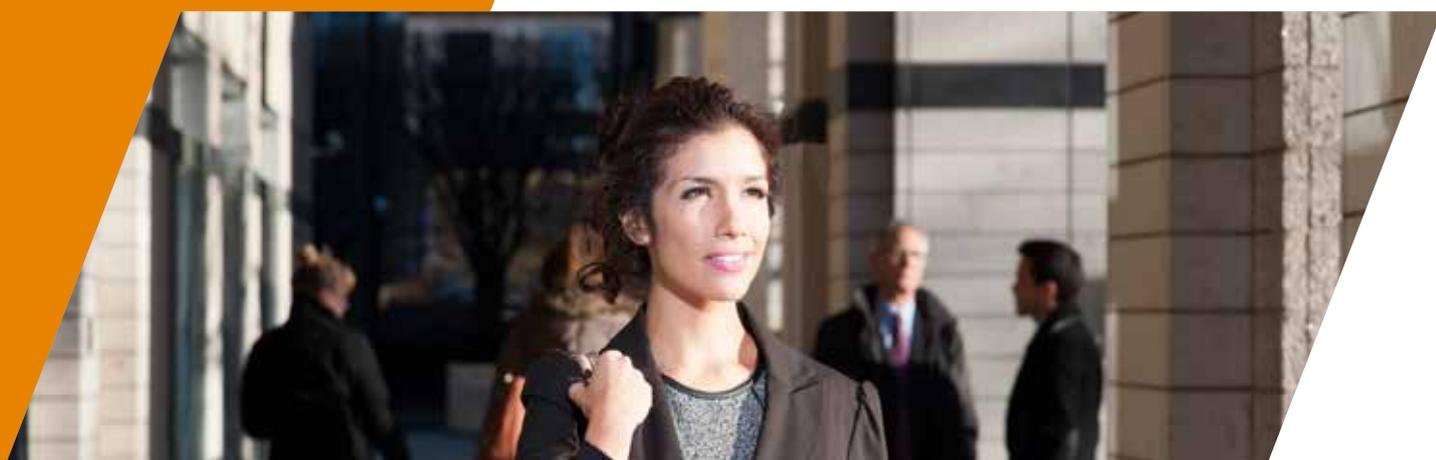


Call for Input: Regulatory Barriers to Social Investments

December 2015



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We are asking for comments on this Call for Inputs by 14 March 2016

You can send comments to us using the form on our website: <http://www.fca.org.uk/your-fca/documents/call-for-inputs-social-investments>

Or in writing to:

The Social Investment Team
Strategy & Competition, Policy Division
Financial Conduct Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

Email: socialInvestmentsFCA@fca.org.uk

We make all responses available for public inspection unless the respondent requests otherwise. We will not regard a standard confidentiality statement in an email message as a request for non-disclosure.

Despite this, we may be asked to disclose a confidential response under the Freedom of Information Act 2000. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the Information Commissioner and the Information Rights Tribunal.

You can download this Call for Inputs from our website: www.fca.org.uk. All our publications are available to download from www.fca.org.uk. If you would like to receive this paper in an alternative format, please call 020 706 0790 or email: publications_graphics@fca.org.uk or write to: Editorial and Digital team, Financial Conduct Authority, 25 The North Colonnade, Canary Wharf, London E14 5HS

Abbreviations used in this paper

CCBS Act	Co-operative and Community Benefit Societies Act 2014
CICR	Community Interest Company Regulator
COBS	Conduct of Business Rules in FCA Handbook
EuSEF	European Social Entrepreneurship Funds
FSCS	Financial Services Compensation Scheme
FSMA	Financial Services and Markets Act 2000
MiFID	Markets in Financial Instruments Directive (EU Directive 2004/39/EC) as amended by EU Directive 2014/65/EU
the Ombudsman	Financial Ombudsman Service
OSCR	Office of the Scottish Charity Regulator
UCIS	Unregulated Collective Investment Schemes
RAO	Regulated Activities Order

