EUROPEAN VENTURE PHILANTHROPY ASSOCIATION

# SOCIAL IMPACT STRATEGIES FOR BANKS

## – VENTURE PHILANTHROPY AND SOCIAL INVESTMENT

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London Business School

DR. LEONORA BUCKLAND | MARCH 2014

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# TABLE OF CONTENTS

## About the Report

This report explores how banks can use their core strengths – financial acumen, investment skills, capital and networks – to actively generate social impact by engaging in venture philanthropy and social investment. Venture philanthropy (VP) and social investment (SI) are philanthropic and investment tools to create more resilient and stronger social purpose organizations able to generate greater social impact. Concretely it means investing (money and management skills) in social enterprises, non-profit organisations and charities so that they can do their job better.

The report seeks to show the full range of VP and social investment initiatives and activities by banks based in Europe, whilst being particularly interested in those that have an engaged investment or venturing dimension. Furthermore, we selected cases that would illustrate a diversity of approaches. At this point in the evolution there are already several pioneering initiatives and exciting stories to share about what can be done by banks in this field. The objectives of the report are:

- To create wider knowledge of how banks in Europe are currently creating social impact through VP and social investment
- To share best practice examples and lessons from banks in Europe pioneering VP and social investment
- To provide practical recommendations and an overview of different strategies for banks engaging in VP and social investment
- To catalyse greater (financial and human capital) investment in VP and social investment initiatives across the banking sector in Europe

This report explores the different strategies banks can adopt in order to increase their positive impact on society, and focuses specifically on strategies that have a primary social impact objective as opposed to investments that aim to maximize financial returns by investing in industries that may have social and/or environmental benefits (e.g. cleantech). As such, the report does not explicitly address those impact investing strategies that aim to generate a financial return first, and where the social impact is a positive side-effect rather than the primary objective. The general term impact investing is frequently used by the banks and often used interchangeably with social investment.

The report was developed with key input from interviews with both executives at banks as well as with other experts on the VP/social investment sector. The interviews were complemented with extensive desk research using external publications, banks' websites and banks' external reports. We are deeply grateful to the people that took time to contribute their ideas and knowledge to this report. A list of sources can be found at the end of the publication.

# Preface

# PREFACE

## Introduction

**A social motive and a profit motive are working together to make investing for social impact an attractive opportunity for banks**. As a result of the financial crisis, many banks are under pressure to be more explicitly and consciously socially-oriented in their business models, moving beyond traditional philanthropy and Corporate Social Responsibility (CSR) towards changing core business practices. VP and social investment provide an attractive approach for banks to experiment with how they can move closer towards a shared value[1] model, whilst building on existing activities and expertise.

The case studies in this report provide concrete examples of how banks can develop strategies that generate social impact. Such strategies include:

1. **Creating a programme** which engages several different departments within the bank to **finance and mentor social enterprises**, as BBVA has done,
2. **Setting up a direct social investment fund** or a **fund-of-funds** to create **track record** and **stimulate the market** as UBS, J.P. Morgan, Deutsche Bank and BBVA have done;
3. **Intermediating individual social investment opportunities** as Bank Degroof and BNP Paribas have done,
4. **Setting up internal business units** engaged in **social investment pursuits** (such as microfinance or social enterprise financing) as Erste Bank has done.

Whilst there is clear potential and significant incentive for banks to play a major and distinct role in VP and social investment, **across the European banking sector initiatives have to date been largely fragmented and small-scale.** This can be explained by the substantial challenges and barriers to banks operating in this relatively immature sector. Moreover, the initiatives that have emerged may be seen by sceptics as PR-led exercises which are unlikely to scale or generate significant change within the banks modus operandi. A more optimistic reading which this report adopts is that they herald the first exciting signs of a real commitment and serious engagement of banks in this emerging space.

**What is evident is that banks have the skills and resources to play a defining role in the future scaling of VP and social investment.** With their deep pockets, significant CSR budgets as well as talent, banks are particularly well placed to use a mix of financing tools including grants, loans and equity as well as non-financial support to contribute to building the social enterprise/social business sector, creating and nurturing along with other players active in the ecosystem such as charitable foundations the pipeline of investible organizations and building stronger social investment intermediaries.

Banks are starting to want to understand and participate in this field, not only because it presents an opportunity, but there is a risk that if they are left out, they will be left behind. Whilst not necessarily profit-making, such initiatives in the long-term and even the medium-term may be sustainable, and will have significant positive externalities in terms of brand/CSR and employee engagement and training.

