Opinion of the European Economic and Social Committee on the 'Proposal for a Regulation of the European Parliament and of the Council on European Social Entrepreneurship Funds'

COM(2011) 862 final — 2011/0418 (COD)

(2012/C 229/10)

Rapporteur: **Ariane RODERT**

The Council and the European Parliament decided, on 20 January and 17 January 2012 respectively, to consult the European Economic and Social Committee, under Article 114 of the Treaty on the Functioning of the European Union (TFEU), on the

Proposal for a Regulation of the European Parliament and of the Council on European Social Entrepreneurship Funds

COM(2011) 862 final — 2011/0418 (COD).

The Section for the Single Market, Production and Consumption, which was responsible for preparing the Committee's work on the subject, adopted its opinion on 17 April 2012.

At its 481st plenary session, held on 23 and 24 May 2012 (meeting of 23 May), the European Economic and Social Committee adopted the following opinion by 194 votes to 1 with 9 abstentions.

1. **Conclusions and recommendations**

1.1 The EESC welcomes the European Commission's proposal for a Regulation on European Social Entrepreneurship Funds to regulate the development of such funds by creating clarity and certainty for all parties concerned while facilitating cross-border raising of capital.

1.2 Social enterprise is a growing sector which makes a significant contribution to achieving the Europe 2020 goals. The EESC welcomes the Commission's interest in this sector and its willingness to support its development and growth.

1.3 Improving access to appropriate capital for social enterprise is a top priority, but the EESC would stress that this initiative should be seen as just one of many much-needed tailored financial instruments that still need to be developed.

1.4 The EESC urges the Commission to continue to use the definition of social enterprise set out in the Social Business Initiative, rather than coining a new definition. Specifically, the different approach in the Regulation to authorising the distribution of profits to owners should be fine-tuned and clarified in order to highlight the specific features of social enterprise in comparison with companies that focus strictly on maximising profit, as well as the fund's approach relative to other, more traditional, venture capital funds.

1.5 In the EESC's opinion, there is a risk that some of the proposed equity instruments may have a limited impact on investment in social enterprise, as the structure of the proposed investment instruments assume a type of ownership that, in many cases, is incompatible with the legal forms within which many social enterprises operate. As regards these legal forms, the most worthwhile instruments for further development are the proposed long-term loans and the scope for 'any other type of participation'.

1.6 Other features of social enterprise also need to be taken into consideration. For example, attention should be paid to the divestment of holdings in relation to operations involving work with vulnerable groups, the impact on social enterprises' estimation of their independence, their specific governance models, the need for long-term rather than short-term investment, and their lower financial returns.

1.7 To improve the impact of these types of funds on social enterprise, they might usefully be seen as one element of a hybrid capital solution, which is the most appropriate form of financing for social enterprise. Hybrid capital combines grants with long-term, 'patient' loans and other instruments whose durability and long-term nature are underwritten by public ownership or guarantees. Combination with other forms of private capital such as grants and donations should also be considered, along with more appropriate forms of ownership in 'portfolio undertakings' (the term used in the Regulation for the entities invested in, i.e. the social enterprises), such as non-voting shares.

1.8 The Regulation proposes that the new funds should primarily be targeted at professional investors and high net worth individuals, with a minimum investment of EUR 100 000. The EESC would however stress that such funds should eventually, under secure conditions, be opened up to the general public and to smaller investments.

1.9 The greatest challenge in this proposal is the need to measure and report on the social effects and impact on society of portfolio undertakings. The EESC recommends taking a joint study and work at EU level as a starting point, and developing criteria and indicators at national level in accordance with the form, approach and objectives of the relevant activities in cooperation with all stakeholders.

1.10 The Commission's power to adopt delegated acts to define key terms should be exercised as soon as possible based on broad and open consultation with representatives of stakeholders, i.e. collective investment undertakings, investors and social enterprises.

1.11 Investment readiness programmes and other forms of capacity-building for all parties should be set up in order to build trust and joint structures specifically tailored to such social entrepreneurship funds.

2. **Introduction**

2.1 Under the Single Market Act ([1]), the Commission is committed to taking a number of measures to support the development and growth of social enterprise in Europe. The proposal for a European legal framework for social entrepreneurship funds is one of those measures, and it is also highlighted as a key action in the Social Business Initiative ([2]).

