Response to FCA Call for Input on Regulatory Barriers to Social Investments

Charities Aid Foundation
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Introduction

0.1 The Charities Aid Foundation (CAF) is a registered charity that promotes charitable giving and provides financial services and social finance to not-for-profit organisations. We help donors – including individuals, major donors and companies – to give more effectively whilst providing financial and fundraising solutions for charities in the UK and internationally, helping good causes to manage their resources more effectively.

0.2 Our pioneering social investment arm, CAF Venturesome has a 14 year track record of providing social investment to charities, social enterprises and community groups. This social investment is mostly in the form of Programme Related Investment, as defined by the Charity Commission. Since 2002, CAF Venturesome has provided over £38m of capital to 470 social organisations.

0.3 CAF has a strong history of campaigning for changes in policy and legislation in order to improve the giving environment and to secure supportive legal, fiscal and regulatory conditions for donors, charities and social enterprises. Our knowledge and understanding – gained through direct experience and research – makes us a trusted voice on giving and the effective use of charitable funds.

0.4 CAF is a member of the Social Investment Forum convened by Social Enterprise UK, and we have separately put our name to a joint submission to this call for ideas through that group. Our own submission focuses on a number of specific areas in the consultation that are of particular relevance to CAF’s work and where we have distinct views based on our experience.
Questions for consumers & consumer groups

Q6: Do you have any evidence (e.g. figures, case studies or other practical examples) of the appetite retail investors have for social investments and related products, particularly compared to donations?

1.1 All the available evidence suggests that interest in social investment is still very much the exception rather than the norm amongst charities and social enterprises. CAF’s own research from 2014 showed that of nearly 2,000 charities surveyed about their experience of, and interest in, repayable finance, 61% stated that they were “somewhat unlikely/unlikely to take it out in the future”.\(^1\) This is corroborated by other research: for instance a 2014 report by the Third Sector Research Centre found that 65% of social enterprises are simply not interested in repayable finance.\(^2\) The Alternative Commission on Social Investment put it bluntly, in stating that “most social sector organisations aren’t interested in finance.”\(^3\) This is not to say that social investment does not play an important part in the overall funding of social sector organisations, but merely highlights the danger of overstating the case.

1.2 Of those organisations that have taken on social investment or are interested in doing so in future, the vast majority are interested in relatively straightforward repayable finance in the form of secured or unsecured loans. CAF’s 2014 research found that, of charities that had either already taken on repayable finance or were positive or neutral about the idea of taking it on over the next 5 years, 38% believed that they were likely to take on a long term mortgage secured on assets, whilst 24% thought they might take on a short-term unsecured loan.\(^4\) Only 5% said they might consider issuing a bond, and only 2% expressed an interest in quasi-equity finance. Once again, other research backs up these findings. Social Enterprise UK’s 2015 State of Social Enterprise survey report found that grant funding was still by far the most commonly-sought type of finance among social enterprises (83% of organisations had sought a grant), with loan finance coming in second place (23% of respondents).\(^5\) By contrast, only 3% of respondents had issued equity.

1.3 Although the FCA Call for Ideas does not mention the actual amounts likely to be raised, it is worth noting that the majority of social organisations need repayable finance under £250k. CAF’s 2014 research found that 37% wanting to borrow over the next 5 years want <£50k, and 29% want £50-£250k; the more recent Social Enterprise UK research found that the median amount of repayable finance raised by social enterprises in 2015

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\(^4\) Charities Aid Foundation, (2014)


\(^6\) Charities Aid Foundation, (2014)
was £60k\(^7\). This has implications for the nature of the finance, as the administrative costs of more complex products like bonds, equity etc. can be prohibitive in proportion to the amount being sought.

1.4 Given this context, it is a matter of concern that the infographic on page 8 of the FCA Call for Ideas (“Forming a Social Enterprise: Step 2, How do I Raise Capital?”) lists “shares and bonds” and “bonds” as the only options available to organisations seeking finance. This ignores the fact that these are currently niche options in the marketplace: instead there should be some acknowledgment of the various options available in terms of loan finance, which make up the vast majority of existing demand from social sector organisations.

1.5 Likewise, the infographic on page 11 (“Investing in a social enterprise: Step 1) does not mention the option of investing via a social investment intermediary, that might offer loan finance to social enterprises, despite the fact (as highlighted above) that this type of finance constitutes a large proportion of the existing demand. It also seems odd that there is no mention in this section of the Social Investment Tax Relief that was specifically introduced by the government in order to boost individual social investment, as this is clearly something that those looking to invest in social enterprises should be made aware of.

1.6 We recognise that the FCA may have chosen to include only those products that would definitely fall within its regulatory remit. However, it is also clear that one of the purposes of the Call for Ideas paper is to provide information on the make up of the social investment market and the ways in which individuals and organisations can offer and accept finance. It is clearly stated that:

“The first infographic below gives an overview of the different structures a social enterprise can use. It describes how they can raise capital, how they can market their securities or products, and who they can sell them to. The aim is to provide individuals involved in, or planning, a social enterprise with a good understanding of what they need to consider when deciding upon a corporate form.”

Given this ambition, it does not seem appropriate to restrict the information on available options to merely those which are regulated by the FCA. Or, if they are to be restricted in this way, it should be made explicit, and the omission of loan finance clearly explained.

1.7 It is not clear to what degree the FCA has a remit or responsibility to try and provide information for prospective social investors or organisations seeking investment. However, on the basis that one of the main known barriers to the development of the existing social investment market is lack of information and awareness, it is admirable that the FCA is aiming to play a positive role in this regard. However, there is a responsibility to ensure that the information in question is as complete and accurate as possible. This is particularly true in this instance because the FCA, as an official regulatory body, will be seen by individuals and charities as an authoritative source, and thus it is crucial that any information it provides is not misleading. Our concern is that the information contained in the existing document is not currently correct and paints an

\(^{7}\) Social Enterprise UK, (2015)
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inaccurate picture of the social investment sector and the options available to social sector organisations seeking finance, and to individuals seeking to support social organisations in this way.

1.8 We would like to see the omissions and errors highlighted above rectified in future FCA publications, in order to minimise the risk of inaccurate and potentially harmful misinformation confusing social sector organisations and potential social investors and thus hampering the development of the social investment marketplace.