1. Porter, M. E. and Kramer, M. R. (2011), 'Creating Shared Value', Harvard Business Review.

# PREFACE

## Structure of Report

The report provides a background on VP and social investment and an overview of why VP and social investment are important for banks and why these movements also need banks to scale and thrive.

The case study section provides an overview of key European banks' activities and presents detailed case studies on interesting initiatives. The section is structured according to types of banks[2] to facilitate navigation (although most of the larger financial institutions have activities in multiple segments). The types of banks are social banks (Triodos Bank); retail banks (including Erste Bank and BBVA); investment banks (including Deutsche Bank and J.P. Morgan); and private banks (including BNP Paribas Wealth Management, UBS and Bank Degroof). The case studies are followed by a discussion of the key drivers, challenges and benefits for banks engaging with VP and social investment by type of bank (retail, investment and private).

The final part of the report includes a discussion of the different options and strategies that banks can adopt in order to engage with VP and social investment, and outlines a series of recommendations emerging from the report. It ends with a conclusion.

2. Please note that throughout the report banks have tended to be categorised into retail bank, private bank or investment bank. Although the lines between these different activities may be blurred and banks can often be combinations of all three, this categorisation has provided a framework within which to discuss VP, social and impact investment as it relates to banks in a more granular and practical way.

# PREFACE

## Executive Summary

### Why are VP and social investment important for banks?

- Social finance is considered the biggest idea to renew the relevance of finance for the 21st century, representing an attempt by banks to reconsider how and why they do business at a very fundamental level
- VP and social investment are powerful new ways for banks to illustrate that they can play a fundamental role in the solution to societies challenges after the moral awakening of the global financial crisis
- Social investment could be an enormous market opportunity and many believe represents the investment philosophy of the future – banks need to understand and gain expertise in this area
- The newer activities of VP and social investment are particularly exciting for banks as they create the possibility:
  - *to integrate a social dimension within core business activities* by creating social impact initiatives which are often revenue-generating and more than CSR but which may not yet meet normal commercial criteria
  - *to harness and channel the talent of banks employees* to create positive social change using their core skills
  - *to re-invigorate and realign philanthropic activities* with a changed environment, where social enterprise is becoming an increasingly important phenomenon and the social sector is moving from subsidy to sustainability

### Why are banks important for VP and social investment?

- Banks are an essential pillar of the social finance industry, as shown in the chart below, since they are fundamental actors in the broader financial services industry as well as sizeable philanthropic investors
- Banks have access to vast quantities of capital – financial, human, and social – which can be used to support, develop and grow the sector and, when it is ready, to mainstream it
  - **Financial capital:**
    - Banks' ability to use a mix of capital sources, including philanthropic, balance sheet and client capital makes them a distinctive and very valuable social investor, particularly in early-stage investments when patient capital is required
    - With their extensive client lists, both private and institutional, banks will be a key intermediary which is essential for the market to grow beyond its current scale and limitations
  - **Human capital:** banks have an enormous amount to contribute to the sector by putting their financial knowledge, innovation and structuring skills to work on internal or external social ventures as well as using their insight into investor requirements and financial markets to clarify how to create a more viable social capital marketplace
  - **Social capital:** activity in this sector by banks sends important signals to all intermediaries, managers and owners of capital which will be catalytic for increasing the supply of capital

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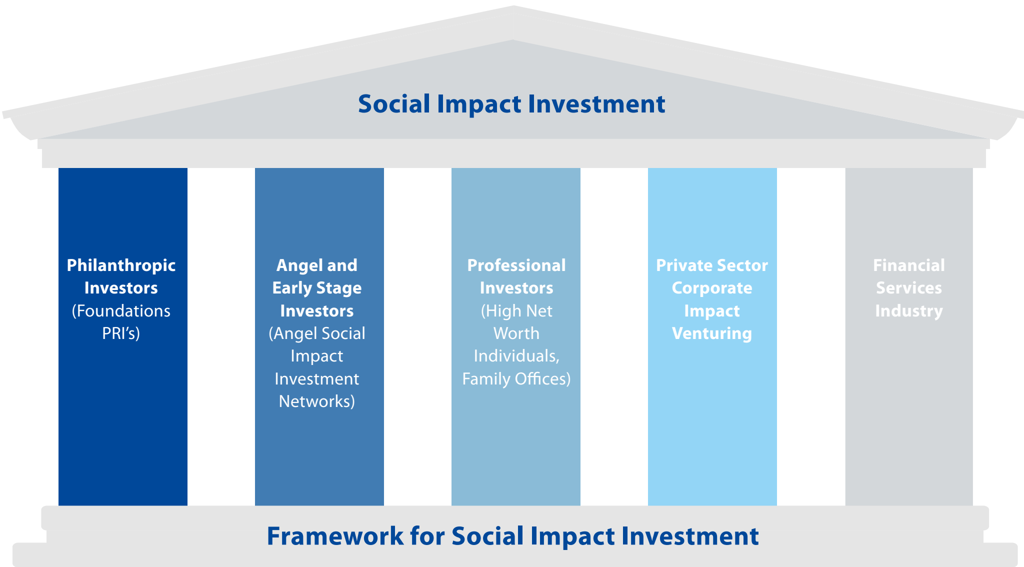


