Personal Finance Society
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Good Practice Guide

APRIL 2018

A practical guide to Social Impact Investing

> "Social impact investing has the power to make a positive change in society, while also bringing positive financial returns. It's a win-win, which is why demand is growing. The market has enormous potential, but we need to make it easier for people to make a social impact investment"

Stephen Barclay, Former Economic Secretary to the Treasury – 14/11/2017

Source: **https://www.gov.uk/government/news/industry-led-review-details-plansto-increase-social-impact-investments-in-the-uk**

This paper is in response to member's requests to provide a summary of good practice within one source document and is based upon the Personal Finance Society's understanding of the regulators rules and current stance. Whilst a summary, it is not intended to be exhaustive and should not be relied upon at the exclusion of other sources of information.

Foreword

Keith Richards

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For some time now there has been evidence of a growing interest in investments with a 'value' related component, with more than half of individual investors expressing an interest in social impact investments.[1] In the retail investment market, such investments can be traced back to socially responsible investing that emerged in the 1970s and found favour in ethically screened investments launched in the 1980s. More recently there has been growth in the market for social impact investments, a style of investing that delivers a social impact as well as a risk-aligned rate of return.

Market growth in this area, whilst receiving encouragement from government, has been hampered by several factors, such as confusion over terminology and information asymmetry between market participants.

In 2017, an industry-led independent report for Government found that, 'a key challenge to the growth of the social impact investment market is a lack of clarity and potential misalignment of expectations among asset owners, managers, advisers and investors in respect of social impact investment strategies, products and characteristics.'

To address this challenge, the industry-led group, in partnership with government, commissioned an 'Impact Investment Adviser Tool'.

This exploratory guide is our contribution to this initiative. We aim to build on the work that has already been done, by providing an overview of this growing market, recent government and regulatory activity, and how financial advisers might assimilate value based investing into their recommendations where appropriate, helping those investors with an interest in social impact investing to align their savings, pensions and investments with their personal values.

[1] *The Value of Being Human: A Behavioural Framework for Impact Investing and Philanthropy, Barclays, 2015*

What is Social Impact Investing?

Definition

Social Impact Investing is an investing approach. A commonly accepted definition of social impact investing remains a matter of some debate, but from a retail investment perspective, social impact investing seeks to generate social impact alongside (not instead of) an acceptable rate of financial return for the individual investor.

Unlike either traditional investments or philanthropy, it seeks to deliver all the following: a financial return on investment, a social return and the availability of capital to recycle.

Primary motivations	Traditional investment	Social Impact investment	Giving and philanthropy
Financial return	✔	✔	✕
Social return	✕	✔	✔
Capital to recycle	✔	✔	✕

Source: **https://www.worthstone.co.uk/Worthstone-Social-Impact-Investment.pdf**

SRI v ESG v Impact Investing

Responsible investing emerged in the 1970s when investors began including or avoiding specific stocks or industries in their investment portfolios through negative or positive screening mechanisms. Such an approach was often driven by moral reasons, with minimal consideration for the economics involved.

Common themes for socially responsible investments included avoiding investments directly or indirectly in companies that produced or sold addictive substances (alcohol, gambling or tobacco) and seeking out companies engaged in social justice, environmental sustainability and alternative energy/clean technology. Such investments could (and can) be made in individual companies or through socially responsible mutual or exchange-traded funds.

Sustainable Investing (Environmental, social and governance investing (ESG)) developed from, and diminished, the use of responsible investing as an investment strategy (although many continue to use the term synonymously). In contrast to negative or positive screening, sustainable investing involves the integration of 'environmental, social and governance' factors into the investment process based on the rationale that companies that adhere to high quality standards in these areas are likely to outperform in the long run (in line with an investment manager's fiduciary duties).

A successful sustainable investment fund manager will typically identify a set of compelling investments based on their normal investment selection criteria, and then apply an ESG filter to this list selecting those investments that are anticipated to generate a scalable, profitable impact.

Despite the often-held belief of a trade-off between investing in companies with a specific focus on ethical and social investment goals and optimal, risk related investment returns, ESG investing seeks to prove that it is possible to achieve both simultaneously.

Impact Investing is the most advanced and builds on all these past iterations of investing designed to accelerate social and/or environmental change. Impact investing is the investment in the shares or loan capital of companies and enterprises that not only measure and report their wider impact on society – but also hold themselves accountable for delivering and increasing positive impact (unlike philanthropic investments where investors are willing to forgo their original investment through philanthropy).

