DESIGNING A SOCIAL INVESTMENT FUND FOR UK PENSIONS

A TECHNICAL PAPER

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This paper demonstrates what a social investment fund that is fit for investment by pension funds on behalf of UK savers could look like.

It has been written to provide helpful insights for investment managers, auto-enrolment providers and corporate employers in considering how they may approach this new product. It follows and complements an earlier paper, Good Pensions: Introducing social pension funds to the UK (SMF, BSC, 2015) that focused on why social pension funds are needed by the UK, the key barriers and how they can be overcome.

This paper aims to address some of the technical questions about how a social pension fund in the UK could work in practice. In particular, it finds that:

- *Many elements of the French solidarity investment fund model can be applied to the development of a UK DC social pensions product.*
- *Further investigation is needed about the potential investable assets, relevant social investment strategies and new approaches to impact reporting and communications to design the fund.*
- *Investment managers, the social investment community and pension providers are needed to play important roles in establishing the UK's first social investment fund for UK pensions.*

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ABOUT THE AUTHOR

About the Author

Simon Rowell is senior director, strategy and market development and leads on generating mass participation in social investment at Big Society Capital. He has led their work on the development of the social investment tax relief in the UK, which became law in 2014 and is advocating for reforms for financial promotions rules to improve access to local social investment. He has also helped build the first Social Investment Research Council, leads public affairs advocacy and acted as secretariat for the UK Advisory Board to the Social Impact Investment Taskforce established under the UK's presidency of the G8.

About Big Society Capital

Big Society Capital is a financial institution with a social mission, set up to build the social investment market in the UK, so that charities and social enterprises can access appropriate repayable finance to enable them to grow, become more sustainable and increase their impact on society. It is doing this by building a diverse social investment market: encouraging investors to lend or invest money to achieve a social as well as a financial return. Since it was set up as an independent organisation in 2012, Big Society Capital has invested, along with its co-investors, over £270 million in specialist organisations who lend to charities and social enterprises. For more information visit www.bigsocietycapital.com

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PURPOSE AND BACKGROUND

The purpose of this paper is to demonstrate what a social investment fund that is fit for investment by pension funds on behalf of individual UK pension savers could look like. The paper is designed to be helpful for **investment managers** considering if and how to establish such funds. It may also be useful for **auto-enrolment providers**, **corporate employers** and **insurers** who may be interested in the structure of funds that could fit into their broader pension offering (as well as advisors). In addition, **Government** may find this paper useful to understand how to implement their objective towards promoting greater choice in pensions.

This paper follows on from and complements the paper *Good Pensions: Introducing social pension funds to the UK*[1] launched in September 2015 by SMF and BSC. *Good Pensions* focused on **why** social pension funds could help develop a new segment of the UK pensions market, the key barriers and how these can be overcome. This paper provides a technical guide as to **how** such a social pension fund could work in practice.[2]

This paper comprises three parts:

- **Part A** describes in detail how a social investment fund could be designed for the UK by analysing the French solidarity investment fund model and stress testing its application to the UK;

- **Part B** investigates in detail three key questions that need to be addressed in structuring the fund – potential investable assets, social investment strategies and impact reporting and communications; and

- **Part C** details the key next steps required to develop a social investment fund for UK pensions.

[1] Good Pensions: Introducing Social Pension Funds to the UK, SMF and BSC, September 2015, accessible at http://www.smf.co.uk/wp-content/uploads/2015/09/Social-Market-FoundationSMF-BSC-030915-Good-Pensions-Introducing-social-pension-funds-to-the-UK-FINAL.pdf
[2] It should be noted that whilst this paper deliberately focuses on developing a social investment fund fit for investment through the pension system, it is anticipated that such a fund may also be investable by individuals through other channels, such as directly through electronic platforms or potentially through ISAs. However, proper consideration of these other channels would require further research.

PART A - DESIGNING A SOCIAL INVESTMENT FUND FOR UK PENSIONS

This Part describes why social investment funds for pension are needed in the UK (reviewing the lessons of *Good Pensions*), how the French have designed a social investment fund suitable for individual investment and then stress testing the French model for the UK.

1. *Good Pensions*: Why social pension funds are needed in the UK

There is a huge range of complex social challenges in the UK, such as youth unemployment, rehabilitation of reoffenders and fuel poverty. Charities and social enterprises in the UK are developing innovative solutions to address these, and the UK has developed a world-leading social investment market to help provide the necessary finance.[3] To date, over 3,000 charities and social enterprises across the UK have received some form of social investment.[4] However, to address the scale of these challenges, much more private finance is needed, particularly in the context of continued fiscal consolidation.

The UK pensions industry holds vast reservoirs of capital that could be deployed to address social needs as well as make a return for retirement. Assets in defined contribution (DC) schemes are expected to be nearly £500 billion by 2030 and the number of DC savers is expected to treble by the end of this decade.[5] Many of these new pension savers, particularly millennials, have a real interest in investing their money for social causes even if a slightly reduced return is required,[6] however currently there are few ethical or social options available for pension savers to choose from. At the same time, the pensions industry is considering how it could engage this new wave of savers to increase customer loyalty and savings, and the Government is wrestling with how to create a long-term savings culture.

Social pension funds are needed in the UK to deliver an opportunity for individual savers to use their own pension choices to invest in social causes they believe in, as well as save for retirement. This could also help engage savers more with their long-term investments.

To develop social investment funds for UK pensions, a number of barriers need to be addressed within the current pensions system. The inertia by individual savers needs to be overcome and the questions around performance, risk aversion and concerns about fiduciary duty by trustees and their agents need to be considered, as do questions raised about the liquidity and scale of social investments by pension providers and investment managers. These are reasonable questions and will take some time to answer.

Helpfully, a similar model has already been tried and tested in France, called the solidarity investment fund, which has enabled substantial numbers of individuals to make social investments through their long-term savings choices. This model provides a helpful platform for considering these real questions about what a social investment fund for UK pensions could look like.[7]

[3] For further information on the social investment market, see Big Society Capital website at www.bigsocietycapital.com
[4] The size and composition of social investment in the UK, BSC, March 2016.
[5] The changing landscape of pension schemes in the private sector in the UK, Pension Policy Institute, 2012
[6] 77% of savers surveyed favoured a social fund over a conventional fund, and 30% still preferred this even when told of an 18% lower overall return, according to Defined Contribution Investment Forum survey, 2013.
[7] Note that there are also other models emerging of using pensions schemes to make impact investments, particularly in the US, see, Unleashing the Power of Pensions, Accelerating Impact Investing Initiative, Dec 2015. These appear to be used for DB schemes at present but lessons could be learned for application to DC schemes.