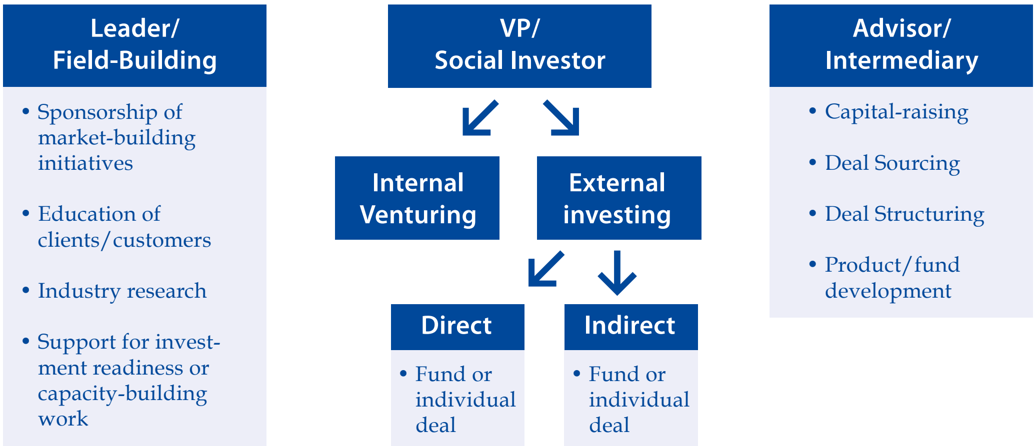

**Banks are an essential pillar of the Social Impact Investment industry[3]**

### In what way can banks engage with VP and social investment?

- The nature of engagement with VP and social investment will depend on the business model of each bank and which type of banking is included – retail, private or investment. There are specific opportunities and areas of focus for each of these different banking types
- In general, as shown in the chart below, banks can engage as leaders/field-builders and/or investors and/or intermediaries:
  - *As leaders/field-builders:* banks can be champions of social enterprise, social and impact investment and can increase the pipeline of investible organisations
  - *As investors*: banks can use their own capital, either from their balance sheets or from their foundations' philanthropic capital to invest in social purpose organisations or to create internal social investment businesses/initiatives. They can do this directly or indirectly, on an individual deal basis or through funds
  - *As intermediaries:* in the history of capital markets, the role of the intermediary has been fundamental. Although there is a strong demand from social ventures for long-term capital to fund the growth of their organizations and demand from investors for a range of instruments blending financial and social returns, there is a market gap for intermediaries raising and deploying capital

3. Adapted from: Martin, M. (2013), 'Making Impact Investible', Impact Economy Working Papers.

## PREFACE




**Role of banks in VP/Social Investment**

**What are the major drivers, challenges and benefits for banks to engage?**

- Banks face significant barriers to engaging with VP and social investment, in particular:
  - the immaturity of the sector
  - cultural and organizational difficulties since implementation requires cross-cutting departmental boundaries, engaging and collaborating with many external players, developing new areas of expertise internally and potentially embracing a new banking paradigm
  - competing calls on their time and resources in difficult operating conditions after the financial crisis from initiatives which are either more urgent or which offer short-term upside
- However, there are strong drivers which are compelling banks to get more involved, for example:
  - increasing pressure from external stakeholders and civil society for banks to change and become more socially-oriented, leading to CSR interest in these newer, more innovative ways to create social impact
  - more bank staff becoming aware and involved in VP and/or social investment and acting as intrapreneurial champions to push initiatives forward despite resistance
  - market forces in the form of increasing client demand and possibility for competitor advantage to be gained by seizing some early ground in this nascent sector
- Retail, private and investment banks face different strengths for each of these major barriers and drivers as outlined in the tables below. Private banks have the strongest market drivers to engage