1. Overview

Introduction

- 1.1** Social investments aim to provide a wider social benefit than an investment where the primary purpose is a purely financial benefit. They are also different from donations where the donor does not expect to get any money back. Social investors generally either expect to get back their initial investment or they expect the organisation to use the investment for its work and provide a return to investors where it can. Social investments can include:
- unlisted equity or debt securities issued by a social enterprise,
 - units issued by unregulated collective investment schemes (UCIS),
 - withdrawable shares issued by societies registered under the Co-operative and Community Benefit Societies Act in Great Britain or the Industrial & Provident Societies (Northern Ireland) Act in Northern Ireland, referred to collectively as co-operative and community benefit societies in this document
 - traditional green or 'ethical' investments.
- 1.2** This is a relatively new but growing market. Studies show that the UK social investment market is currently worth just over £200m¹, although retail investors currently have a minority stake. There are an estimated 180,000 SME social enterprise in the UK, rising to 688,000 if sole traders are also taken into account.²
- 1.3** When we consulted on "*the FCA regulatory approach to crowdfunding (and similar activities)*"³, some respondents from the social investment sector raised concerns about the potential impact of regulation of crowdfunding on the growth of the social enterprise sector, which often relies on crowdfunding for capital.
- 1.4** In our follow-up Policy Statement on "*The FCA's regulatory approach to crowdfunding over the internet, and the promotion of non-readily realisable securities by other media*"⁴, we said we would comment further on the social investment sector. . This Call for Input is our follow-up to this commitment. We want to:
- explain the different structures a social enterprise in the UK can have and how our rules may apply and
 - ask for views about specific rules and policies which may be hindering investment for social

1 www.cityoflondon.gov.uk/business/supporting-local-communities/Pages/Social-investment-FAQs.aspx

2 ibidem

3 www.fca.org.uk/news/cp13-13-regulatory-approach-to-crowdfunding

4 www.fca.org.uk/news/ps14-04-crowdfunding

purposes.

- 1.5** While some consumers may invest in products with a social purpose primarily for the social benefits they offer, other consumers will see the social objective of an investment as an added benefit rather than as the primary purpose for their investment. In line with our mandate, we will therefore look to consider the adequate protections for retail investors. It is important that we can balance the differing expectations of consumers when making investments against the differing degree of risk. Retail investors may be more familiar with these products than institutional investors.
- 1.6** This document provides a useful guide for social enterprises and other stakeholders. It should help them understand the different regulatory requirements which apply to them, such as the financial promotion rules. The responses will also give us and other regulatory bodies a better understanding of the barriers social enterprises may face in establishing themselves and raising capital.

Who does this document affect?

- 1.7** This document will be of interest to:
- individuals who want to set up a social enterprise
 - existing social enterprises that want to raise capital
 - social enterprises that are subject to investment by investment funds
 - financial advisers interested in offering social investments to their clients and
 - retail investors and consumer organisations with an interest in investments that have an underlying social purpose.

Next steps

- 1.8** We will review the responses we receive and consider any further actions we may need to take.

Sending your input

- 1.9** We need to receive your evidence by 14 March 2016. We cannot commit to review any evidence we receive after that date.
- 1.10** We will treat all responses as available for public inspection unless you ask us not to. We will not take a standard confidentiality statement included in an email message as a specific request for non-disclosure. We may be asked to disclose a confidential response under the Freedom of Information Act 2000, and we will consult you if we receive this request and it affects you. Any decision we make not to disclose the response can be reviewed by the Information Commissioner and the Information Rights Tribunal.