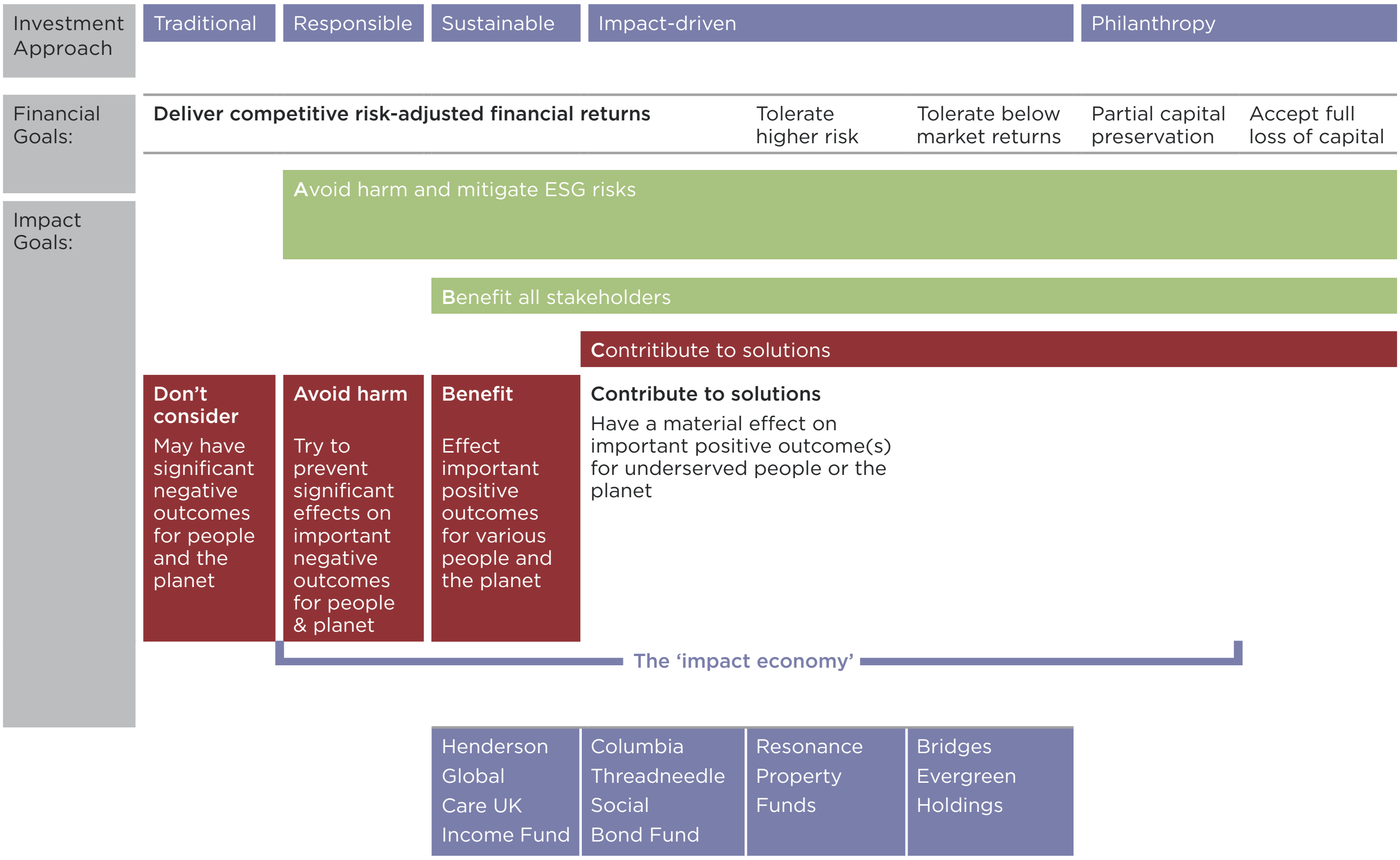
As with responsible and sustainable investing, there are many ways retail investors can get involved, although in recent years the growth of crowdfunding has helped retail investors who have less risk capital to widen the impact investing space.

According to a research from McKinsey & Company (How impact investing can reach the mainstream: Nov 2016) 'impact investing' does continue to mean different things to different people, calling on impact fund managers to 'clarify their intentions as well as trade-offs inherent in their approaches'. The spectrum of capital illustrated below can help you do that.

What is Social Impact Investing? Continued

The 'spectrum of capital'

One way of understanding the range of investment opportunities is to map the broad range of risk/return strategies and objectives in impact investing, as below.



