Big Society Capital:

Unlocking mainstream finance for social impact investment

BACKGROUND

Big Society Capital (BSC, previously known as the Big Society Bank) has been established by government to help grow the market for social investment, thereby making it easier for social business to access capital. BSC's activities will focus largely on the 'supply side': supporting the development of new social investment products and intermediaries. But its success will depend heavily on the 'demand side': mainstream investors' willingness to engage with social investment.

According to government, BSC's success will be measured by "the amount of capital it succeeds in attracting to social investment as well as the growth and sustainability of the social investment market… Over the next two decades, its success will be reflected in the establishment of social investment as an accepted asset class."[1] Perceived regulatory barriers could limit BSC's ability to attract mainstream capital. These hitherto overlooked obstacles must be addressed if BSC is to fulfil its potential.

THE PROBLEM

Social investments are based on the concept of 'blended value': they deliver a blend of social and financial return. In some cases this will mean that investors accept below-market financial returns on investments which deliver a high social return. But many institutional investors believe that they are legally restricted to investments that maximise financial return, making them unlikely even to consider social investments.

Charitable organisations

The government has recognised this problem in relation to charitable organisations with investment assets. Following a recommendation from the Social Investment Taskforce[2], the Charity Commission was asked to review its guidance to make clear that charitable organisations can legitimately engage in social investment[3]. Existing guidance imposed overly prescriptive distinctions between grant-giving for charitable purposes and investment for financial return, making charitable organisations reluctant to pursue investment opportunities which further their mission whilst generating some financial return. The new guidance is expected towards the end of October. It is hoped that it will be far more flexible, freeing charitable trustees to pursue their charitable objectives in the way they think best, rather than fearing liability because they did not maximise return on their investments.[4]

Pension Funds

But if the BSC is to succeed in its mission, it must reach out beyond philanthropic investors to mainstream institutional investors – including the £1450bn held in our pension funds.[5] As the Social Investment Taskforce notes, "A vibrant social investment market depends on the active participation of a wide variety of investors"[6]. The government's 'vision' for social investment foresees individual savers choosing to invest for good, and urges that "pension fund managers must seriously consider social investment products as and when they emerge"[7]. Yet this vision seems unlikely to become a reality unless current restrictive interpretations of the law are changed.

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POLICY BRIEFING

The legal duties of pension fund trustees tend to be seen in even more restrictive terms than those of charitable trustees. Pension trustees have a fiduciary duty to act in the best interests of their members, which includes a duty to invest their money prudently. This is generally interpreted as a requirement to maximise risk-adjusted returns and ignore all other considerations .[8] This narrow conception of trustees' latitude to invest has several consequences:

- *Legal handcuffs*: Trustees do not feel able to consider and accommodate members' social or ethical preferences, or their wider interest in, for example, a community with lower crime rates.
- *Misaligned incentives*: Investment managers are evaluated based on short-term, benchmark-relative returns, giving them little room to consider social investments which might lead to short-term underperformance even if they might be financially prudent over the longer term.
- *Herding behaviour*: Departing from conventional investment norms is assumed to be legally risky. This can hold back the development of new asset classes, such as social investment.
- *Cultural hostility*: Fear or suspicion of anything concerned with non-financial impacts could mean that even social investments which are financially attractive are ignored.

Of course it is important that trustees do not pursue their own interests – including their social and political agendas – at the expense of beneficiaries. But current interpretations of the law go far beyond this core principle. Trustees with their beneficiaries' best interests at heart should be free to make reasonable, prudent decisions without fear of liability. The law should not bar them from weighing up all relevant factors and investment options, or from pursuing innovative new ways to serve their members' interests.

THE SOLUTION

FairPensions' recent report, '*Protecting our Best Interests: Rediscovering Fiduciary Obligation*', analyses relevant case law and finds that the law may be less restrictive than is often assumed. However, it also finds that the legal position remains unclear in several respects[9]. We therefore recommend that statutory clarification is needed to restore common sense to the law. We suggest that such a measure could be modelled on directors' duties under the Companies Act 2006[10]. We also suggest that pension fund trustees would benefit from more detailed guidance, similar to the Charity Commission's guidance for charitable trustees. Such guidance should be flexible and non-prescriptive, with the aim of creating an enabling environment.

ABOUT FAIRPENSIONS

FairPensions is a registered charity that promotes Responsible Investment (RI) by pension schemes and fund managers. RI generally involves shareholder engagement with companies to ensure that environmental, social and corporate governance (ESG) risks with the potential to affect long-term financial returns are monitored and managed. We also work with policymakers to improve transparency and accountability to savers, and to remove regulatory barriers to RI.

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1. Cabinet Office, 'Growing the Social Investment Market: A Vision and A Strategy', Feb 2011
2. Final Report of the Social Investment Taskforce, April 2010
3. Charity Commission, 'Consultation: Charities and Investment Matters', December 2010 , http://www.charitycommission.gov.uk/About_us/About_the_Commission/Consultation_char_invest.aspx
4. FairPensions' response to the consultation on draft revised guidance can be found at http://www.fairpensions.org.uk/sites/default/files/uploaded_files/CC14ResponseFeb2011.pdf
5. Towers Watson, Global Pension Asset Study 2011, www.towerswatson.com/assets/pdf/3761/Global-Pensions-Asset-Study-2011.pdf – based on figure of US$2279bn converted at today's exchange rates.
6. Final Report of the Social Investment Taskforce, April 2010
7. Cabinet Office, 'Growing the Social Investment Market: A Vision and A Strategy', Feb 2011
8. See FairPensions, 2011, 'Protecting our Best Interests: Rediscovering Fiduciary Obligation', Ch1.
9. See Chapter 4 of the report for more details.
10. Section 172(1), Companies Act 2006. For more details see Chapter 6 of our report.