# PREFACE

### Table 1: Drivers for Banks' Involvement in VP/SI and Impact Investment

Please note that for the tables 1-3, darker shaded boxes indicate a stronger relationship.

| | Client demand | Competitor Advantage | Personal belief | Bank Ethic | CSR interest |
|---|---|---|---|---|---|
| Private Bank | | | | | |
| Investment Bank | | | | | |
| Retail Bank | | | | | |

### Table 2: Challenges for Banks' Involvement in VP/SI and Impact Investment

| | Market Immaturity | Culture /organisational | Profit and priorities |
|---|---|---|---|
| Private Bank | | | |
| Investment Bank | | | |
| Retail Bank | | | |

### Table 3: Benefits of Banks' Involvement in VP/SI and Impact Investment

| | Internal rewards: staff satisfaction, cross-departmental working | Improved product offering for clients | Enhanced position to exploit long-term business opportunity |
|---|---|---|---|
| Private Bank | | | |
| Investment Bank | | | |
| Retail Bank | | | |

### How are European banks currently engaging?

- Whilst there is clear potential and significant incentive for banks to play a major and distinct role in VP and social investment, across the European banking sector initiatives have to date been quite fragmented and relatively small-scale, in terms of both human and financial capital committed
- There is an R and D tone of engagement to these projects with banks exploring and experimenting with the emerging field, before deciding whether and how to participate further and more fully
- Total financial commitments by European banks surveyed in this report for investment in social enterprise/social business (excluding pure microfinance funds) is approximately €261 million[4]
- As illustrated by the time chart below with key initiatives by banks, in the last few years there has been an acceleration of activity. Whilst historic activity was predominantly a broad field-building role of championing social enterprise and social investment, banks have recently moved towards a more explicit and engaged role as venture philanthropists/social investors and/or advisors/intermediaries, bringing these social impact strategies more into their core business areas
- Banks are active from a variety of different starting points, depending on geography and business model as well as the unique circumstances of the initiatives' development. Since there is no roadmap for the creation of such initiatives, nor are there many existing examples to follow, and due to the personal nature of much of the initiative (powered by individuals belief and commitment), these projects are all bespoke and different. They

4. Includes Deutsche Bank UK Impact Investment Fund; J.P. Morgan Social Finance Unit Fund plus Global Health Investment Fund despite them being US/European; BBVA social enterprise financing through Momentum Project 2011 and 2012; BNP Paribas financing for PhiTrust Innovation Funds; ABN Amro Social Impact Fund; UBS Impact Investment Fund, LGT Impact Ventures Fund UK and Erste Bank social enterprise financing.

range from setting up a social finance business unit within an investment bank, to creating a social bank within a commercial retail bank, to developing a social investment/VP product to sell to philanthropic private clients to setting up an internal social investment fund-of-funds run by the private equity department
- Many banks are still uncomfortable about raising client capital for social and impact investment, since the risk/return spectrum is still undeveloped
- Whilst the sums might be small and the initiatives rather fragmented, there is real cause for optimism in that banks are being very thoughtful about how and when to enter the field, have gained a huge amount of senior and internal support for existing initiatives and have garnered significant perceived benefits by those who have committed
- In addition, banks have shown themselves to be perceptive about the fact that VP and social investment require significant internal cross-departmental and external collaborative dimensions, needing new skills and expertise which they are often sourcing by engaging with external experts in the field
- What is most disappointing is that a more engaged, VP approach to social investment using the broad section of financing tools of grants, loans and equity seems to be less evident