2. The Current Regulatory Framework

- 2.1** In this chapter, we set out the situations when our rules apply to social enterprises wishing to raise capital. Our aim is to clarify how and when our rules apply to social enterprises and retail investors.
- 2.2** We have four ways for consumers to finance enterprises with a social goal:
- Donation-based: consumers can decide to give money to social enterprises whose activities they support
 - Reward based crowdfunding: In return for backing a project, supporters receive rewards which may be a simple public acknowledgement of the support, or free gifts such as theatre tickets
 - Investment-fund based: Investors can decide to invest in an unregulated collective investment scheme whose investment strategy is to invest in assets with a social purpose. They may also be able to invest in European Social Entrepreneurship Funds or in green or 'ethical' funds
 - Investment-based: Investors invest directly in new or established social enterprises by buying shares or debt securities
- 2.3** We do not regulate donations or reward based crowdfunding. However, when firms promote or sell units in unregulated collective investment schemes ('UCIS'), or securities issued by social enterprises, our rules may apply to them. This is because shares in a company, most debt securities, and units in collective investment schemes are all classified as 'specified investments' in the [Regulated Activities Order 2001](#) ('RAO').
- 2.4** Arranging the sale of investments, advising on these investments, or managing these investments are all regulated activities, as set out in the RAO, and we authorise and regulate firms that undertake these activities. In general, firms need to be authorised, have their promotions approved by an authorised firm, or ensure an exemption in the Financial Promotion Order is available, or that the RAO does not apply, before they can promote their investments. Additionally, the legal structure of a social enterprise may also affect the forms of finance they can use, how they can come within our scope and what exemptions to this are available.
- 2.5** The first infographic below gives an overview of the different structures a social enterprise can use. It describes how they can raise capital, how they can market their securities or products, and who they can sell them to. The aim is to provide individuals involved in, or planning, a social enterprise with a good understanding of what they need to consider when deciding upon a corporate form.

Forming a social enterprise: Step 1

1. Financial Conduct Authority or Department of Enterprise, Trade and Investment NI

- Societies registered under the Co-operative & Community Benefit Societies Act (CCBS Act) or under the Industrial & Provident Societies (NI) Act.

2. Community Interest Company Regulator

- Community Interest Companies limited by shares or guarantee.

Where should I register?

3. Companies House

- Charitable companies.
- All public or private companies limited by shares or guarantee.

4. Charity Commission, Office of the Scottish Charity Regulator, or the Charity Commission for Northern Ireland

- Charitable companies (dependent on jurisdiction).

1. FCA: Societies Registered under The Cooperatives and Community Benefit Societies Act ('CCBS Act'):

The FCA must be satisfied that that you meet the requirements to be a 'co-operative', or a 'community benefit society' as set out in the CCBS Act. In Northern Ireland, you are registered under the Industrial and Provident Societies Act (Northern Ireland) 1969 by the Registry of Credit Unions and Industrial & Provident Societies. Community Benefit Societies may also be charitable.

2. Community Interest Company Regulator: Community Interest Companies

Community Interest Companies may be private companies limited by shares or guarantee, or public companies. To qualify for registration, you must satisfy the office of the Community Interest Company Regulator ('CICR') that your activities will be carried on for the benefit of the community (the 'community interest test'). You must also register with Companies House.

3. Companies House: Companies

As a company, you can take one of three forms: a public company (which is limited by shares); a private company limited by shares and a private company limited by guarantee. You must register at Companies House.

4. Charity Commissions: Charities

A charity which proposes to be either a company or a community benefit society, a Charitable Incorporated Organisation ('CIO') or a Scottish Charitable Organisation ('SCIO') must register with the appropriate authority to establish a corporate vehicle. Subject to the exceptions available in England & Wales, all charities must also register with their national charity regulator: the Charity Commission (England & Wales) (which also registers 'CIOs'), the Office of the Scottish Charity Regulator (which also registers 'SCIOs') or the Charity Commission for Northern Ireland.

In England & Wales, community benefit societies cannot also register with the Charity Commission.

How can I raise Capital?

Forming a social enterprise: Step 2

How can I raise capital?

1. Shares and bonds

- Societies registered under the Co-operative & Societies Act.
- Public companies limited by shares.
- Public community interest companies limited by shares.