2. Design of the French solidarity investment fund

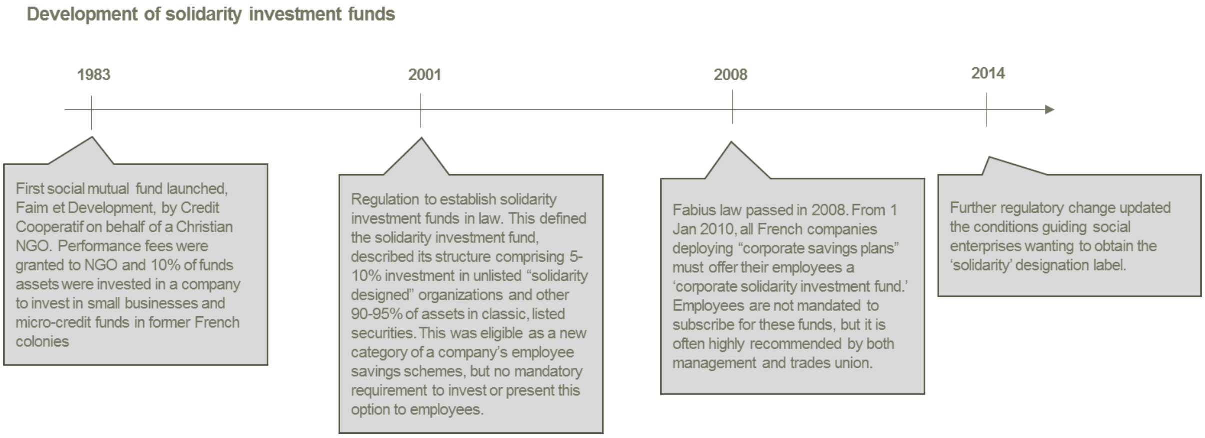
The French solidarity investment fund model is a prime example of how to involve ordinary savers in making social investments through a traditional fund structure. It should be noted that solidarity investment funds form one part of a wider solidarity finance system operating in France for decades. This section reflects and builds on the existing study on the French system in *Good Pensions*.

2.1. History of solidarity investment funds in France

Solidarity investment funds developed in France through a combination of market activity and Government intervention. Whilst there have been elements of the solidarity investment funds in place since 1983 and the *Fabius Law* was passed in 2001, the real expansion of solidarity investment funds has come since 2008 when the *LME Law* (*Bill for Modernisation of the French Economy)* was passed mandating that corporate employee savings schemes must offer a solidarity investment fund option.[8] The legislation had the objectives of increasing the engagement between employees and employers, and increasing rates of saving, as well as directing capital to social enterprises.

The broad timeline of key actions in the development of solidarity investment funds is described below.[9]

Figure 1: Development of solidarity funds



In 2002, there was only approximately €200 million in solidarity savings (including solidarity investment funds). As shown to the right, the 2008 law has helped drive a significant increase in the size of investment into the solidarity economy, particularly solidarity investment funds (to 2013). Assets in solidarity investment funds are now over **€6 billion**.[10] This has led to over 1 million individual savers in France.

[8] Bringing mass retail to impact investing: The French "90/10" solidarity investment funds, Guilhem Dupuy and Cyrille Langendorff, 2015
[9] Taken from Bringing mass retail to impact investing, 2015, and Finansol, www.finansol.org/en/what-impact-on-society.php
[10] Finansol website, www.finansol.org/_dwl/social-finance.pdf

Figure 2: French solidarity-based retail assets

Source: Finansol, as cited in The How's and Whys of Social Impact Investing[11]

2.2. What does a solidarity investment fund look like?

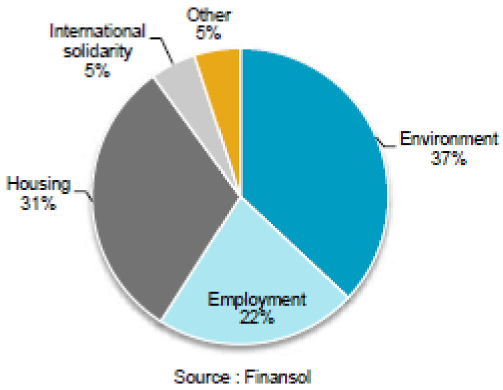
Solidarity investment funds are invested 5-10% in social investments into 'solidarity designated' organisations and 90-95% in listed securities (both equities and fixed income), which are managed according to core Social Responsible Investment (SRI) principles. For the purposes of this paper, this 5-10% will be called the 'high impact' segment and the 90-95% will be termed the 'responsible investment' segment.

Figure 3: Structure of solidarity investment fund

The social issues that have benefited from investment include the environment (37%), housing (31%), employment (22%), and international solidarity (development) (5%). This data describes the broader solidarity finance market in France, not just solidarity investment funds, but it is believed to be reflective of the split amongst investment in the 5-10% of the high impact segment of the solidarity investment funds.

[11] The How's and Whys of Social Impact Investing: Financial innovation driving social innovation, The Report of the French Advisory Board to the Social Impact Investment Taskforce established by the G8, 2014

Figure 4: Composition of high impact segment of solidarity investments



Source: Finansol, as cited by The Hows and Whys of Social Impact Investing

Investments made by funds include debt, equity and guarantee products, with average size between €100,000 and €300,000 per investment. Investors will invest on average €3,500. The performance of solidarity investment funds so far has been reasonable, with studies showing that they performed as well as traditional French stocks.[12] It is also suggested that the solidarity investment fund offered greater stability and resilience of returns during financial crisis.

2.3. **How is a solidarity fund managed?**

With respect to traditional investment managers, there are two primary models for structuring and managing the solidarity investment fund:

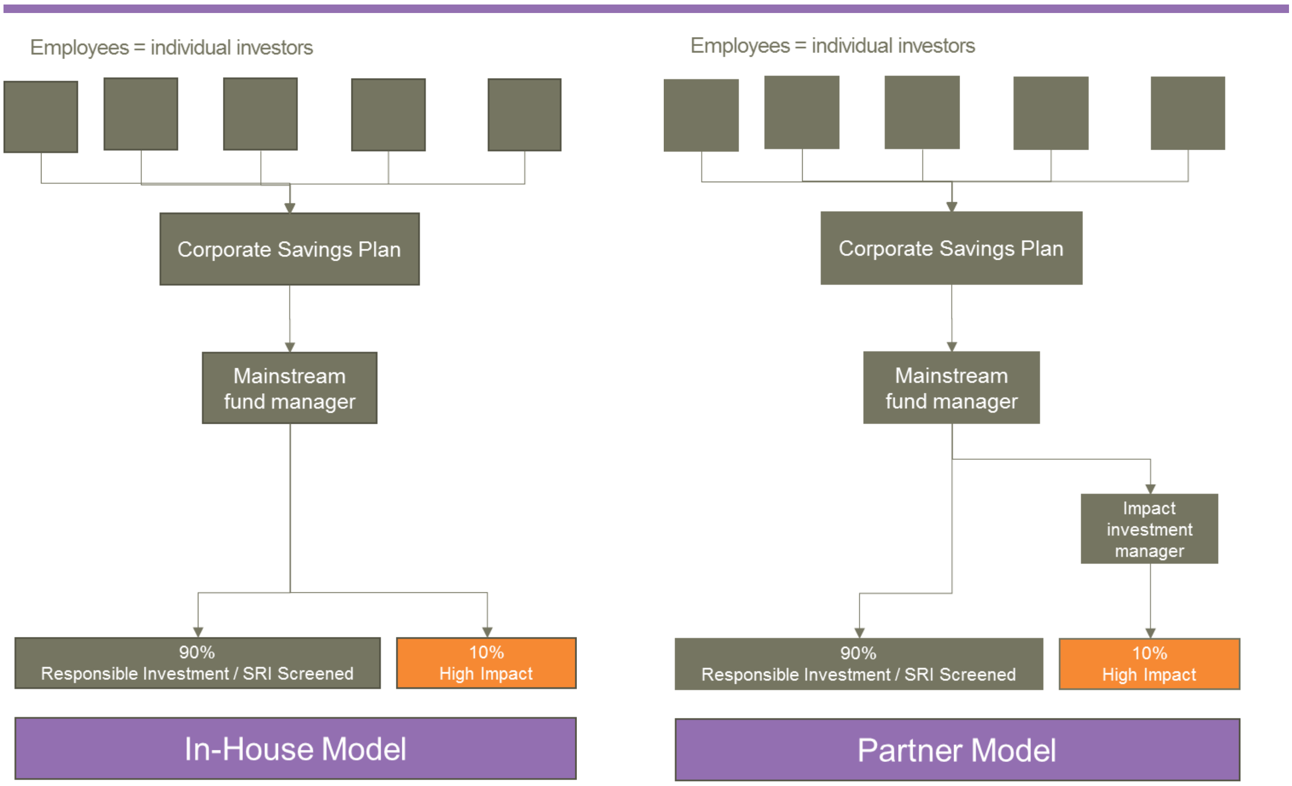
In-House Model: Investment manager manages both responsible investment and high-impact segments; or

Partner Model: Investment manager manages responsible investments, but outsources management of high-impact investments to specialist impact investment manager (such as Ecofi Investissements). This manager can either advise on direct investment of mainstream manager's assets or manage its own separate fund vehicle that onward invests.

In the early stages, most solidarity investment funds operated according to the Partner Model, as most traditional investment managers didn't have the expertise or knowledge to invest directly into social investment assets. Now, there are an increasing number of managers operating according to In-House Model (such as BNP Paribas), demonstrating an increasing confidence and interest amongst more mainstream investment managers to engage with impact investment directly. The increase in use of In-House Model also reflects an increased understanding of its fit with the strategic objectives of the financial institution that operates the traditional investment manager. For instance, it might determine that this investment activity helps with increasing employee engagement or through helping leverage more suitable funds to help finance existing charity clients.

[12] The financial performance of solidarity investment funds: the French case, Yves Jegourel and Samuel Maveyraud, Jan 2009

Figure 5: Models of solidarity investment fund management



3. Applying the solidarity investment fund model to the UK

In the UK, there are not yet any funds that replicate the French solidarity investment funds that offer social investment opportunities to a broad range of individual savers or pension investors. Whilst there are a small number of ethical funds established already and Abundance has established a platform to invest peer-to-peer in energy projects through a self-invested personal pension (SIPP), there are not directly comparable social investment funds that large institutional investors could direct individual client money towards.

The Threadneedle Big Issue Invest *Social Bond Fund* is the fund that currently comes closest to replicating the French model. This fund invests in listed bonds that deliver a financial and social return and is permitted to invest up to 10% into unlisted securities, including charity bonds. This is only invested into debt instruments and does not currently have any pension fund investors. See more detailed description in the figure below.

Figure 6: Case study on Threadneedle Social Bond Fund

Case Study: Threadneedle Social Bond Fund
The Threadneedle Big Issue Invest Social Bond Fund is the result of a partnership between Threadneedle Investments and Big Issue Invest aiming to bring social investment into the mainstream of financial services. The fund invests in a diversified portfolio of UK bonds from a range of issuers, and targets particular social outcomes while aiming to generate attractive risk-adjusted returns in line with a typical UK corporate bond portfolio. Social impact is considered through a partnership of Big Issue Invest in three parts. First, an innovative Social Assessment Methodology defines the social issues the fund tackles and embeds social impact in the investment decision-making process. Second, the Social Advisory

Committee, which includes independent parties and social issue assessment experts, reviews and challenges individual bond choices and overall performance of portfolio. Third, social performance is assessed in an annual published Social Performance Review.

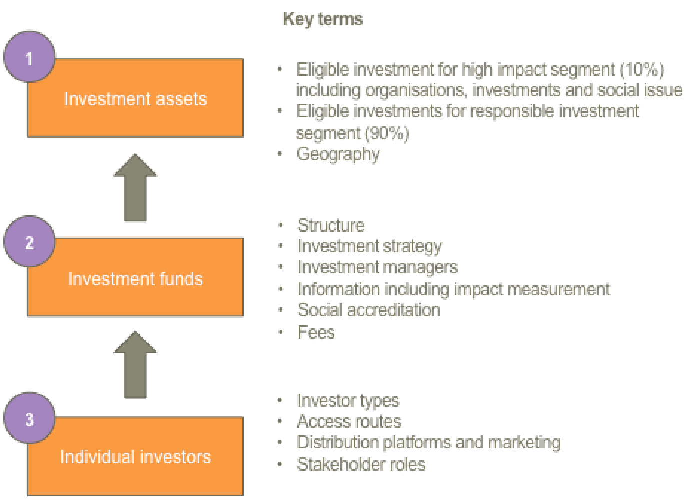
Approximately one third of the assets are invested in supporting Housing & Property, with the rest of the portfolio split across Health & Social Care, Transport & Communications, Utilities & the Environment, Financial Inclusion, Education, Employment & Training and Community Services. Investments are also guided in part by reviewing levels of deprivation in geographies associated with potential investments, with higher values applied to relatively deprived areas.