**Timeline of key European Bank Social/Impact Investment activities**

**2007**

**J.P. Morgan**
launches Social Finance Unit, with $100m impact investment commitment from balance sheet

**2011**

**Deutsche Bank UK**
launches £10m Impact Investment Fund

**RBS**
sets up £5m community loan fund for social entrepreneurs

**Barclays, HSBC, Lloyds and RBS**
make £50m equity investment into UK's Big Society Capital

**BBVA**
launches Momentum social investment project, investing in 2011 €2.5m in Spanish social enterprises

**2012**

**BNP Paribas Wealth Management**
launches social investment fund product – PhiTrust Innovation 1

**2013**

**ABN Amro**
launches €10m Social Impact Fund

**Berenberg Bank**
co-founds with LGT Venture Philanthropy UK £30m fund

**UBS**
launches $50m own-branded impact investment fund

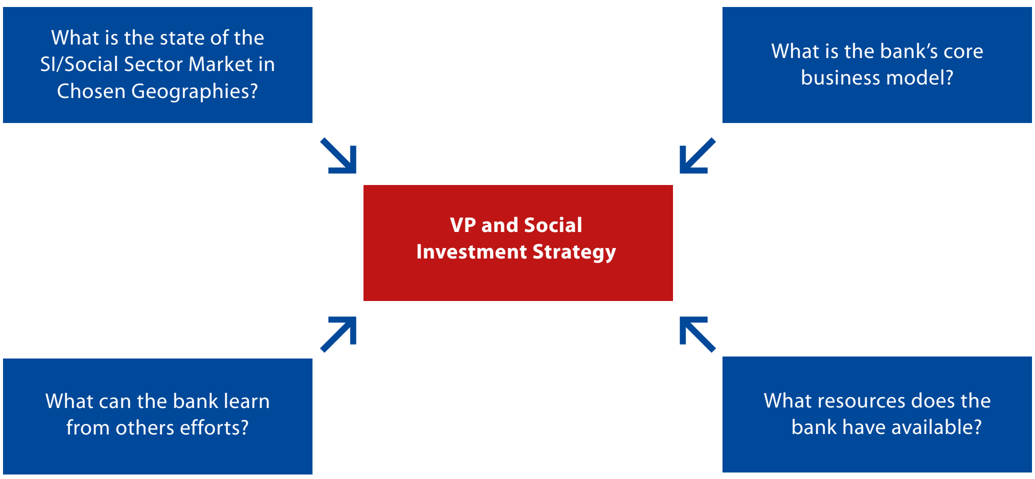
**EIF**
launches Social Impact Accelerator €60m fund

**J.P. Morgan and the Gates Foundation**
announce $100m Global Health Investment Fund

# PREFACE

### What more can European banks do?

- There is no one or right way for banks to engage in this field, and the multiplicity of existing activities and approaches by banks is a reflection of both market immaturity as well as banks different business models, capabilities and strategies. Banks should draw inspiration and ideas from the examples of banks in the role of leaders/field-builders; investors and advisors/intermediaries
- Many more banks can and should do something in this field – the size and scale of the initiative is less important than might be expected due to the immature state of the market and the reality that it is through small-scale initiatives and endeavours that new markets are built
- The key for banks is to build precedent, momentum and confidence and to feel that they are in the position to play the important role that they will increasingly be needed for as the VP and social investment markets grow
- Developing or renewing a strategy for involvement in VP and social investment will require considerable thought and attention to four factors as shown in the chart below: 1) the state of the social investment and social sector market in chosen geographies; 2) the bank's core business model; 3) learnings from existing initiatives/players; and 4) resources available for the bank




**Factors for banks to consider when developing a VP and Social Investment Strategy**

### Conclusions and Recommendations

- As the market evolves and settles and the required infrastructure is generated, banks will increasingly enter the field in order to capture potential value. Yet their involvement is likely to lag the general market evolution, due to issues of risk and complexity of organisational structures
- There is much that banks can do to both shape and contribute to this hugely exciting new sector, but care needs to be taken that as banks do bring in more capital and help to mainstream VP and social investment, the social mission and conscience of the movements are not lost in the rush for financial returns. There is a risk that banks will just increase the supply of capital without contributing to the major issues on the demand side, in particular the lack of investible propositions and the need for engaged philanthropy to build the pipeline

#### Recommendations – Banks in General

- Each bank should develop a VP and social investment strategy that fits their needs and environment. No matter how small the initiative or involvement, do something
- A bank's charitable foundation is an important and relatively easy place to start with experimenting with these strategies. All banks' foundations should be exploring how they can use VP and social investment strategies to make maximum use of their income and asset base
- At some point, involve where possible core business units, since social investment strategies will achieve maximum impact if they become integrated into the bank itself
- Balance investment and/or advisory and intermediary activities with important leadership and field-building activities. Banks need to play their part in helping to create appropriate market infrastructure
- Ensure a social return focus, where efforts and capital invested produce positive social change. Beware of only cherry-picking financially attractive social investment deals. All market participants need to co-operate and find ways to help to build the pipeline of socially investible organizations
- Be open to collaboration and knowledge-sharing, even within the competitive banking industry
- Use the human capital resident within the bank to maximum use – social investment activities provide excellent staff volunteering opportunities