Source: The Rise of Impact: Five Steps Towards an Inclusive and Sustainable Economy, UK National Advisory Board On Impact Investing, 2017 & Impact Management Project 2017

Government position on Social Impact Investing (SII)

The UK has been a pioneer in social impact investing. In 2000 a taskforce was established at request of HM Treasury to investigate how entrepreneurship could be applied to combine financial and social returns. The UK again took the initiative in 2012 and 2013, launching Big Society Capital, a wholesale social investment institution, to grow the market and then established a Social Impact Taskforce and National Advisory Board during its presidency of the G8, helping take the idea global. In 2015 this led, among other things, to the Social Impact Taskforce being expanded into the Global Impact Investment Steering Group of 13 member states plus the EU.

Social Investment Tax Relief – launched in 2014

Social Investment Tax Relief (SITR) is the government's tax break for social investors - it helps social enterprises and charities raise investment from individual investors by offering those investors 30% income tax relief on loans or equity investment into those charities and social enterprises. This tax relief - the first of its kind in Europe - levels the playing field between traditional businesses and charities and social enterprises seeking investment, as it is similar to the enterprise investment scheme that is used by investors investing in promising start-ups.

In the three years since its launch, more than £4 million has been invested into more than 40 social enterprises and charities across the UK. These include investments in social enterprises like Freedom Bakery (a bakery that trains and employs ex-offenders) and Street League (the UK's sport for employment charity), as well as community businesses and assets like Clevedon Pier and FC United in Manchester.

Industry-led independent Advisory Group on 'Growing a Culture of Social Impact Investing in the UK' – launched 2016

In 2016 the UK Government launched an independent advisory group that was led by Elizabeth Corley, chair of Allianz Global Investors, and convened senior representatives from across the investment and savings industry. The group was asked to develop recommendations for industry and government on how they could enable individuals to make investment choices that reflect their social values and generate a financial return for them.

On 14/11/2017 the advisory group published its report 'Growing a Culture of Social Impact Investing' (**https://www.gov.uk/government/publications/growing-a-culture-of-social-impact-investing-in-the-uk**), making recommendations to industry, government, and regulators on how to grow a culture of social impact investing in the UK.

Regulatory position on Social Impact Investing

The FCA have responded to government activity, stating they want to see the market for social investment develop in a way that provides appropriate protection for consumers and is sympathetic to the social motives shared by people who actively choose to invest in a business or financial instrument because it has a social impact.

Regulatory (FCA) comment and positioning to date includes:

Date	Format	Key message/s	Link
31/10/2016	FCA FS 16/11 - Call for Input: Regulatory Barriers to Social Investment	Confirmed that the FCA 'do not believe regulation is preventing the social investment market from developing. It can, on the contrary, ensure the development of strong practices which in turn lead to investor confidence and so encourage and support the market'	www.fca.org.uk/publication/feedback/fs16-11.pdf
14/12/2015	FCA Call for Input: Regulatory Barriers to Social Investment	Set out the current regulatory framework using video and interactive graphics and called for input in respect of how regulation is working in relation to the growing social investment market	www.fca.org.uk/publication/call-for-input/social-investments-call-for-input.pdf
06/03/2014	FCA PS14/14 – The FCA's policy statement summarises and gives response feedback to CP 13/13	'We consider it possible for social investments to be promoted and sold to retail investors in ways that comply with our Conduct of Business Rules' The FCA also said it would comment further on the social enterprise sector.	www.fca.org.uk/publications/policy-statements/ps14-4-fca%E2%80%99s-regulatory-approach-crowdfunding-over-internet-and
24/10/2013	FCA CP 13/13 – The FCA's Regulatory Approach to Crowdfunding (and similar activities)	Some respondents raised concerns about the potential impact of crowdfunding regulation on the growth of the social enterprise market	www.fca.org.uk/publications/consultation-papers/cp13-13-fca%E2%80%99s-regulatory-approach-crowdfunding-and-similar

At the time of writing, the FCA position is that no specific regulatory barriers exist to prevent retail investors or financial advisers increasing their involvement in social impact investing. The industry led group wrote to the FCA and the FOS in November 2017, requesting further comment on specific issues. This letter can be found at:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/659059/Advisory_Group_Letter_to_FCA___FOS.pdf

The responses by the FCA and the FOS can be found at:

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/680781/FCA_Response.pdf

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/680782/FOS_response.pdf

Social Impact Investing, the advice process and understanding client preferences

Whilst the financial services industry is responding to the demand for social impact investing with a range of new products and investment opportunities, the challenge of suitability, a solid definition, common standards, and levels of education and awareness remain.