The fund offers daily liquidity and an annual management charge of 0.30%, encouraging investment from both institutional and retail investors. Major investors have included the City of London and Warwickshire County Council, and at least 25% has been invested by retail investors. This has helped the fund reach almost £100m in assets under management by Q3 2016, aiming to achieve an annual gross return in line with that of a UK sterling corporate bond index.[13]

3.1. How easily can the solidarity investment fund be applied in the UK?

There are three key elements to the design of a social investment fund suitable for the UK pensions system, and each of these has its own key terms. It is possible to use these basic elements of a social investment fund to 'stress test' the French solidarity investment fund model against UK requirements to determine what would need to change for application to the UK.

Figure 7: Key terms of solidarity investment fund



The table below provides an initial analysis of the level of ease/difficulty of applying the French solidarity investment fund model to the UK, using the following levels:

	No significant difference, straight-forward application to the UK
	Some difference in application in France and UK, some changes to terms required to adapt for UK
	Substantial differences in application in France and UK, material changes required to adapt for UK

[13] Colombia Threadneedle UK Social Bond Fund Website accessed in September 2016

Figure 8: Table showing the stress test of the French model to the UK context

No	Term			Key difference?
1	**Investment assets**			
1.1	**High-impact segment (10%) - Organisations**	Solidarity designation label: ○ A third staff employed as work integration program; or ○ Management elected by workforce and abiding by pay rules Solidarity designation granted by individual French prefectures (local councils).[14]	No equivalent label. Closest designation is *regulated social sector organisation*, which comprises: ○ Registered charity ○ Community Interest Company ○ Community Benefit Society Each body regulated by a 'social' regulator, and included within definition for Social Investment Tax Relief. This would be a very limiting definition for the UK market, excluding all "profit with purpose" businesses and many social enterprises. It is unclear if there are sufficient investible opportunities using this existing definition.	
1.2	**High-impact segment (10%) - Investments**	Range of investment types (with average investment size): ○ Micro-credit loans (€100k) ○ Equity & quasi-equity (€300k) ○ Guarantees (€100k) ○ Property (€300k)	Similar range of investment needs with similar investment sizes. Note: Many social investors in the UK do not currently use guarantees as financial instruments.	
1.3	**High-impact segment (10%) - social issues**	Investment provided across major social issues: ○ Environment (37%) ○ Housing (31%) ○ Employment (22%) ○ International (5%) ○ Other (5%)	Different balance of social issues expected. Social issues in the UK social investment market less concentrated, with: ○ Employment (12%) ○ Social care (11%) ○ Education (10%)[15] Housing will likely also provide significant investment opportunity. Pure environment investments are expected to be limited, except to the extent that they relate to 'community energy' projects.[16]	
1.4	**Responsible investment segment (90%) – Organisations investments, social issues**	Invested in stocks and bonds of listed companies, using screened for socially responsible investment.	Similar eligible investments. There may also be scope for increasing the strategic alignment in investment approaches between the high-impact (10%) and the responsible investment (90%) asset segments.	
1.5	**Geography**	5% investments in international development social issues, however organisations still must be registered in France.	Focus of major part of funds to be on the UK. Could set a maximum threshold of 10% for international activities. However, all organisations invested in must be registered in UK.	

[14] In 2014, a new designation system has been implemented to include more criteria and greater impact reporting, however it is unclear as to whether this will restrict or boost investment activity.
[15] According to a survey of fund managers and advisers in Growing social investment: Landscape and economic impact, GHK, 2013
[16] This is because there is already a significant amount of investment relating to renewable energy initiatives – this is viewed as outside the traditional definitions of pure social investments and the volume of potential investment would risk seriously diluting any investment into more 'social' activities.

2	Investment funds			
2.1	**Structure**	Structures largely through promissory notes not UCITS IV compliant.	Same legal structures expected, however further study needed.	
2.2	**Investment strategy**	A range of strategies are possible, including: ○ Diversified fund ○ Equity growth fund ○ Debt fund	Many new investment strategies should be considered. Increasing diversity of investment strategies should be encouraged to develop to suit a broader range of investment channels, including default pension funds, pension options and other pension fund allocations, with a range of different mandates.	
2.3	**Managers**	Managers are: ○ Specialist impact investment managers (e.g. Ecofi) ○ Mainstream investment managers (e.g. BNP Paribas) Partnerships between the two manager types are encouraged.	Seek a mix of managers at the outset, though with early focus on engaging with greater number of mainstream managers to encourage wider public participation in social investment. Limited number of mainstream investment managers currently managing social investments in UK.	
2.4	**Information (including impact reporting)**	No specific information rights provided to individual savers. Sometimes monthly and/or quarterly reports provided on the high-impact segment.	UK may seek to ensure individual savers receive sufficient information about social impact to make informed pension fund selections and to monitor the ongoing social impact of their investments. This can lead to greater engagement, a shared interest of the pensions industry.	
2.5	**Social Accreditation**	Finansol accredits solidarity investment funds managed by banks, investment funds, insurance companies, mutual funds and employee savings accounts. The label is granted by an independent committee. There are 135 labelled funds.	No similar mechanism exists in the UK. An independent body, such as a body chaired by BSC, could help accredit relevant social investment funds.[17]	
2.6	**Fees**	2% fees on high impact segment, market rates for investment management of overall portfolio. However, note may be accounted for differently in management model A (see Part A).	UK may look to same fee structure, while recognising the need to keep overall fees low to meet regulatory requirements and remain competitive in the UK market.	

[17] Such an accreditation mechanism could for instance seek to consider the different protections a fund embodies to serve such accreditation, such as the asset, mission and performance locks referred to in The Social Business Frontier, BSC and Bridges, 2014. It could also build on lessons from other comparable rating methodologies, such as LuxFlag.

