



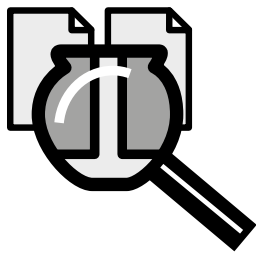
ACT

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# CONTENT

Acknowledgements	ii
Glossary and abbreviations	iv
Foreword	vi
The syllabus	viii
Reading list	x
Using this study text	xi
<b>Chapter 1:</b> Setting the Scene	<b>1</b>
<b>Chapter 2:</b> Understanding Client Motivations	<b>2</b>
<b>Chapter 3:</b> Identifying a Client's Specific Social Investment Objectives	<b>3</b>
<b>Chapter 4:</b> Comparing Types of Investment Products	<b>4</b>
<b>Chapter 5:</b> Segmenting the Client's Investment Pot and Explaining Risk	<b>5</b>
<b>Chapter 6:</b> Blending Social Impact and Traditional Investments	<b>6</b>
<b>Chapter 7:</b> Social Investment Tax Relief (SITR) Legislation (Part 1)	<b>7</b>
<b>Chapter 8:</b> Social Investment Tax Relief (SITR) Legislation (Part 2)	<b>8</b>
<b>Chapter 9:</b> Measuring and Reporting Social Impact	<b>9</b>
Appendix 1: Defining 'Social Impact Investment' and 'Social Value'	a.
Appendix 2: Social Impact Measurement and Reporting	e.
Test Question Answer Sheet	g.



## CHAPTER 4

# COMPARING TYPES OF INVESTMENT PRODUCTS

### Chapter contents

Introduction / Learning objectives	4.01
4.1 Positioning social investment products on the spectrum of capital	4.02
4.2 Defining the social investment market product set	4.02
4.3 The range of financial products	4.03
4.4 Identifying the right product to meet client objectives	4.08
4.5 Product criteria to be considered	4.08
4.6 Mapping the range of social investments	4.14
4.7 Implementing different approaches for social impact	4.17
Conclusion / References	4.19
Self-test questions	4.20

## Introduction

Social investment capital can be deployed in a variety of ways to achieve positive social impact. In this chapter we consider the various product options and what differentiates them. A unique feature of social investing from a financial perspective is that there is a variety of investment opportunities, which range from those seeking market rates of risk-adjusted returns to those offering a concessionary return in order to achieve their social purpose. The key differentiator of social investment opportunities is that the underlying investment is intentionally targeting a defined and measurable social impact. This has implications for the adviser, who must carefully consider the criteria used to evaluate the effectiveness of investment in a product that may be required to meet the client's intended dual objectives (financial and social).