## PREFACE

| Recommendations – Retail Banks | Recommendations – Private Banks | Recommendations – Investment Banks |
|---|---|---|
| • Consider whether more could be done to lend to social enterprises, social business and other SPOs, what the barriers to doing so are and what the bank needs to do to make more lending happen<br>• Voluntarily track and monitor lending to social purpose organizations<br>• Consider whether a retail ethical product is possible | • Attempt to bridge the existing internal and human capital divide between philanthropy and investment, ensuring that there are staff with expertise in VP and social investment<br>• Educate clients, as appropriate, about VP and social investment<br>• Educate client relationship managers, as appropriate, about VP and social investment<br>• Consider whether individual or fund VP and/or social investment product offerings are possible, considering client appetite<br>• Where client demand exists, create appropriate VP and/or social investment product offerings<br>• Use clients human capital – VP and social investment activities provide excellent mentoring opportunities for clients | • Build knowledge and expertise in social investment, applying skills of financial innovation and structuring where possible<br>• Where possible, help to create more track record around social investment funds and products by investing own capital and internally managing funds/products or appointing external managers to do so<br>• Consider what would be required for increased institutional client demand and help the market to develop such products |

# PREFACE

## Part 1:

# About the VP and Social Investment Market

# ABOUT THE VP AND SOCIAL INVESTMENT MARKET

### What is VP and social investment?

Venture philanthropy (VP) and social investment (SI) work to build stronger Social Purpose Organisations (SPOs) by providing them with both financial and non-financial support in order to increase their societal impact. In Europe the VP/SI approach uses the *entire range of financing instruments* (grant, debt, equity etc.), with grant-makers more often identifying with the term 'venture philanthropy', and equity and debt investors with the term 'social investment'. Social investment can take the form of asset capital issuing loans, working and transitional capital, or growth capital.

Venture philanthropy and social investment share seven characteristics:
1. *High engagement*: hands-on relationships with SPO management
2. *Organisational capacity-building*: building the operational capacity of portfolio organisations by funding the core operating costs rather than individual projects
3. *Tailored financing*: using a range of financing mechanisms tailored to the needs of the supported organisation
4. *Non-financial support*: providing value-added services to strengthen management
5. *Involvement of networks*: enabling access to networks that provide skill-sets and resources to the investees
6. *Multi-year support*: supporting a limited number of organisations for 3-5 years, then exiting when organisations are financially or operationally sustainable
7. *Performance measurement*: placing emphasis on good business planning, measurable social outcomes, achievement of milestones and financial accountability and transparency

### Why are VP and social investment important?

Venture philanthropy and social investment are tools within the philanthropic and investment toolbox to help to create more resilient and stronger social purpose organizations. The need for VP and social investment is growing because:
- **SPOs** (including social enterprise and NGOs with trading arms) are rapidly **growing sectors** in Europe, with such organisations working on **new and innovative solutions** to meet worsening social challenges. VP and social investment are particularly suited to help develop and scale such new, ambitious SPOs
- **Governments** on austerity drives are **slashing their spending** and existing SPOs need significant help and support to become robust enough to survive and thrive in the difficult funding climate. VP/SI can offer crucial guidance as well as funding in this time of transition
- SPOs are becoming more open to **exploring different financing options** – for different needs. Grants, whilst they are often essential at the early stages, cannot meet a social entrepreneur's rising capital needs as the enterprise goes to scale. VP/SI offers tailored financing
- Despite their potential to tackle social problems, currently **SPOs** face significant **difficulties accessing finance** for starting-up, as well as for R&D and development of new pilot projects

# ABOUT THE VP AND SOCIAL INVESTMENT MARKET

**In summary, the VP and social investment movements are providing key financial as well as intellectual and social capital to support SPOs playing a crucial role in developing new, innovative responses to entrenched societal challenges**. Players engaged in these movements from the philanthropic, public as well as the financial (venture capitalists, private equity/hedge funds and bankers) and corporate worlds are contributing their skills, knowledge and techniques to develop new models to finance and nurture these organizations.