3	Individual investors			
3.1	**Individual investors types**	Corporate employees, with willingness and financial ability to contribute to employee savings plans. Anecdotal evidence that average saving pot of €3,500 means available to mass affluent, but unclear about retail investors.	Individual savers contributing to DC pension schemes. As in *Good Pensions*, this could apply to savers with a range of wealth levels, including the general public.	
3.2	**Access**	Currently solidarity investment funds are available as individual funds accessible as part of the corporate savings plans, but also as individual investment opportunities.	Corporate savings plans culture largely non-existent in UK, pensions schemes likely access point for large numbers of savers. Note that pension scheme funds will be treated differently to long-term savings that are withdrawable after a time period.	
3.3	**Distribution platforms**	Marketed through companies applying through their employee savings policies.	Distribution platforms suitable to DC pensions: 1. Auto-enrolment providers 2. DC pension scheme providers, such as large companies, local authorities, charities.	
3.4	**Stakeholder roles**	Corporate employers and trades union play a key role in marketing the schemes, and recommending them. Corporate employers often match the employee investment making it more attractive investments to manage for investment managers as well as individual investors.	Work with key stakeholders to encourage use of social investment funds, innovation of fund models and facilitate greater take-up. Large companies are key stakeholders to work with. Many have started to demonstrate interest in making social investment (e.g. Centrica Ignite fund) and evidence from BSC's Business Impact Challenge suggests many see strategic benefits of helping business align more with social issues of demonstrated interest.[18]	
3.5	**Tax treatment**	Exemption from capital gains and income tax on earnings during saving period and withdrawal (except for social costs related to healthcare and reduction of national debt).	Same principles behind tax treatment. In UK, pension contributions are invested pre-tax and not taxed during contribution period, but 75% pension pot subject to income tax on withdrawal.	

3.2. **What are the key differences in applying to the French model to the UK?**

The stress test reveals that there are many elements of the design of the French solidarity investment fund model that could be directly applied to the UK, particularly the structure and the engagement with key stakeholders. However, there are four key differences:

- **Eligible investment assets need to be clearly defined and broadened (table reference 1.1):** The current universe of investable assets within the most commonly used definitions of 'social investment asset classes' is smaller in the UK than in France. New funds at set up will not need significant investable assets, however in the longer-term, a deeper pool of investable assets will be needed.
- **Investment strategies available to meet needs of different pension providers (table reference 2.2):** Developing a diverse range of funds that can match the specific investment strategies needed to fit within the broader investment funds portfolio held by a pension fund is vital to making this acceptable to the default fund. These investment strategies need to be able to bundle together the relevant social investment assets in order to be complementary to the other investment funds in the portfolio (e.g. match social investment debt funds to a broader

[18] Business Impact Challenge website at http://businessimpactchallenge.com/

debt investment portfolio).

- **Greater focus on impact measurement and related investor communications (table reference 2.4):** The French approach does not have significant focus on the measurement of the social impact of its investments until recent changes. The UK has developed expertise on impact measurement, residing in particular amongst existing social investment funds and advisers. New social pension funds should have a robust and appropriate impact measurement process is in place to actively engage investors by informing them of the social impact attributable to their pension investments. Impact objectives for the high-impact segment and the responsible investment segment should be broadly consistent.
- **Individual investors in the UK will be employees contributing to DC pension schemes (table reference 3):** The French model is different in that encourages individuals to participate in corporate savings plans arranged by employers, which are not the primary source of savings for retirement. This difference in the source of funds will mean different distribution and marketing approaches, as well as some different approaches to structuring the funds.

The first three of these differences are key questions that require significant further investigation. Part B below describes these questions in more detail and proposes some ideas to start addressing them. The final difference, the nature of individual investors is also critical, but not considered in detail in this paper, as it warrants further independent further study by research (note that the Social Investment Research Council has currently commissioned research on the nature of individual investors which hopes to investigate which investors would be keen to make social investment through their pensions, expected publication in late 2016).

PART B: KEY QUESTIONS FOR STRUCTURE OF SOCIAL INVESTMENT FUND

This Part B investigates three priority questions raised in the stress test in Part A as needing to be addressed for the establishment of a social investment fund for pensions in the UK.

1. What are the potentially investable social investment assets in the UK?

This section describes what types of potential social investment assets may be available in the UK, estimates the size of those asset pools and considers the likely upper limit on the initial size of a social investment fund for pensions in the UK. Note for the purposes of this paper, only social investment assets within the UK are considered because there is an assumption that many of the individuals would be more likely to want to see their impact locally. However, many of the approaches to measuring possible investable assets could be applied internationally.

What are the types of potentially investable assets?

'Responsible investment' is already a working term within UK financial institutions and by a number of expert bodies already, such as UNPRI[19]. This term often refers to investments in listed companies that have passed a socially-responsible investment (SRI) screen. Estimates from Eurosif 2014, suggests that norms-based screening in UK represent approximately £60 billion and ESG integration practices closer to £1 trillion, however these underlying assets are not necessarily based in the UK. No data is available for this, but this could represent approximately £80bn in equities and £25bn in debt issued if just 5% of the available investments met the SRI screen.[20] This is likely not to be the binding constraint on the establishment of a social investment fund for UK pensions.

It is less immediately apparent as to what should be included within 'high-impact' investment segment. One key component of 'high-impact investments' should clearly be social investment, capitalising on the recent progress in the UK social investment market. In *The size and composition of social investment in the UK*,[21] social investment is described as 'where both investors and users of capital intend to make a positive social impact.' This is a useful starting point, however misses opportunities to capture the broader range of assets that deliver impact, offer variety and provide access to the deeper pool of investment assets necessary for investment by pension funds. Therefore, we suggest that there may be three potential groups of high-impact assets that may be invested in:

- Social investment (traditionally smaller investment sizes)
- Larger investments into the social sector (large organisations with defined social purpose)
- Investments for broader public purpose (by organisations not within social sector, but intending to deliver a social impact, such as public institutions)

This high-impact investment segment should also prioritise investments that are in need of further capital provision, due to liquidity, shorter track record or longer-term investment period. The table below provides an indication of the possible range of assets that a social investment fund could consider, as well as a best estimate of the current market size by calculating the total stock amount of current easily observable investment in each asset class. This approach has been conservative and does not include any assessment of how easy each asset class will be to invest in by a fund.[22]

[19] The Principles of Responsible Investment defines 'responsible investment' as "*an approach to investment that* explicitly acknowledges the relevance to the investor of environmental, social and governance factors, and of the long-term health and stability of the market as a whole. It recognises that the generation of long-term sustainable returns is dependent on stable, well-functioning and well governed social, environmental and economic systems."
[20] FTSE350 debt and equity issues
[21] The size and composition of social investment in the UK, BSC, 2016
[22] Note that these are only estimates based on existing publicly available information and current investment amounts to provide an estimate of scale. These do not incorporate estimates of future demand. We welcome any updates or corrections to these figures.