2. Bonds only

- Private companies limited by guarantee.
- Private community interest companies limited by guarantee.
- Charitable companies.

1. Shares and Bonds

Co-operative and Community Benefit Societies can issue bonds and withdrawable shares. You can only sell these shares to members, who must apply to the society if they want to cash them in. Societies must specify how much notice of withdrawal they must receive, and under what condition they can withhold repayment or write down the value of shares. In some circumstances, societies can also issue transferable shares, which can be traded between buyers and sellers with the society's consent.

All forms of public companies can issue shares and bonds but they are bound by the terms of their memorandum of association. In certain circumstances, and if the total offer is more than €5 million, they may need to abide by the Prospectus Rules.

Public Community Interest Companies Limited by shares can issue shares and bonds but a minimum of 65% of any profit must be reinvested back into the company or used for the community which the company was set up to serve.

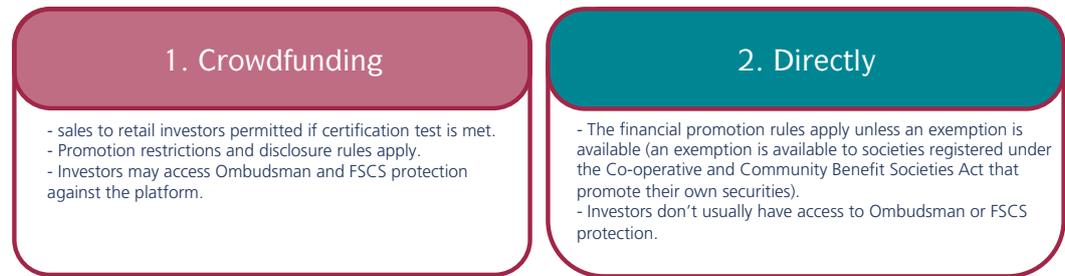
2. Bonds only

Private Companies and Community Interest Companies that are limited by guarantee have no share capital. They often raise funds through grants or donations because they are not allowed to market their securities to the public.

Charities are often funded by grants and donations. However, some charities have the power to issue debt instruments.

How can I market to retail investors?

Forming a social enterprise: Step 3



How can I reach retail investors?



1. Crowdfunding

You can market your shares or bonds through a crowdfunding platform. In this case, the platform acts as the FCA-authorized firm that approves your invitation to people to invest (the financial promotion).

The platform must follow the rules in our Conduct of Business Sourcebook. These rules include requirements for all communications to be fair, clear and not misleading and firms may only sell securities that are not readily realizable to retail investors if they certify that they:

- are high net worth, or
- are sophisticated, or
- have received advice from a firm authorised by the FCA, or
- will not invest more than 10% of their net investable assets in these types of security.

Where no advice is provided, the crowdfunding platform is also responsible for checking that the investor has the necessary knowledge or experience to understand the risks involved in investing in your securities, as set out in our Conduct of Business Sourcebook Section 10.

These rules do not apply if the shares are withdrawable shares issued by a co-operative or community benefit society. The financial promotion rules also do not apply to debt securities bought directly from these enterprises.

2. Directly

One way to attract retail investors is to market products by issuing a 'financial promotion'. This is an invitation to one or more people to invest. Unless exemptions apply to the promotion (if you are a co-operative or a community benefit society issuing withdrawable shares or debt securities), it must be approved by an authorised firm. The promotion must meet the requirements of our Conduct of Business Sourcebook Chapter 4; for example, it must be clear, fair, and not misleading. Once your financial promotion has been approved, you can issue your securities to investors without being subject to other FCA rules.

3. A Financial Adviser

Before advising investors to invest in unregulated collective investment schemes that invest in social enterprises or in securities from social enterprises, financial advisers must meet European rules set out in the Markets in Financial Instruments Directive ('MIFID') and implemented in FCA Conduct of Business 9 rules, and perform a 'suitability test'.