2.2 Social enterprise is an emerging sector in the EU, and estimates suggest that social investments could grow rapidly to become a market well in excess of EUR 100 billion ([3]), underlining the potential of this emerging sector. Ensuring that the sector continues to grow would be a valuable contribution to meeting the goals of the Europe 2020 strategy. However, regulatory requirements at the EU and national levels are not designed to facilitate the raising of capital for these kinds of undertakings, as the EESC explicitly pointed out in its exploratory opinion on social entrepreneurship and social enterprise (INT/589) ([4]).

2.3 The aim of the proposal for a Regulation on European Social Entrepreneurship Funds (hereinafter 'the Regulation') is to establish uniform rules and requirements for collective investment undertakings that wish to use the designation 'European Social Entrepreneurship Fund'. The Regulation sets out rules for these funds, with the aim of building trust, certainty and confidence among investors and supporting the growth of social enterprise by improving the effectiveness of fundraising from private investors. The proposal underwent public consultation and an impact assessment in 2011.

2.4 This opinion identifies priorities and recommends clarifications that need to be taken into account if the proposal on European Social Entrepreneurship Funds is to achieve the intended result.

3. **EESC comments on the proposal for a Regulation**

3.1 *Chapter I - Subject matter, scope and definitions*

3.1.1 The EESC welcomes the Commission's intention to support and raise awareness of social enterprise in Europe, and is pleased that access to capital for growth and development is regarded as a priority area. In the Committee's view, the proposal for a Regulation could make it easier for some parts of the social enterprise sector to raise private capital. It is a much-needed initiative, alongside other proposals in the Social Business Initiative that also refer to the need for other funding solutions.

3.1.2 Capital is fundamental to the growth of social enterprise, but some of the capital described in the Regulation is, by its nature, particularly difficult to make accessible to social enterprise, particularly within the social economy. The Regulation should therefore be seen as just one of a number of measures that need to be taken to improve access to development capital for social enterprise.

3.1.3 Of the investment instruments referred to in the Regulation (Article 3(1)(c)), the emphasis should be on loan instruments such as low-interest loans, or 'patient capital', as the equity instruments can be harder for certain stakeholders to access. Many social enterprises in Europe are owned by their members, partners, foundations or non-profit organisations, which in many cases makes external ownership difficult. Other, more appropriate, forms of ownership that already exist in some Member States – such as special shares without voting rights freely transferable and various types of debt instrument – should be regarded as securities and other financial assets in social enterprise. Tax incentives should also be examined more closely as one element of the revenue model.

3.1.4 The investment instruments referred to in the Regulation (Article 3(1)(c)(v)) should place greater emphasis on the instruments commonly used by social enterprises, which are more appropriate to their characteristics, such as the equity securities, special initiatives within the financial sector (cooperative banks ([5]), ethical and social banks ([6]) and commercial banks with social programmes ([7])), innovative

([1]) COM(2011) 206 final.
([2]) COM(2011) 682 final.
([3]) See J. P. Morgan, *Impact Investments: An Emerging Asset Class*, 2011.
([4]) OJ C 24, 28.1.2012, p. 1.
([5]) www.eurocoopbanks.coop.
([6]) www.triodos.be.
([7]) www.bancaprossima.com, https://www.unicredit.it/it/chisiamo/per-le-imprese/per-il-non-profit/universo-non-profit.html and www.ubibanca.com/page/ubi-comunita.

instruments such as 'social impact bonds' [8], and favourable tax-funded solutions. These and other financial assets may form part of the 'hybrid capital', more typically used by social enterprises.

3.1.5 Public participation in these funds, for example using 'fund of funds' approaches or pension funds, should be promoted as a way of ensuring that the investments have a long-term perspective. The EESC would, however, stress that it is important not to combine public commitments with Structural Funds resources that have different political aims.

3.1.6 The definition of 'qualifying portfolio undertaking', as the Regulation calls social enterprises, sets an annual turnover limit of EUR 50 million (Article 3(d)). The Commission should consider removing this ceiling, as it is liable to discourage expansion. Such a ceiling would also exclude certain branches of social enterprise such as health and care, and social housing.

3.1.7 The EESC considers it essential that the definition of social entrepreneurship and social enterprise should be consistent with the definition in the Social Business Initiative. The Regulation proposes a somewhat modified definition for a 'qualifying social portfolio undertaking' (Article 3(1)(d)): the difference is, among other things, the description of its activities (Article 3(1)(d)(i)). The EESC believes that the mission of the organisation serves better, as social enterprise is a complex sector with a variety of activities.