Figure 9: Estimate of potential high-impact investments

Asset Type	Description	Example	Market Size (stock)	What's included/ source[23]
Social investment assets				
SME charity debt	Small and medium-sized charities and social enterprises have a demand for simple repayable loan finance. This may be secured or unsecured.	Factory Skatepark in Scotland raised £500,000 from Social Investment Scotland in a long-term loan to develop new facilities.	£703m	Social banks, non-bank lending, from BSC valuation data
Equity-like capital	Small and medium-sized charities and social enterprises require growth capital to expand their businesses and impact. Charities do not have equity within their capital structure, so this takes the form of 'quasi-equity', such as revenue participation agreements.	HCT Group raised £9.95m from investors to sale its community transport business, with part repaid when revenues increase above a certain threshold.	£32m	BSC internal data
Social impact bonds	Social Impact Bonds (SIBs) enable investors to provide up-front capital to social organisations to deliver an innovative social service for the public sector. If the service is successful (and cost savings are made), the Government pays the investor a return. 31 SIBs exist.	Local Solutions has raised capital from private investors to support vulnerable young homeless people in Merseyside.	£14m	BSC internal data
UK microfinance	Many individuals (8m) and SMEs in the UK can't access the personal finance they need. Community Development Financial Institutions (CDFIs) play a role in providing these financial services. These organisations may require on-going investment to finance their activities.	East Lancs Moneyline received a £950,000 investment from Big Society Capital to expand its business to 20 branches across the country.	£19m	Based on amount lent in 2014 to 42,000 individuals (average term around 1 year). CDFA 2014[24]
Credit unions	Lending by credit unions to individuals often who are financially excluded by other mainstream financial providers.	Eastern Savings & Loans Credit Union provides a range of loans from £500 over 6 months to up to £7,000 over 5 years.	£720m	ABCUL website
Charity bonds	Charities, particularly larger charities, are starting to finance investment needs through charity bonds, which can be issued to retail investors. A platform (Retail Charity Bond plc) has been created by Allia to facilitate issuers, and a backstop facility has been supported by Big Society Capital to encourage initial issues of charity bonds.	Golden Lane Housing raised £10m to help refurbish homes.	£86m	Across 18 bonds, from BSC internal data
Social property	Investment has been made to finance the purchase and operation of properties that service the social sector and local authorities. These can provide more affordable housing and/or housing for those with specific needs. They often are invested in through specialist social property funds.	Real Lettings Property Fund (managed by Resonance) buys and leases properties to charity St Mungos Broadway to help people transition from homelessness.	£130m	BSC valuation data plus external sources
Community shares	Community groups across the UK are obtaining finance to run outreach programs, run local services and purchase assets of community value. Many communities have issued shares to finance these operations.	Hasting Pier Charity raised £500,000 to refurbish Hastings Pier using community share capital. It was oversubscribed.	£96m	Raised over the past 5 years, from Community Shares Unit
Profit with purpose	Private companies that are committed to delivering a social mission (and usually embed this commitment in	The Gym Group provides 24hr gym facilities and raised equity investment from Bridges	£462m	Various

[23] The table below should be read in conjunction with The size and composition of social investment in the UK, BSC, March 2016. Data used in this exercise is taken from various sources, including BSC valuation data.
[24] Inside Community Finance, CDFA, 2014

Asset Type	Description	Example	Market Size (stock)	What's included/ source[23]
	their governance) are raising debt and equity investment to fund their growth.	Ventures to grow its business. Part of this stake has been sold to Phonex Equity Partners.		
Large social assets				
Large charity debt	Larger charities with substantial assets have received significant loans larger with high-street financial institutions.	Bank loans similar to loans to private companies	£2.8bn	NCVO Almanac 2015
Large Charity Bonds (listed)	Bonds issued by large charities such as Wellcome Trust and Motability.	Wellcome Trust, largest registered charity in UK, issued £400m bond issue in July 2014	£6.4bn	Outstanding issuance, from BSC internal calculations
Housing association bonds (some listed)	Housing associations have long been raising long-term capital through bond issues to finance further development and maintenance of social housing. (Smaller housing associations that struggle to raise capital may be deemed part of the high-impact segment).	Together Housing Group raised £250m in a public bond issue to fund regeneration of houses in North England through a partnership of 6 housing associations	£19.6bn	ONS estimates and Cannacord Genuity
Commercial bank loans to Housing Associations	Bank loans to housing associations largely on secured basis.	Bank loans similar to loans to private companies	£39.4bn	ONS estimates/ BSC internal data
Public purpose assets				
Local authority bonds	Local authorities have limited borrowing powers to raise finance for new investment. The municipal bond agency newly created is designed to encourage greater use of finance by agencies.	GLA launched a £600m bond in 2011 to finance the construction of Crossrail (saving £65m in borrowing costs)	£850m	From public works loan board. Note £7bn refinancing targeted by municipal bond agency.
Quasi-government bonds	Government agencies, such as TfL, are raising their own financing for renovations and long-term investment.	TfL is the leading public sector issuer of capital markets debt after the Government's Debt Management Office. Debt raised finances maintenance and operations.	£8.5bn	Debt outstanding by TfL, with further £4.5bn borrowing requirement up until 2021, from TfL website
Social infrastructure	Hospitals and schools have been often been financed through PFI/PPPs in the UK. UK has been a leader in PFI expenditure, and involves both equity and debt financing. PFI expenditure is set to continue, particularly for investment in health and education.	Priority Schools Building Programme launched in 2013 raised £3.5bn to fund rebuilding of 261 schools using diverse capital mix	£57.7bn	Current value of PFI deals (ed and health >£20bn), from PFI projects: 2015 summary data, HM Treasury, Dec 2015
Green bonds (GBP-denominated)	Bonds issued by large companies where the proceeds are used for environmental purposes. These often finance low carbon projects and the proceeds are ring-fenced and there is transparency around the issue.	Unilever Plc issued a £250m Sustainability Bond in March 2014 repayable in four years to fund for CO_2 and water improvements in manufacturing plants. It was three times over-subscribed.	£1.6bn	GBP outstanding and denominated issued in 2014. Climate Bonds Initiative. Note \$58.5bn climate themed bonds issued by 2014

Are there sufficient investable assets?

The figures above demonstrate that:

- There is a reasonable **diversity** of types of potential assets to invest within the high-impact investment segment; and
- There is reasonable **scale** of high-impact assets.[25]

Figure 10: Total size of potential investable assets

	Estimated investable assets (2015)
Social investment assets	£ 2.3 billion
Larger social assets, including Housing Associations and listed Charities	£68.2 billion
Public purpose assets	£68.7 billion

Whilst obviously small compared to other investment markets, there could be at least £2.3 billion of smaller social investment assets available for investment within the high-impact portion (or nearer £70 billion if include larger social assets). When considering that only up to 10% (average 7.5%) of the social investment fund would be invested in high-impact assets segment, this means that a fund of **£10 billion** could be established comprising only a third of the currently available (smaller) social investment assets (approx. £750 million), or around 1% of the total larger social assets. To take account of the time to transition to the full social investment fund model, the proportion of high-impact assets (and social investment assets) of the total fund could originally start smaller and proportion of investment could increase towards the 5-10% allocation as the fund grows in expertise and the broader industry of investment opportunities develops.

