existing EU frameworks are not tailored to emerging funding needs of social businesses, so this approach, while having very low cost implications, would also be very limited in its effectiveness. Option C4 was preferred to option C3, as it showed greater effectiveness in supporting social entrepreneurship funds; cost impacts for the two options would largely be similar (they differ mostly in regards legislative forms rather than content of measures).

Summary of overall proposal

Uninform rules as under option C4 would combine with transparency measures and a label as under option A3, to establish a common EU notion of social entrepreneurship funds. To ensure effective take-up, the fund managers would be able market designated funds across the EU once they had completed a simple registration procedure (this would offer a passport to fund managers for this purpose that do not receive one under the AIFM-D). Each fund would need to be predominantly invested in social businesses, and avoid the use of leverage. Some general rules on the conduct of business and organisation of the manager would apply, and steps would need to be taken on reporting and transparency, including on the social performance of the funds. Competent authorities of Member States would be required to supervise the funds and withdrawal the registration of non-compliant managers.

The approach is staged and incremental, allowing for greater standardisation of social performance measurements and possible extensions to retail investors in the future. In addition, a second level of implementing measures subject to further impact assessment are envisaged on transparency measures.

6. IMPACTS OF THE PROPOSED APPROACH

Benefits

Under a staged approach in an emerging market segment, incremental benefits are expected initially, but with the potential for more significant benefits over time as the market matures.

The scale of immediate and future benefits is necessarily difficult to quantify. Improved trust in the sector, more efficient cross-border fundraising, and clearer demarcation of investments targeting social businesses from other investments would aid funds, leading to strong inflows of capital, better geographic distribution and viability for funds, and a more developed ecosystem capable of reducing costs for social businesses.

Improved trust, access to funds, and comparability of investments would aid investors in efficiently allocating their capital and reduce the potential for mis-sales and a loss of trust in social investments more widely.

Such impacts for funds and investors would clearly aid social businesses – supporting the continued emergence of the sector and the variety and sustainability of available finance. A thriving social business sector across the EU would contribute to increasingly smart, sustainable, and inclusive growth. Improved private investment in social businesses would also reduce fiscal and other stresses on public finance.

Costs

Transparency and reporting measures are likely to incur some compliance costs for the fund industry, related to changes to systems and procedures for gathering and providing information, and costs on publication of information. Streamlining cross-border fundraising would however reduce costs for funds seeking to do this. Since costs are only borne by those seeking access to the new EU social investment fund label and associated passporting rights, so are proportionate to the business opportunities the new framework opens up.

New requirements could also indirectly impact social businesses themselves; costs might be incurred related to requests for reports and data necessary for improved fund transparency, and could include associated systems or data gathering costs. However, such costs are likely to be absorbed by business as usual costs related to becoming 'investment ready'. Better coordination of measures across EU should also provide an opportunity to reduce overlapping or competing steps and lead to a more rationalised social business eco-system.

It is possible that new measures would lead to some re-allocation of investments from other kinds of social investment fund or philanthropic giving, however there is little evidence on the scale of any such impact that might be expected.

Monitoring and evaluation

Significant steps on future monitoring and evaluation will be needed, particularly in light of the incremental impact of measures.

The impact of the measures identified here on the efficiency of the market, including on levels of take up the new framework, of cross-border fundraising and the size and costs of EU social entrepreneurship funds, will need careful monitoring so as to allow for future calibration of the framework. Assessments of indirect costs for social businesses, including any impacts on businesses that benefit from the measures compared to those that do not and the geographic dispersal of funds will need to be reviewed in the future. The monitoring of levels of compliance with the measures at national and EU level will also be important.

The refinement of measures on the assessment of social and environmental methodologies will be a key area for further work.

7. CONCLUSIONS

This impact assessment supports EU steps to develop a coordinated and coherent EU framework for investment funds targeting social businesses. A lack of trust and confidence in social investment propositions holds back the development of funds supporting social businesses, while poorly developed fund regimes and inefficiencies in cross-border access to investors are hindering growth.

To tackle these problems, this assessment concludes that a dedicated European social investment fund framework which gives passporting rights to the managers of these funds is the most effective and efficient approach. To succeed, such funds must be predominantly invested in social businesses and provide clear and effective disclosures, including on social performance.

By acting now Commission can aid the growth of the social business sector, stimulate and broaden investment choices across the EU, and deepen the pools of capital that funds that

invest in social business can tap into. This will contribute to an EU that makes a strong commitment to social entrepreneurs and the smart, inclusive and sustainable growth they bring.