3.1.8 With regard to profits (Article 3(1)(d)(ii)), the EESC refers to its opinion INT/589, which clearly states that social enterprise is 'primarily not-for-profit, with surpluses principally being reinvested and not being distributed to private shareholders or owners'. The statement in the Regulation that profits are permitted and may be distributed to shareholders and owners needs to be clarified by further specifying that the profit must be used to achieve the enterprise's primary social goal and that, in the very rare cases where exceptions to this may be granted, rules must be laid down to ensure that the social goal is not jeopardised. This approach, and the associated rules, should be clarified in the Regulation, in particular to differentiate it from the parallel process relating to the Regulation on venture capital funds, which targets small and medium-sized enterprises [9].

3.1.9 The types of services or goods, the methods of production of services or goods, and the target groups of activities with a social objective (Article 3(1)(d)(i) and Article 3(2)) must be defined in consultation with a working group representing social enterprise. It is important for this working group to reflect the diversity of social enterprise in Europe.

3.1.10 A fourth requirement should be applicable to 'qualifying portfolio undertakings'. In the case of dissolution of the social enterprise, the majority of its net assets (for example a minimum of 60-70 %) cannot be distributed amongst partners, shareholders, owners or workers but must be used for social impact objectives.

3.1.11 The Regulation will initially be addressed to professional investors and 'high net worth individuals'. This should also include specialist investors from the public and not-for-profit sectors, such as cooperative banks and socially oriented financial institutions. However, the EESC recommends that the Commission establish, as soon as possible, a timetable for opening the fund up to the general public, as participation of this kind is also of considerable public interest.

3.2 *Chapter II – Conditions for the use of the designation 'European Social Entrepreneurship Fund'*

3.2.1 In the EESC's view, the proportion of qualifying portfolio undertakings in a fund – which must account for at least 70 % of a fund's assets – is suitable as a first step. However, it is also advisable to regulate what assets are not permitted in the remaining 30 % of the fund's assets, to further highlight the fund's focus on social enterprise. An assessment of whether the acquisition of assets other than qualifying investments is appropriate should always be required (Article 5(1)). Solid, sustainable investments such as government bonds should be encouraged, in order to stabilise the fund. For the same reason, the definition of 'cash equivalents' should be clarified.

3.2.2 There are a number of similarities between the proposal for a Regulation on European Social Entrepreneurship Funds and the UCITS Directive [10]. These similarities and differences should be clarified, particularly with regard to the definition of professional clients (Article 6), the activities of managers (Article 7) and the application of the funds (Article 8). As social enterprises are often small and locally based, it is important to make it easier for smaller funds too to operate in this market. In the longer term, therefore, the minimum investment threshold of EUR 100 000 should be reconsidered (Article 6(a)).

3.2.3 It is important to be able to rapidly identify, prevent, manage, monitor and disclose any conflicts of interest, and measures to avoid conflicts of interest must be in place before the Regulation enters into force. It is important for the Commission to clarify, at this early stage, what steps it has in mind (Article 8(5)), and also to make it clear what rules apply if conflicts of interest arise between portfolio undertakings and investors and/or fund managers (Article 8(2)).

[8] www.socialfinance.org.uk/sib.
[9] COM (2011) 860/2 final.
[10] Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009.

3.2.4 The Regulation on Social Entrepreneurship Funds is wholly dependent on the ability to quantify social effects and impact on society, which is very difficult. There is currently no one unambiguous method that can readily be applied to the environment in which European Social Entrepreneurship Funds operate. It is important to measure the social impact (in both qualitative and quantitative terms) of activities rather than of the undertakings in the portfolio. Instead of trying to find ***a single*** uniform method for monitoring and assessing social impact, it would be more helpful to develop an EU framework with criteria and measurable indicators framed at national level. The Commission should clarify, at this stage already, what its intentions are in relation to measuring social effects and impact on society, by launching a study of different measurement methods and experiences in cooperation with social enterprises, researchers and capital providers.

3.2.5 One of the key foundations of social enterprise is independence. The procedures to be put in place by fund managers – which under the Regulation are to include 'measuring and monitoring … positive social impacts' – should therefore be defined more clearly, i.e. as their obligation to report to investors on the social impact in order to ensure that holdings really are in social activities (Article 9(1) and (2)). The lack of clarity here fosters misunderstandings about the role of fund managers, and therefore must be rectified. It is both inappropriate and unrealistic to require fund managers to measure and monitor the social impact, partly because it would reduce the independence of social enterprises and partly because of the lack of appropriate and effective measuring and monitoring methods.