In future, the amount of high-impact assets are expected to grow over time from this current conservative estimate of investment (stock). This could be as a result of Government policies to encourage commissioning of innovative public services from charities and social enterprises which need risk capital, spin-outs of public services from Government, increasing investment by wholesale investor Big Society Capital, and a broader need for the third sector to develop independent sources of capital. In addition, new fund structures may also develop to make such asset types more accessible to investment by institutional investors, such as pension funds. These could include: blended capital funds, social property REITs and social holding companies.

2. What should the investment strategy be?

Given the diversity of types of assets, a variety of investment strategies are possible. Investment managers will need to consider how best to match the investors' social motivations (the pension fund and their underlying members) with the financial needs of the broader investment portfolio (as it is assumed that a social investment fund may form one part of the overall pension fund offering to individuals).[26]

The investment strategy for the social investment fund therefore should consider traditional portfolio management factors, such as liquidity, risk and return, but also include the element of impact strategy. This yields a richer source of possible investment strategies to consider – see below.

[25] Note further detailed study of these social impact investment asset classes would be very welcome, and BSC would be keen to discuss with others about how this could be developed (as in Part C).
[26] Allocation for Impact, G8 Social Impact Investment Taskforce, 2014, describes how impact investments can be treated as either a separate asset class themselves or a part of all existing asset classes, including cash, debt, public equity and alternatives. It further elaborates on the performance of each of these asset classes and how they could be integrated into portfolios.

Figure 11: Possible investment strategies

Fund strategy	Composition
Growth	Equity-like social investment assets, such as social growth finance, social venture capital and SIBs, as well as responsible companies.
Stability	Debt-like social investment assets, such as SME charity debt, UK microfinance and charity bonds, as well as bonds of housing associations, local authorities and responsible companies.
Diversified	Mix of equity-like and debt-like investments.
Tri-sector	Selection of social investments from social sector issuers, public sector issuers and private sector issuers.
Impact hedging	Traditional private investments targeting high financial returns, alongside high-impact investments, targeting a high social impact.
Social theme	Investments targeting companies addressing a particular bundle of related social issues, such as youth services, youth unemployment and education services.
Geographical	High impact investments targeted on a particular geography to encourage individual participation on the understanding that social benefits will accrue to local area.

Each strategy would require a different selection and proportion of assets in both high impact and responsible investment segments, according to how they will help implement the fund strategy. A diversified fund would be the most straight-forward approach to establish as the first fund.

Given the variety of possible assets to include in funds and complexity, investment managers may find it valuable to be accredited by an external independent body that certifies that eligible assets are included within the social investment funds. This will give pension funds and individual investors the confidence that this is a genuine social investment fund, learning from the role of *Finansol* in France.

3. How will the social impact be measured and communicated?

As identified earlier in Part B, a robust and appropriate impact measurement process is essential to ensuring that a social investment fund for pensions is fundamentally different to other ethical investment funds, and that the social return is actually delivered. Ability to communicate this impact effectively and clearly to the pension savers will be important to ensure they appreciate and engage more with this fund.

How should the impact of the social investment fund be measured?

The social investment fund should have commitment to impact embedded across the entire fund. This impact achieved can be across a range of social outcomes (described below), therefore meaning a variety of funds are possible.

Figure 12: Social outcomes

Source: Big Society Capital website

Currently, the UK is not a leader in amount of responsible investment, with only €2.784 billion in investment assets subject to 'best in class' screening[27]. Developing a social investment fund for UK pensions provides the opportunity to develop a new approach to impact measurement by utilising both the existing measurement tools of responsible investment (some examples suggested below) alongside the range of social impact measurement tools emerging from the social investment market.

Figure 13: Range of suggested responsible investment measurement tools

	Responsible investment tool
1	Exclude investments in companies explicitly linked to negative social outcomes (e.g. bad labour practices)
2	Exclude investments in companies that produce products and/or services that are explicitly linked to negative social outcomes (globally, not UK specific) and prefer those linked to positive outcomes
3	Positively screen all other potential investments for positive social impact using range of best-in-class methodologies (e.g. B Corps accreditation) to assess a company's preparedness and performance across a range of environmental, social and governance issues.
4	Use themed investment funds (e.g. Threadneedle Social Bond Fund) where available
5	Expect all managers to utilise integrated ESG approaches to investment decision making, with particular emphasis on ensuring social outcomes are appropriately reported on
6	Actively engage and utilise voting rights arising from investments to vote in favour of corporate governance promoting improved social and environmental outcomes and to increase disclosure of measurement of products and services linked to positive social impacts
7	Encourage and support development of agreed social outcome expectations for business ('norms') that can be codified and referenced to help influence behaviour change
8	Sign up to the UN PRI, UK Stewardship Code, GIIM and other leading responsible investment initiatives

Some possible ways to integrate impact measurement across both the high impact and responsible investment segments are already starting to emerge in the social impact investing market:

- Focus on **governance**: Establish a process for external input to challenge social choices. Threadneedle Social Bond Fund has a Social Advisory Committee where external experts provide challenge on the social value of individual bond choices.
- Focus on **one** potential **beneficiary group** or one particular **social outcome** relevant to the manager and/or the investors and feasible to measure and monitor and report that on an on-going basis across the entire portfolio. For instance, this measure could be improved quality employment prospects in deprived areas across the UK, educational attainment for children from disadvantaged backgrounds, or improved health outcomes for areas classified as food deserts. The particular beneficiary group and/or social outcome to choose should be important to the fund and the investors, and proportionately more information should then be sought and reported on than the general other reporting from standard ESG/SRI frameworks.
- **Set targets for amount (%) of portfolio** invested in eligible companies, such as those that derive a certain percentage of their revenues from products linked to positive social outcomes.
- Using **scientific measurement to measure impact**. BlackRock has recently launched its first impact fund that has pioneered a more scientific approach to measuring impact – see case study below.

[27] European SRI study 2014, Eurosif, 2014

Figure 14: Case study on Blackrock impact fund

Case Study: BlackRock Impact World Equity Fund
In August 2015, BlackRock launched its Impact World Equity fund, its first impact investing fund that uses traditional insights and big data technologies to invest in equities globally. The fund invests in a diversified portfolio of equity securities targeting competitive benchmark returns and aggregate social impact outcomes, against the MSCI benchmark. This assessment is completed by the Scientific Active Equity team, with scores more than 8,000 companies daily across three societal impact outcome areas: health, the environment and corporate citizenship. This impact analysis takes place alongside return and market risk analysis in order to develop a consistent portfolio. The fund also offers a unique way of connecting investors to their investments, through the use of transparent reporting, whereby investors can understand both the financial returns and the social impact of the fund.[28]

How should investors be communicated with and engaged?