This means they must assess the investor's financial position, their investment objectives (including how long the investor wishes to hold the investment and what they wish to achieve) and their appetite for risk.

4. Investing in a European Social Entrepreneurship Fund ('EuSEF')

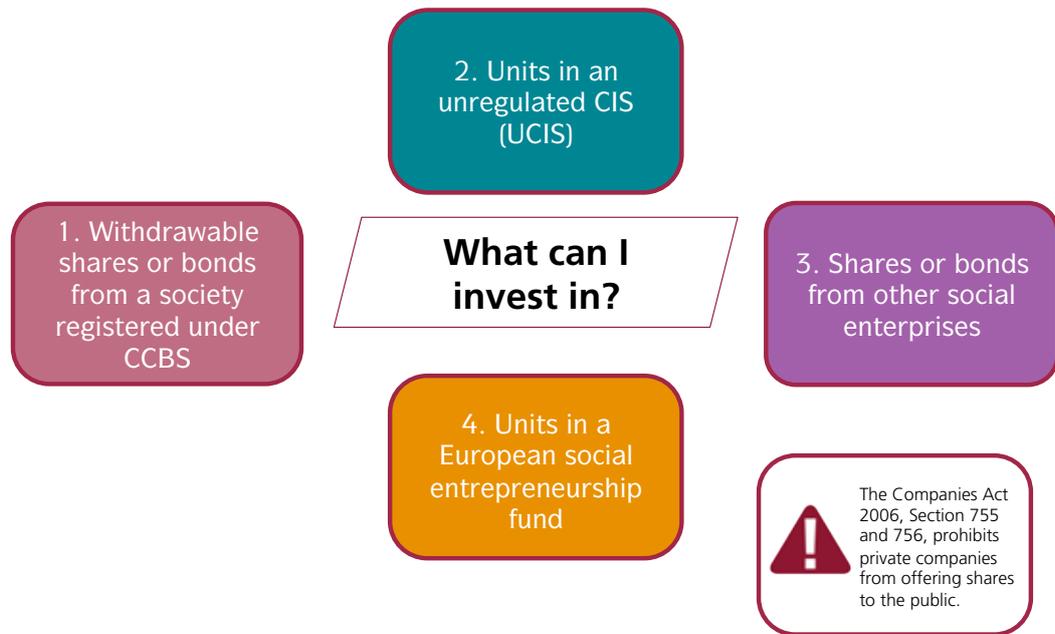
EuSEFs are a type of investment fund created by European legislation. EuSEFs have to invest up to 70% of their capital in social businesses. The legislation allows asset managers to market their funds across Europe and makes it easy for investors to identify investment funds that have a social purpose.

5. Private Companies

Private companies are prohibited by Section 755 of the Companies Act 2006 from issuing securities to the public.

What can I invest in?

Investing in a social enterprise: Step 1



1. Withdrawable shares or bonds from a society registered under the Co-operatives & Community Benefit Societies Act

Withdrawable shares are shares that you can only sell back to the society, not to anyone else. The society’s share offer document will state when you can cash in your shares and how much notice you must give. If the society suspends share withdrawals you may not be able to cash in your shares. There is a legal limit to the value of society shares one person can hold in a single society: £100,000 in Great Britain and £20,000 in Northern Ireland.

Bonds are a form of debt finance, not units of ownership in a company. Bonds are a loan directly from you to the organisation. A society has to repay the amount of the bond to the investor; usually they will do this with some form of interest.

2. Units in an unregulated collective investment scheme (‘UCIS’)

A collective investment scheme is one where several investors pool their money in an investment fund. A fund manager will invest the pooled money in one or more types of asset, such as in social enterprises. We do not regulate investment funds that invest in social enterprises. Because of this, they cannot generally be marketed to retail investors unless they have received advice to invest in these funds from a firm or advisor we regulate.