### Learning objectives

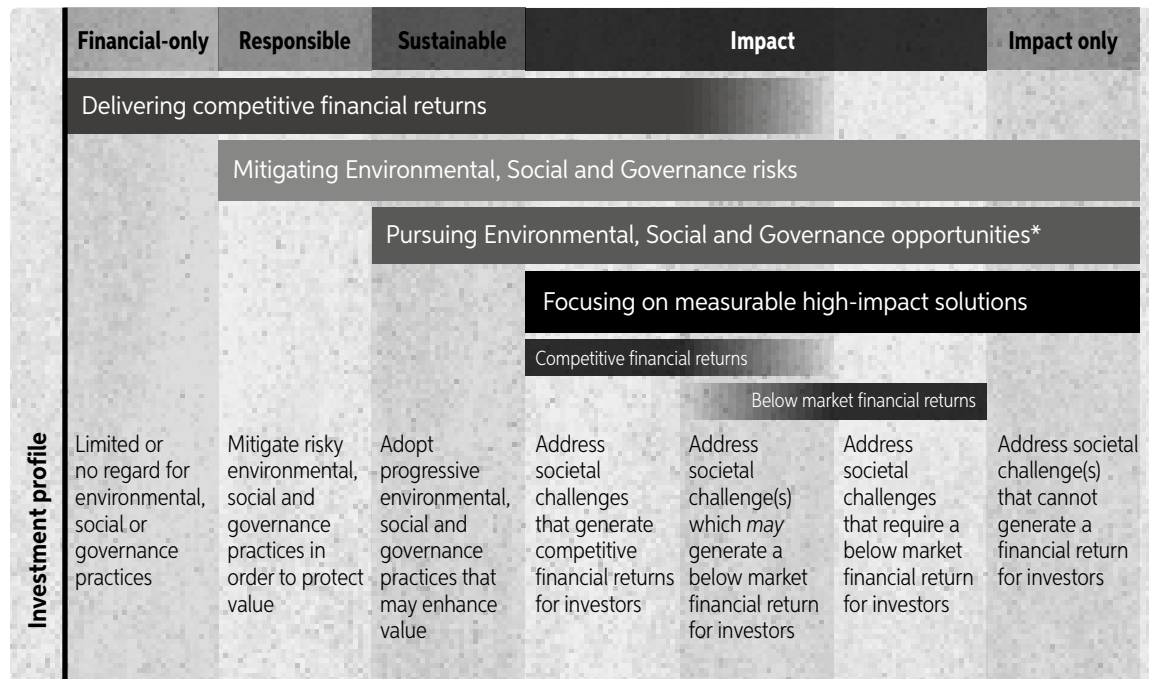
**After studying this chapter you should be able to describe a range of possible investment products to achieve social objectives and explain how to compare these by:**

- describing the various current types of social investment products available: charity/social deposit account; charities consortium bond; social investment fund; community shares; Social Investment Tax Relief (SITR) – (see chapters 7 and 8 for further details); equity investment; social impact bond;
- explaining, in general terms, the potential risks associated with various types of social investment products;
- explaining how the potential level of engagement with front-line investee organisations/ enterprises varies for the products above;
- explaining how the investment is targeted to a specific social purpose for each of the products above.

## 4.1 | Positioning social investment products on the spectrum of capital

Social investment products sit on a wealth deployment continuum, from traditional investment to philanthropy, where no financial return is expected. The 2014 report from the G8 Social Impact Investment Taskforce, Asset Allocation Working Group, illustrated the landscape based on both investor financial objectives and social impact (see Figure 4.1).

**Figure 4.1 'A spectrum of capital'**



\* This integration of sustainable practices across an organisation's core business may also be termed Corporate Social Responsibility (CSR), although many organisations have a separate (often philanthropic) CSR 'carve-out' that is distinct from their approach to sustainability

Source: G8 Social Impact Investment Taskforce, Asset Allocation Working Group (2014)

## 4.2 | Defining the social investment market product set

As discussed in Chapter 2, the key to social investment is to view it as a unique and separate strategy for capital deployment from that of traditional financial-only investments, which are shown to the extreme left-hand side of Figure 4.1. Social investment offers products in the 'Impact' range of the diagram.

The financial objectives of social investment are varied, but it should still provide a return on capital, albeit with a possibility that the financial return may be lower than for an equivalent traditional investment carrying the same level of risk. The aim is still to repay investors, through the return of the initial capital investment and possibly with a positive return of additional income over and above the original capital. This can be in the form of interest, dividend or capital growth.

Actual returns will vary, depending on investment type, term and risk – much like traditional investments. Social investment, however, also intentionally sets out to realise positive social outcomes, and these results will be part of the 'return'. Unlike simple philanthropy, where any funding is in the form of a non-repayable gift, social investment is looking for the enterprise to generate income from its activities sufficient to repay the investment and make a return. It provides capital to enable social enterprises and charities to proceed with solving the immediate social need, as with philanthropy, but that is only the beginning.



## Key learning point

An investor is often seeking a financial return but social investment can sometimes realise extended impact when investors choose to recycle their investments, reinvesting in social enterprises in a perpetual cycle using the same initial capital, thus facilitating further and increasing social impact, with tangible results.

### 4.3 | The range of financial products

Figure 4.2 outlines examples of the type of instruments and product structures used in the social investment market. These investment products are the means by which money is received from and returned to the investor.