### About the European VP and social investment markets

EVPA's 2012 annual survey of VP/SI identified about 100 VPOs practicing this approach in Europe, of which 61 responded to the survey. The survey shows that **the market is rapidly evolving and becoming more sophisticated, with an increasing use of debt and equity rather than simply grants, and a shifting emphasis towards VPOs wanting some financial payback from their investees.**

Some of the key conclusions of the survey were that:

- *Average financial support by VPOs increased by 27% in 2011* as compared to 2010: VPOs have invested almost €1.4 billion through financial and non-financial support since they began their operations. In the fiscal year 2011, they provided investees with €278 million of financial support
- *Many VPOs have non-profit structures*: 41% of VPOs are managing social investment funds but the majority have non-profit structures (67%)
- *Societal return is the main purpose; financial return is becoming more important*. VPOs requiring a social return only decreased from 50% to 26%; VPOs where societal return is a priority but they accept a financial return increased from 38% to 48% and VPOs were societal and financial returns are on an equal footing increased from 10% to 25%
- *Social enterprise is a key target of European VPOs*, representing the largest increase of funding from 25% in 2010 to 39% in 2011

There is a range of organisations practicing a VP/SI approach incorporating the key VP characteristics, incubated from within the foundation, finance and corporate sectors.
It is important to note that the broader social investment market, including those who do not engage actively with investees, is significantly larger and more diverse than that contained within the EVPA definition.

# ABOUT THE VP AND SOCIAL INVESTMENT MARKET

## VP organisations in Europe – sample of key players[5]:

| VPO | Headquarters | Year founded | Legal structure | Geo focus | Sector focus | Target org. | Financing | VP average investment size (€) |
|---|---|---|---|---|---|---|---|---|
| **BMW Stiftung Herbert Quandt** | Germany | 1970 | Foundation | Africa, Europe, Asia, Latin America | Education, Environment, Social Innovation, Responsible Leadership | NGO, Social enterprise | Grants | N/A |
| **BonVenture** | Germany | 2003 | Foundation + Fund | Austria, Germany, Switzerland | Education, Environment, Social services, etc. | Social enterprise, NGO | Grants, Loans, Mezzanine, Equity | €250,000 - €1m (1-5 years) |
| **CAF Venturesome** | United Kingdom | 2002 | Charity (social investment fund) | United Kingdom | No focus | NGO, social enterprise | Loans, Mezzanine, Equity | €110,000 |
| **Canopus Foundation** | Germany | 1997 | Foundation | Africa, Asia, Latin America | Renewable Energies and Energy Efficiency | NGO, Social enterprise | Loans, Mezzanine, Equity | €250,000 |
| **Children's Investment Fund Foundation** | United Kingdom | 2002 | Foundation | Africa, Asia | Education, Environment, Health | NGO | Grants, Guarantee, Equity | €2.1m |
| **Grameen Crédit Agricole Microfinance Foundation** | Luxembourg | 2008 | Foundation | Africa, Asia | Advocacy, Development, Enivironment, Health, Social services, etc. | Social enterprise | Guarantee, Loan, Equity | €600,000 |
| **Impetus Trust** | United Kingdom | 2002 | Charity | United Kingdom | Economic disadvantaged | NGO, social enterprise | Grants | €1m |
| **LGT VP** | Switzerland | 2007 | Foundation/ Fund | Europe, Africa, Asia, Latin America | Education, Health, Environment, Development, etc. | NGO, social enterprise | Grants, Loans, Mezzanine Equity | €500,000 - €1m |
| **NESsT Europe** | Hungary | 1997 | Charity | Eastern Europe, Latin America | Social enterprise development | NGO, social enterprise | Loans, Guarantees, Equity, Grants | €51,600 |
| **Noaber Foundation** | Netherlands | 2000 | Foundation | Europe, North America | Health, care, e-health | NGO, social enterprise | Loans, Equity, Mezzanine, Guarantees, Grants | €10,000-€1m (grants), €100,000-€3m (investments) |
| **Oltre Venture** | Italy | 2002/6 | Fund | Italy | Development and housing, health, microfinance | Social enterprise | Equity, Loans | €480,000 |