To this end, the industry-led Advisory Group on mainstreaming social impact investment recently commissioned a design agency (‘Uscreates’) to develop social impact investing guidance (referred to as ‘the tool’) to increase knowledge of impact investment amongst investment firms and advisers alike and encourage them to start offering it to clients.

This tool comprises the following:

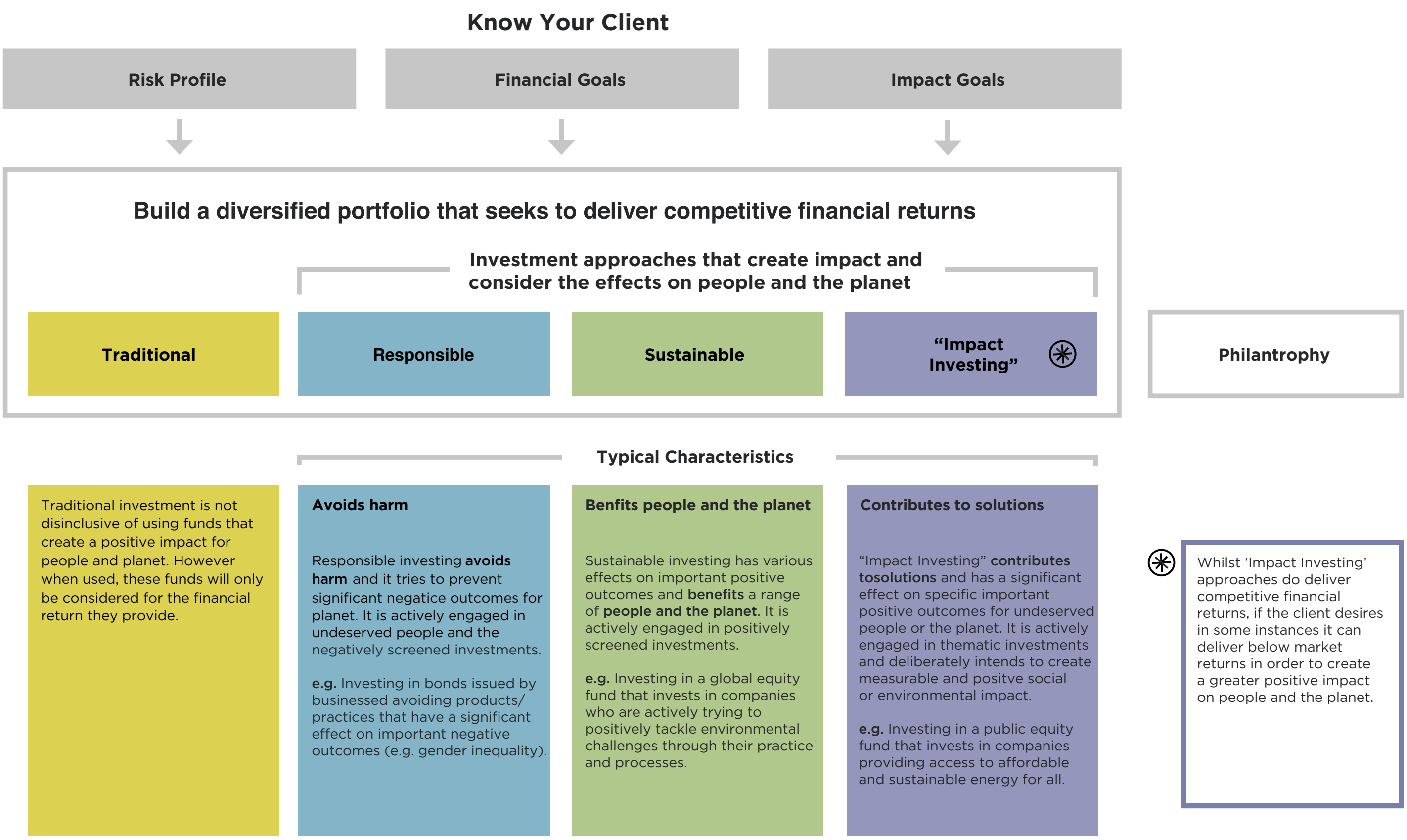
1. an educational model that outlines the different approaches within investing and shows how creating impact can be included in the advisory process
2. an access point to knowledge on funds that create impact
3. a conversational pack which adapts according to different levels of adviser’s knowledge and skill, providing tools to use with clients to articulate their preferences when investing in funds that create impact.