Figure 4.2 Types of investment products

Types of investment products	Examples
<b>Social Deposit Account</b> Funds deposited are used to lend to charities, social enterprises and community organisations to help them meet their objectives. Investors earn interest on these accounts.	Charity Bank Unity Trust Bank Triodos Bank
<b>Charity Bond</b> A charity bond is a way of debt financing social enterprises or charities. These organisations then repay the investor with interest as an income during the investment term and return their original investment.	Scope Bond Wellcome Trust Golden Lane Housing
<b>Social Investment Fund</b> A ready-to-deploy pool of capital available to charities or social enterprises through a professionally managed, diversified fund.	Big Issue Invest Impact Ventures UK Real Lettings Property Fund
<b>Community Shares</b> An investment in Community Benefit Societies or Co-operatives to finance local community projects.	FC United of Manchester Exeter Real Food Store Dingwall Wind Cooperative
<b>Crowd Funding/Microfinance</b> A way of using smaller sums of money to fund businesses. Crowd funding allows organisations to receive investments from a large number of individuals, often directly. Similarly, microfinance allows individuals to take out small low interest loans.	Spacehive Kiva Buzzbank
<b>Equity Investment/Debt Finance</b> Investors provide risk capital focused on socially motivated companies that can employ repayable capital and deliver a return to investors. Equity investors also exercise a degree of control over the social enterprise and can expect dividends from profits.	Bristol Together bond issue Individual private equity deals
<b>Social Impact Bond (SIB)</b> A structure where an investor funds a service provider to deliver a specified social outcome, which a public body has commissioned and contracts to pay for, subject to the achievement of predetermined results criteria."	Peterborough SIB Think Forward SIB Essex SIB
<b>SITR Fund</b> A discretionary investment management service investing into qualifying social enterprises to benefit from Social Investment Tax Relief (SITR)."	Resonance Bristol SITR Fund Bright Futures SITR Fund Social Investment Scotland Community Capital Fund

Figure 4.2 is not intended to be an exhaustive list but does provide an overview of the main investment product types that have been launched to date that sit in the 'Impact' area of the 'spectrum of capital' in Figure 4.1.

The categories in Figure 4.2 are mainly traditional investment structures and will therefore be familiar. The three that may be less familiar are the 'community shares', 'social impact bond' and 'SITR fund'.

## Community shares

This is a particular form of share capital called 'withdrawable shares', issued by community benefit societies and co-operatives. They are exempt from the financial promotion rules and are different in character from company shares because they can be withdrawn or cashed in. Community benefit societies and co-operatives may also use other forms of capital raising, such as issuing debt or transferable shares.

### Key features:

- **Term:** Variable, dependent on the individual organisation. Some will have a minimum period of investment.
- **Return:** The amount of interest that can be paid on shares is limited and paid gross of tax. The value of the shares can go down but the value generally cannot increase above the original amount invested.
- **Size of investment:** Maximum £100,000 limit (£20,000 in Northern Ireland) on an individual shareholding.
- **Social impact:** The investor would only buy shares in organisations whose social objective or local community activity they wish to support.
- **Risk factors:** High risk, as all an investor's capital can be lost. The investment is dependent on the profitability and sustainability of the enterprise.
- **Risk mitigating measures:** This type of investment is designed to attract investors who are prioritising the social objective, therefore less emphasis is placed on the financial return. Shares in community benefit societies can, in some circumstances, qualify for SITR (shares in co-operatives do not qualify for SITR).