The social investment fund needs to overcome the current disengagement of individual investors with their savings and investments, which has been exacerbated by the introduction of a complex pension system. Recent research by NEST suggests that "*Consumers feel far more disconnected from their money in a pension than they do in other savings vehicles like a cash ISA or a bank account*."[29] One of the most common questions that is asked by individuals is "*What happens to my money?*" and "*Where does my money go?*"

A social investment fund would be able to help address these questions. 77% favoured a social fund over a conventional fund[30] and the social purposes of these investments appeal directly to the motivations of individual investors. Recent research from Barclays suggests that whilst over half were interested in social investments, only 9% were currently engaged.[31]

A social pension fund would therefore need to effectively communicate the:

- Intended social purpose of the investments; and
- Actual social impact achieved.

The impact reporting content should ideally focus on case studies of the stories and personalities of the people benefitting (particularly for the investments in the high-impact segment) together with summary data of the overall measurable impact across the portfolio. For investments into a social pension fund, impact performance information of this type should be routinely reported to investors alongside financial performance reporting that would be provided as standard. Developing systems to collect and synthesise this information will be one of the key challenges for any investment manager seeking to launch a social pension fund.

New technology should be used, including smartphone applications, to encourage engagement between individual savers and their impact investments. This can catch on to current trends. Equiniti reports a 238% increase in 2014 in members registering to use a smartphone app that lets users track the performance of their pension investments and see the total value of their fund, from around 8,000 to 28,000. It has also seen a 500% increase in the number of members using the self-service app.[32]

[28] Colombia Threadneedle UK Social Bond Fund Website accessed in December 2015
[29] Improving consumer confidence in saving for retirement, National Employment Savings Trust, NEST, 2013
[30] What do pension scheme members expect of how their savings are invested? NAPF, 2013
[31] The value of being human: A behavioural framework for impact investing and philanthropy, Barclays, 2015
[32]How a smartphone could get you a bigger pension, Daily Telegraph, Dec 2015

The nature and frequency of the communications to individual investors would likely follow established industry best practice already in place for reporting financial performance. Behavioural decision-making insights might also prove useful to ensure information is provided at the right time, to the right people and in the right manner to capture and retain their interest.

PART C: HOW TO ESTABLISH A SOCIAL INVESTMENT FUND FOR UK PENSIONS

The previous Parts have outlined the key design features of a social investment fund for pensions and the challenges that any investment manager or pension provider must consider when considering the unique characteristics of social impact investing. A number of questions remain about how this would work in practice, and therefore this Part describes what an investment manager, social investment manager and pension provider could do to help develop these products to become a new part of the UK pensions landscape.

Importantly, it is acknowledged that there are other initiatives that have attempted related efforts to enable pension investments aligned with values, including Sharia-compliant pensions[33] and the launch of the Abundance SIPP, which is a SIPP that can make peer-to-peer investments into specific energy projects.

1. Investment managers

This paper is a first attempt to outline a blueprint for how a social investment fund for pensions could be designed in the UK. Further research is needed by experts in investment management, product development and pension operations to develop the details of how this could work in practice.

Next steps	Action	Potential partners
Establish investor interest	Determine if existing investors (including pension funds) already making social investments or expressing interest in doing so further (e.g. through short survey)	In-house, research currently being completed by Social Investment Research Council[34]
Define investable assets universe and develop strategies	Detailed review of the definition, size, nature and potential future growth of each of the different classes of investable assets	Research providers (e.g. Bloomberg), pensions consultants, mainstream financial institutions research depts.
Investor engagement	Consider how new models of engagement could work for sharing evidence of impact with investors, e.g. using technology or new reporting methods. Also determine how the impact assessments could be delivered within existing disclosure requirements (including cost).	Employee advisors, technology platforms

2. Social investment community

The social investment community could play a key role in helping social investment funds for UK pensions develop.

Next steps	Action	Potential partners
Impact portfolio	Articulate the range of possible approaches to measuring impact for debt and equity and stress test these approaches using new approaches of measuring impact of listed portfolios of debt and equity	Social investment impact advisors, such as NPC, Big Issue Invest, Sustainalytics
Managing high impact segment	Offer to investment managers the ability to manage high impact segment and share details about costs and returns of managing current portfolio.	Social investment forum, social investment managers, existing social investment managers in France

[33] Sharia compliant pension scheme increases choice but at a cost, Financial Times, 4 July 2014
[34] The Role of Individual Investors in Social Investment, commissioned by Social Investment Research Council, forthcoming

Sell assets	Enter into discussions to sell some of existing high impact assets to seed the high impact segment of new social pension funds. This could also help spur the development of a new secondary market.	Existing foundations, social investment managers, Big Society Capital
Accredit social fund providers	Develop capacity to accredit funds or investment managers to independently certify they are appropriately social, similar to the role of *Finansol* in France. This could involve an independent committee and see a robust standard develop.	Big Society Capital, Social Stock Exchange, UKSIF

3. Pension providers

The social investment community and investment managers will only invest time in developing products if there is evident future demand for them. Pension providers, auto-enrolment providers and corporate employers (and insurers) can play a critical role in establishing that demand.

Next steps	Action	Potential Partners
Ask all existing providers	Ask all retained investment managers for information on current social investment products offering	In-house (corporate employers, auto-enrolment providers, pension platforms), social investment managers, Big Society Capital
Call for funds	Clearly articulate publicly your interest in receiving proposals about a social investment fund in a formal call for funds	Big Society Capital

Call for funds

The single most important action to occur would be for pension providers to call for the development of social investment funds for UK pensions. This would help the social investment community and investment managers develop the relevant products to meet their needs and rapidly accelerate this development process. Big Society Capital is committed to helping develop social investment funds for pensions in the UK. We are therefore very keen to work with pension providers to establish their confidence in this process and to help partner to call for funds, and are willing to commit time and resources to this effort. We are very keen to hear from any pension providers interested.

Further comments

This paper has been produced to generate discussion about how a social investment fund could be established for the UK pensions industry and what investment managers and pension providers can do to develop working products. We'd be very keen to hear your feedback about the paper, your thoughts on if and how this works for you, and whether you would be interested in working with BSC to develop these ideas further. To do so, please contact:

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