3. Shares or bonds issued by other social enterprises

When you buy shares, you effectively buy some ownership of an enterprise. The enterprise has no legal obligation to repay the amount invested, or to pay interest (or dividends). Social enterprise shares are not usually publicly traded on a recognised stock exchange, which means it will be more difficult to find a buyer for your shares quickly.

Bonds are a form of debt finance, not units of ownership of a company. They can be considered as a loan directly from the investor to the enterprise. Bonds require the enterprise to repay the amount effectively borrowed from the investor, and usually they will do this with some form of interest.

4. Units in a European Social Entrepreneurship Fund ('EuSEF')

EuSEFs are a type of investment fund created by European legislation. EuSEFs have to invest up to 70% of their capital in social businesses. An investor must invest a minimum of €100,000 and state in writing that they are aware of the risks associated with investing in such a fund.

How can I invest in a social enterprise?

Investing in a social enterprise: Step 2



How can I invest?



1. Crowdfunding Platform

Crowdfunding allows investors to invest through an online platform. You can only invest in a social enterprise's unlisted securities if you certify that:

- you are a high net worth individual (your annual income must be at least £100,000 or your net investable assets must be at least £250,000 excluding primary residence, pension and insurance) or
- you are a sophisticated investor (who has the knowledge and experience required) or
- you have received advice from a firm authorised by the FCA or
- you will not invest more than 10% of your net investable assets in these types of security.

Unless you are taking financial advice from a firm authorised by the FCA, the platform must ask questions so they can assess whether you have the necessary knowledge or experience to understand the risks involved in the investment. For example, it is important that investors understand that the securities may not be easy to sell on and they may not get back their capital or an investment return. While everyone can invest in the unlisted securities of social enterprises, these FCA rules mean that firms must check investors understand the risks or limit their exposure to an affordable amount.

FCA rules do not apply if the securities are withdrawable shares issued by a co-operative or a community benefit society.

2. Financial Adviser

Financial Advisers must be authorised by us and must comply with our Conduct of Business rules. An adviser can only advise you to invest in unregulated collective investment schemes or in securities issued by social enterprises if this is suitable for your personal circumstances. They must carry out a 'suitability test' to assess your financial position, your investment objectives (including how long you wish to hold the investment and what you wish to achieve) and your appetite for risk.

3. Directly in a social enterprise

Social enterprises sometimes issue their own invitations to buy shares or bonds. They must make sure that an FCA-authorised firm has approved the financial promotion before they begin it. When the firm has given its approval, the social enterprise can market its securities to you directly without being subject to further FCA rules.

Co-operative or community benefit societies issuing withdrawable shares or debt securities do not have to get this financial promotion approval as the requirements do not apply.

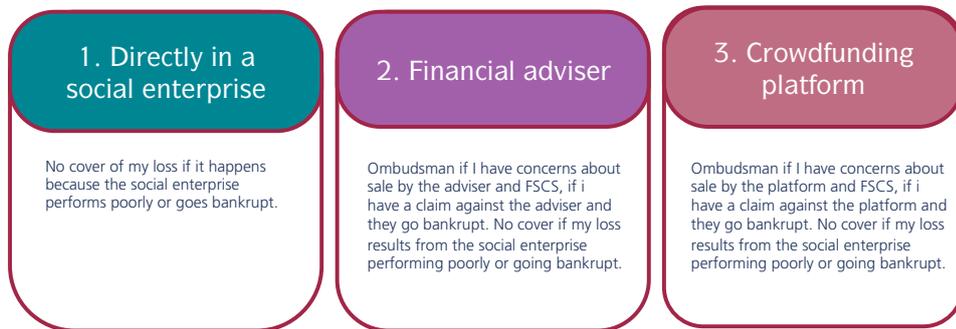
4. EuSEF fund

EuSEFs are a type of investment fund created by European legislation. EuSEFs have to invest up to 70% of their capital in European businesses. An investor must invest a minimum of €100,000 and state in writing that they are aware of the risks associated with investing in such a fund.