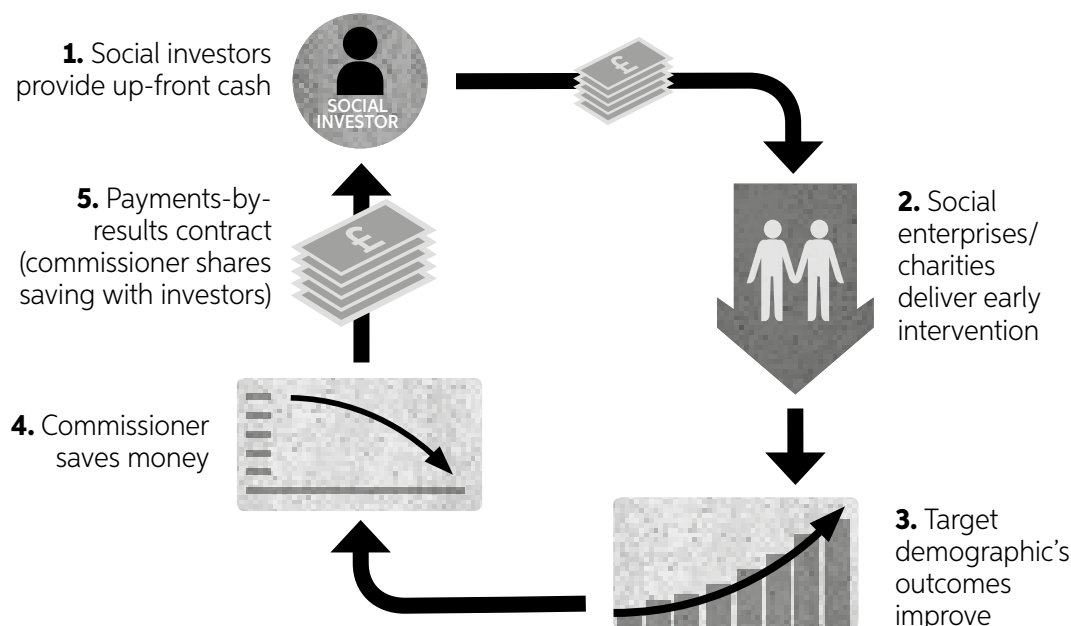
## Social impact bond

A social impact bond (SIB) is a 'payment-by-results' contract in which a commissioner, often in the public sector, agrees to pay for pre-agreed and verifiable outcomes delivered by a social enterprise or charity; up-front capital is supplied by investors. This 'payment-by-results' approach is essentially the opposite of the traditional method of government/local authority funding. The public authority only pays once the targeted outcomes are achieved, rather than paying up-front irrespective of the resultant outcome.

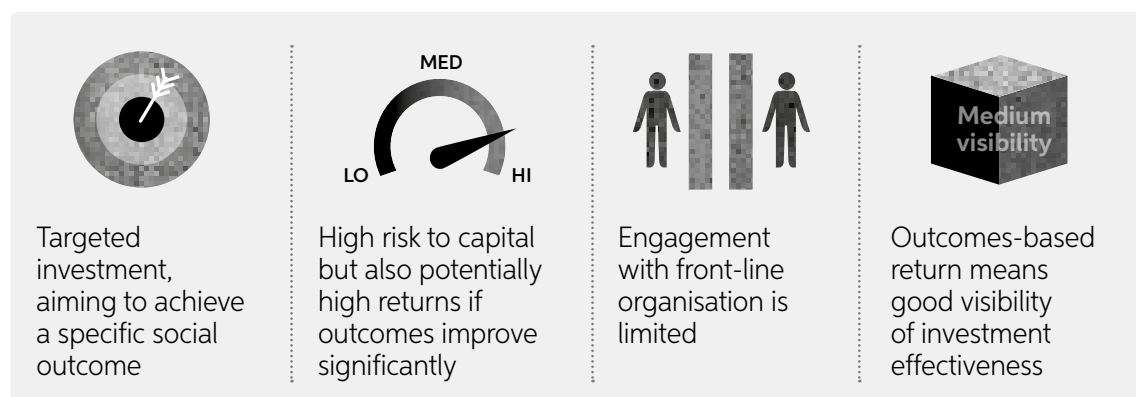
The targeted outcomes might be for early intervention in an area that may not ordinarily attract funding but could translate to longer-term savings for the commissioner; for example, improving young people's longer-term prospects or having fewer children in social care. On achievement of the targeted outcomes a proportion of the public sector savings is paid to investors. The investors, having provided the risk capital to fund the services required at outset of the contract, are repaid, with interest, from the commissioner payment. The actual investment is structured as a debt instrument – a loan note, for example – between the investor and the social enterprise or charity responsible for delivering the services.