To access the tool – **https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/659063/Impact_Investment_Adviser_Tool_-_Final_Report__UsCreates.pdf**

The educational model

This is a conceptual framework, based on ‘the spectrum of capital’ that visually demonstrates how ‘knowing your client’ can be extended to specifically include impact goals alongside risk assessment and financial goals and how the different approaches to investment sit on a scale between traditional investment and philanthropy.

How investment that creates impact can be included in the advisory process



This diagram is inspired by and borrows from the work of the Impact Management Project and Bridges ‘Spectrum of Capital’.
It was developed by design agency Uscreates who were commissioned by The Department for Culture Media and Sport.

Social Impact Investing, the advice process and understanding client preferences continued

Knowledge of funds that create impact

To offer investments that create impact, not only will some advisers need to gain knowledge of the subject, but increase their awareness and knowledge of funds that are available. Below are some useful resources highlighted within the tool to get started with.

Please note, some have restricted access that require regular payment to access some areas within and their inclusion within this document does not imply any direct endorsement from the Personal Finance Society

Worthstone's online Impact Portal provides the ability to scope, screen and rank over 200 collective investments (including Unit Trusts, OEICs, REITs, Investment Trusts and ETFs) amongst a defined universe of ESG, SRI, Sustainable and Impact funds available to UK retail investors. This independent resource presents research on the funds which all have an overall star rating based on a methodology of maximising impact, minimising ethical compromise and delivering on financial expectations.
https://www.worthstone.co.uk/impact-portal/impact-investments/

Fund EcoMarket is a database of comparable investment options that are considered sustainable and responsible, as well as topical research
http://www.fundecomarket.co.uk/

The ACT manual for social investment is a learning tool that provides education on this area of investment and has 70 self-test questions to measure and evidence an adviser's level of competency.
https://www.worthstone.co.uk/adviser-competency-training/

Conversational pack

This aspect of the tool is split into three levels depending on current understanding of investing to create impact.

1. Beginner – A simple starter question that allows your client to indicate whether investments that create impact are of an interest to your client, and if so, overall how much of a preference is it to them.

   Question – Which of these sounds like you?

   Answers

   1. *I don't really mind about the effect my money has on the people and planet*
   2. *I would like to invest my money in a way that creates positive impact for the people and planet, but I don't mind how that happens*
   3. *I would like to invest my money in a way that creates positive impact for the people and planet and I have some specific ideas of how I would like to do this.*

The creators of the tool suggest moving into the intermediate level if your client selects the third answer above.

2. Intermediate – The intermediate tool is used to help your client identify specifically how they would like to use their money for investing in impact. It is split into two.

   The first asks the client to identify which approach (if they have a preference) they would like to take when investing. Clients can be led through this approach by asking to place different topics into one of four boxes: areas to avoid; areas to avoid where possible; areas to invest in and areas to invest in where possible. There could be two dozen different topics, including animal testing, tackling poverty, armaments and health and wellbeing. The important element of this approach is that it combines screening out undesirable activities with a focus on making a positive social impact.

   The second intermediate approach asks clients to choose from one of three themes. They are **responsible investment**, which avoids harm by screening out undesirable activities; **sustainable investment**, which focuses on activities that have a beneficial impact on society and the environment and '**impact investment**' that is even more focussed on a particular set of goals, such as providing access to affordable and sustainable energy for all.

3. Specialist – A more detailed assessment that shares with your client the further nuances of investing to create impact and asks them to articulate more detailed preferences.

   The kind of questions that could be asked here are:

   - Would you like your investment to target lots of individual projects (micro) or would you like to target the issue at a national/global level (macro)?
   - Do you want your investment to be targeted to benefit a specific group of people (exclusive)? Or would you like your investment to be wide reaching (inclusive)?

Social Impact Investing, the advice process and understanding client preferences continued

To access the tool **www.gov.uk/government/uploads/system/uploads/attachment_data/file/659063/Impact_Investment_Adviser_Tool_-_Final_Report__UsCreates.pdf**

Final Thoughts

Social impact investing is a rapidly developing investment approach that can help advisers make their client communications and onboarding process more relevant to client's concerns and aspirations.

It is important that investors understand where their money is invested in and choose the product that's right for them and advisers can play a powerful role in helping them do that.