How is my investment protected?

Investing in a social enterprise: Step 3

How is my investment protected?



1. Directly in a social enterprise
You cannot use the Financial Ombudsman Service or the Financial Services Compensation Scheme if the enterprise performs poorly, if you have wider concerns about the investment, or if the enterprise goes bankrupt. This is because social enterprises are exempt from FCA rules for selling their securities.
2. Financial Adviser
A financial adviser must meet the rules in the FCA Conduct of Business rules. The adviser must ensure the product is suitable for you and your objectives when they advise you to invest in it. If you have concerns about the way the investment was sold to you and do not feel they have resolved this satisfactorily, you can take your complaint to the Ombudsman. If you lose your money because you have received unsuitable advice and the adviser goes bankrupt, you may use the Financial Services Compensation Scheme ('FSCS').
3. Crowdfunding platform
Crowdfunding platforms must meet the applicable rules in the FCA Conduct of Business. For example, all communications must be fair, clear and not misleading and, where investors act without taking financial advice from a firm authorized by the FCA, firms must check that investors have the necessary knowledge or experience to understand the risks involved in investing in unlisted securities. If you have concerns about the way the investment was sold to you, you can complain to the firm. If you do not feel they have resolved your complaint satisfactorily, you can take your complaint to the Financial Ombudsman Service (the Ombudsman). If you lose your money because you have a claim against the crowdfunding platform and it goes bankrupt, you may use the Financial Services Compensation Scheme ('FSCS').
However, if you lose your money because you have invested in a social enterprise that performs poorly, you will not have access to the Ombudsman or the FSCS.

3. The Call for Input

3.1 During our consultation on the “regulatory approach to crowdfunding and similar activities”

(CP13/13)⁵, some stakeholders in the social enterprise sector raised concerns about the impact of regulation and the potential inability of consumers to make social investments. We held discussions with industry participants who told us that we could help some social enterprises by explaining our regulatory approach to their specific sector, as they sometimes struggled to understand how our approach applied to their specific form.

3.2 We hope chapter 2 on the regulatory framework that currently applies will help social enterprises and retail investors, respectively, to understand the requirements they must meet and the protection they have if they invest in investments with a social as well as financial purpose.

3.3 Based on the responses to CP13/13, we also agreed to look at the social investment sector, which we do in this call for input. We want to understand the factors that could potentially restrict this market, place a disproportionate burden on social enterprises that want to raise capital and on those wishing to market these products or securities to potential retail investors. We would like respondents to consider both FCA rules and other types of legislation and highlight which rule is specifically causing them difficulties when they respond.

3.4 We are also interested in views about the potential risks to consumers investing in this sector. This is because it is important, as part of our consumer protection responsibility, that investors are making informed decisions and understand the risks associated with making social investments. We are also interested in evidence about consumer demand for these products, particularly which groups of consumers are making these types of investments.

Questions for social enterprises

Q1: Have you experienced any problems trying to establish a social enterprise or raise capital for a social enterprise? If yes, please provide details of the problems, identifying in particular those caused or exacerbated by regulation. Where a problem is caused by FCA rules or policies, please identify the rule and explain why.

Q2: How are you interested in raising capital? Who is your target client base for the products you will sell to raise capital?

⁵ <http://www.legislation.gov.uk/apni/1969/24/contents>

Questions for financial advisers and other intermediaries, including crowdfunding platforms

Q3: Have you experienced problems in advising investors who wish to invest in social enterprises, or for whom investment in a social enterprise may be suitable? If so, please provide details of those problems.

Questions for consumers & consumer groups

Q4: Have you identified barriers to investment in the social sector for retail investors? If yes, please provide details of these barriers, in particular identifying those that may be caused by regulation.

Q5: What kind of rules do retail investors need to consider when making sound investment? Have you identified any consumer protection concerns in this area? Please explain these concerns and how they might be addressed.

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

Financial Conduct Authority



PUB REF: 005163

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