**“This ‘payment-by-results’ approach is essentially the opposite of the traditional method of government/local authority funding.”**

**Figure 4.3 The multiple stakeholders typically involved in a SIB agreement**



**Figure 4.4 Investment product criteria dashboard - SIB**



### Key features

- **Term:** Medium- to long-term investment. Current SIBs range from 3 to 8 years.
- **Return:** Variable, based on the targeted outcome achieved and saving made by the commissioner in preventing the need for later remedial services.
- **Size of investment:** No limits, unless qualifying for SITR, in which case, the relevant annual limit would apply (see Chapter 8).
- **Social impact:** Focuses on preventative measures to improve social outcomes, such as a reduction of reoffending or keeping children and families together.
- **Risk factors:** High risk. Investors can lose capital if the expected impact is not achieved.
- **Risk mitigating measures:** This type of contract works well in data-rich outcome areas. The targets to be met are realistic and service providers often have evidence of previous success in achieving these objectives. Cornerstone investors or grant funding may provide a 'first loss' facility. SIBs can, in some circumstances, qualify for SITR.

## Step-by-step implementation

Given that SIBs focus on preventative services to provide both a targeted social benefit and a financial return to the investor:

- **Step 1:** A public sector organisation commits to paying for positive social outcomes in a target population.
- **Step 2:** On the strength of this commitment, money is raised from investors, which goes to one or several service providers to deliver specified outcomes.
- **Step 3:** These social outcomes are measured during the investment period.
- **Step 4:** Payments to investors are based on the extent to which the specified outcome targets were achieved.



### Client relationship builder

SIBs offer a very transparent and narrowly defined objective, which enhances the ability to match it to a client's specific social objective.

## Social investment tax relief fund

SITR is a government initiative to encourage investors to invest in qualifying social enterprises through newly issued shares or unsecured debt investments. These are covered in detail in Chapters 7 and 8.

An SITR fund is one approach that provides professional fund management and diversification in accessing these investments. They are structured in a very similar way to many Enterprise Investment Scheme (EIS) investments and do not have a separate legal entity. Instead, as has become industry standard for the structure of EIS 'funds', they comprise a collection of discretionary management agreements between investors and the designated fund manager. In terms of structure and reporting, the principal variations, from an investor perspective, that an adviser needs to appreciate are:

- the investment instrument is predominantly debt;
- the addition and receipt of an impact report.