3.2.6 The measurement issue is also reflected in the rules concerning the annual report and the method used to measure social outcomes (Article 12(2(a)). It must be made clear how this reporting relates to the technical measurement specifications that the Commission intends to produce.

3.2.7 The annual report also provides an opportunity for fund managers to make divestments in relation to portfolio undertakings (Article 12(2)(b)). The Regulation needs to make it clear what rules apply to divestments of assets in qualifying portfolio undertakings. Assets of a social enterprise working with vulnerable target groups cannot be divested in the same way as holdings in commercial undertakings, due to the delicate nature of the work. Investors and fund managers must be made aware of the special nature – and thus sensitivity – of these activities and adjust their behaviour accordingly. The Commission should also indicate how account is to be taken of the secondary market created by such divestments. Many social enterprises depend on long-term, reliable investments to be able to develop their activities.

3.2.8 It is important to clarify how the measurement methods the Commission is intending to develop relate to the method that fund managers are supposed to use for reporting and the basis for the information they send to investors (Article 13(1)(c) and (d)). It is also important to give a definition of assets other than qualifying portfolio undertakings and to describe the criteria used for selecting these assets. The Regulation should include rules defining non-qualifying assets and investments for this part of the fund as well (Article 13(1)(e)). With regard to a fund's valuation procedure and pricing methodology (Article 13(1)(g)), the EESC believes that a model needs to be developed that is specifically tailored to the forms and activities of social enterprises.

3.3 *Chapter III – Supervision and administrative cooperation*

3.3.1 Rules on administrative measures and sanctions applicable to breaches of the provisions of the Regulation must be uniform across the EU, and such rules should therefore be framed at Community level, and not left up to the Member States (Article 20(2)). These rules must be effective, proportional and dissuasive. Measures thus need to be found in addition to a simple ban on using the designation 'European Social Entrepreneurship Fund', as the initiative also aims to create trust, and therefore to minimise abuse. Protective mechanisms need to be established for portfolio undertakings within funds, so that they can continue their activities if sanctions are imposed on the fund manager.

3.4 *Chapter IV – Transitional and final provisions*

3.4.1 The Regulation states in several places that delegated powers are conferred on the Commission for a period of four years after the Regulation enters into force in 2013. The majority of these powers are key to the design of the funds, such as the area of activity (goods, services and production methods), any distribution of profits and conflicts of interest. All stakeholders – i.e. collective investment undertakings, investors and social enterprises – must be involved in the process of defining these delegated acts. The stakeholder group referred to in the Social Business Initiative could play a key role here.

4. **Other comments**

4.1 It is important for the impact of this Regulation to be monitored on an ongoing basis to ensure that the main target groups of social enterprise (which is often the social economy), do actually have greater access to appropriate capital. The EESC will draw attention to this on an annual basis as part of its ongoing work on social enterprise and the social economy.

4.2 As social funds in a broader sense (private or public) are an unfamiliar and relatively limited concept in most Member States, a strategy needs to be developed to raise their profile. Many countries in Europe do not have any such funds, and in

countries where they do exist there is little public awareness of them. The Commission has a key role to play in gathering and disseminating these innovative and effective tools for generating and developing growth in social enterprise in Europe.

4.3 There is also a real need to provide support and programmes for investment readiness and capacity-building (in terms of structures and understanding) targeted at all parties involved – investors, fund managers and portfolio undertakings – at both EU and Member State level. The 'intermediaries' already in place in a number of Member States have a key role to play here, and should be encouraged. It is also worth mentioning that investments in social enterprise have been identified as low risk in a number of contexts [11], which should be highlighted in these programmes.

4.4 The Regulation talks improperly very often of 'shareholders' of social enterprises, implying therefore that the publicly incorporated company by shares is the most usual social enterprise. This is not true and can be misleading. The right thing is to use the term 'member' or 'partners' of social enterprises, consisting mainly of cooperatives, associations, foundations and limited liability companies (which have no shares but social participations and members).

Brussels, 23 May 2012.

The President
of the European Economic and Social Committee
Staffan NILSSON

[11] Bank of Italy, 2011, notes a default rate for non-profit institutions of 4.3%, well below the average default rate for all sectors (5.4%), for non-financial firms (7.9%) and for micro-enterprises (10.3%). In addition, Cooperative Banks (BCC) showed a default rate for non-profit institutions of only 0.6% (source: Federcasse, Italian National Association of Cooperative Banks).