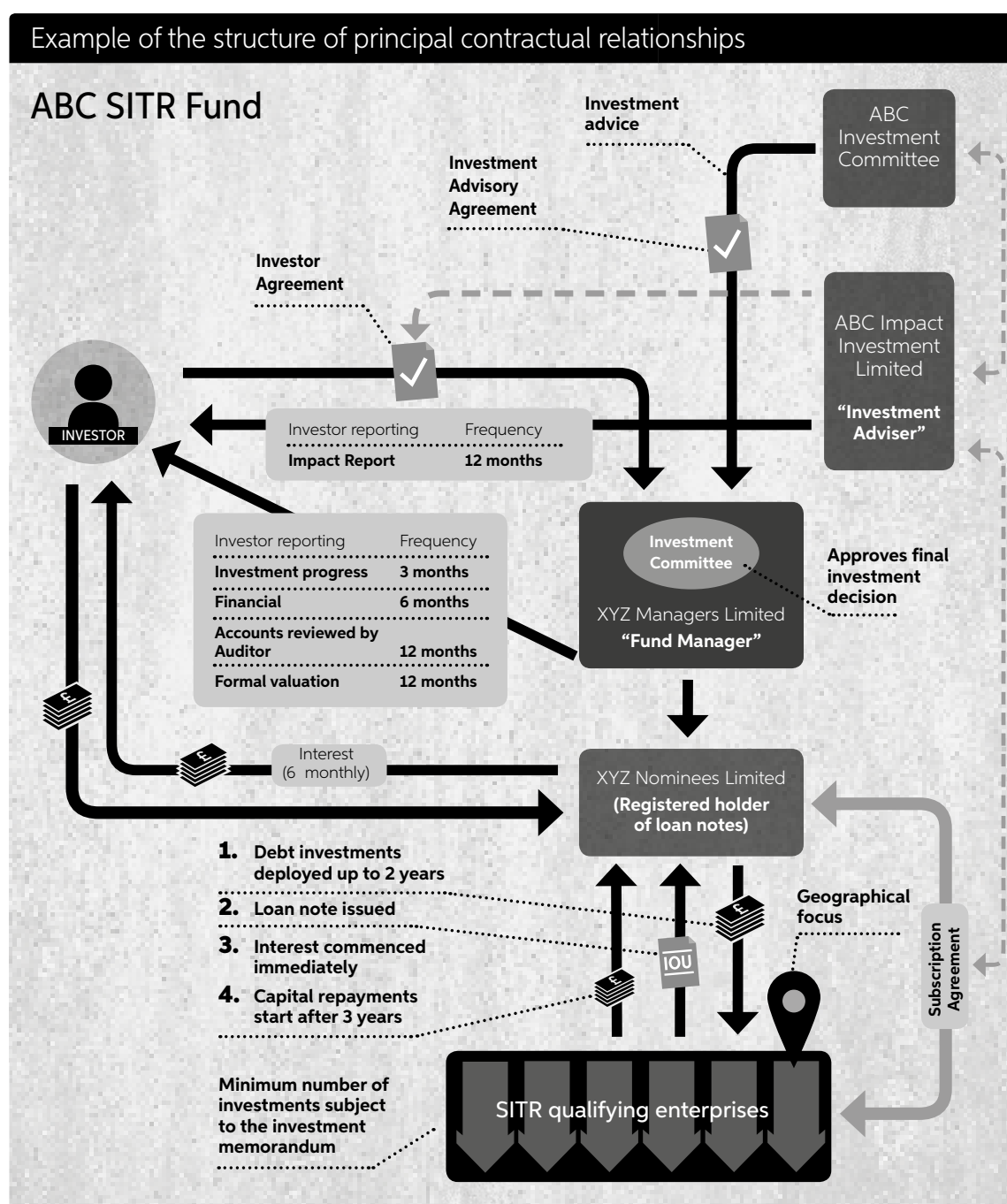
Typically, an SITR fund works on the basis that the fund manager manages investments on a discretionary basis, making investments recommended to them by the investment adviser. As a result, the investment is neither a collective investment nor a pooled investment. Nevertheless, the fund manager will usually attempt to maintain a pro-rata approach, so that all investors whose investments are accepted at the same time (i.e. 'interim closing date') will have the same investments in their portfolio, but in proportion to the amounts invested by each individual. Figure 4.5 represents this graphically. It provides an example of the structure of principal contractual relationships and information flow for an outsourced SITR fund investment.

### Key features

- **Term:** Medium- to long-term investment. There is a minimum holding period of 3 years; current SITR funds target exits ranging from 6 to 8 years, to allow for a 2-year investment period.
- **Return:** Variable. Including interest from loan notes and return of capital as debt is likely to be the predominant investment.
- **Size of investment:** SITR annual limit would apply (see Chapter 8).

- **Social impact:** Variable, depending on the social impact objective of the fund.
- **Risk factors:** High risk – all an investor's capital can be lost. Investments must be unsecured and rank below all other creditors. The investment is dependent on the ability of the enterprise(s) to repay debt, determined by their profitability and sustainability.
- **Risk mitigating measures:** For some social investors, a tax incentive is seen as a way of providing a cushion against a potential loss. Debt investments may offer a more predictable payment profile and potential exit.

Figure 4.5 SITR fund legal framework



Source: Independent Product Review, Worthstone (2016)

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ISBN No. 978-0-9957813-0-6