5. EVPA Directory 2013: http://www.evpa.eu.com/knowledge-centre/publications/evpa-publications/

## ABOUT THE VP AND SOCIAL INVESTMENT MARKET

| VPO | Headquarters | Year founded | Legal structure | Geo focus | Sector focus | Target org. | Financing | VP average investment size (€) |
|---|---|---|---|---|---|---|---|---|
| **PhiTrust** | France | 2005 | Fund, Endowment | Europe, Africa, Asia, Latin America | Development, Environment, Health, Microfinance, etc. | Social enterprise | Loans, Equity, Grants | €150,000-€500,000 |
| **Shell Foundation** | United Kingdom | 2000 | Foundation | Europe, Africa, Asia, Latin America | Environment, Cleantech, Sustainable mobility, etc. | Social enterprise | Guarantee, Loans, Mezzanine, Grants | €100,000-€7.5m |
| **Social Venture Fund** | Germany | 2010 | Social enterprise | Europe | Education, Environment, Health, etc. | Social enterprise | Loans, Mezzanine, Equity | €500,000-€1.5m |
| **Voxtra** | Norway | 2008 | Foundation | Africa, Asia | Livelihoods, income generation, agriculture | NGO, social enterprise | Loans, Mezzanine, Equity, Grants | €1.75m |

### Likely growth of the VP/social investment market

**In Europe, the market for VP and in particular social investment is forecast to grow rapidly, as the result of several inter-linked factors:**

- *A rapid growth of demand from social enterprises seeking funds*. For example, a recent report 'The First Billion' by BCG forecast demand for social investment in the UK to rise from £165 million of done deals in 2011 to £1 billion by 2016 as a result of trends including the growing outsourcing of public services to private providers; a new statutory requirement for commissioners to consider social value when awarding contracts; and a shift towards higher-risk models of payment.[6] A recent report on impact investment, 'Making Impact Investible',[7] identified four 'mega-drivers' underpinning the likely growth of organisations suitable for social investment, outlined below

### The Mega-Drivers of Sustainable Value Creation

1. *Massive pent-up demand at the Bottom of the Pyramid* (BoP): refers to the 4 billion people with incomes below $3,000 annually in local purchasing power
2. *Driving green growth*: results in improved human well-being and social equity, while significantly reducing environmental risks and ecological scarcities
3. *Reconfiguration of the welfare state*: the welfare state needs to be reconfigured as some government expenditure are structurally higher than their revenues; a large proportion of expenditure is on healthcare, education and welfare
4. *Emerging lifestyles of health and sustainability (LOHAS) segment* at the Top of the Pyramid (ToP): consumers are willing to spend more on products designed to be environmentally conscious, sustainable, socially responsible, and better both for people and the planet

6. Brown, A. and Swersky, A. (2012), 'The First Billion, A Forecast of Social Investment Demand', Boston Consulting Group.
7. Martin, M. (2013), 'Making Impact Investible', Impact Economy Working Papers.

## ABOUT THE VP AND SOCIAL INVESTMENT MARKET

- *An increasingly supportive public policy environment and significant supply-side stimulus for social investment and social enterprise.* At both an individual country level and European level there has been support and momentum for social enterprise and social investment. The UK has been the leader in this field, launching in 2012 Big Society Capital, a £600 million bank that aims to help grassroots charities and social enterprises by supporting intermediaries, such as VP and social investment funds, with capital. Moreover in 2011, The European Commission launched the 'Social Business Initiative', establishing a policy framework for the promotion of social entrepreneurship. As part of this initiative, the European Investment Fund has recently launched a Social Impact Accelerator fund, a €60 million social impact investing fund of funds which aims to address the growing need for equity finance to support social enterprises by providing equity capital to social investment intermediaries. It is a public-private partnership, with Credit Cooperatif and Deutsche Bank joining the European Investment Bank Group at first closing with other private sector investors expected to join later. Also, in March 2013, the European Parliament voted in favour of new legislation creating a voluntary label for funds investing in social sector organizations such as social enterprises. This is the European Social Entrepreneurship Fund regulation 'EuSEF'. It will provide the managers and their funds investing in social sector organizations a pan-EEA marketing passport

> *'What we've done for business entrepreneurs we must now do for social entrepreneurs. We must give them the resources to innovate in the way we resolve social issues. Big Society Capital aims to transform the flow of capital into the social sector and to boost significantly its ability to improve people's lives.'*[8]
>
> Sir Ronald Cohen, Big Society Capital Chairman

8. http://www.bigsocietycapital.com/sites/default/files/pdf/Prime%20Minister%20Launches%20BSC.pdf

# ABOUT THE VP AND SOCIAL INVESTMENT MARKET

### Big Society Capital[9]

Big Society Capital (BSC) is the world's first social investment bank. BSC was launched in April 2012, with an estimated £600 million of capital to be paid in over 5 years, £400 million of which will be from unclaimed assets left dormant in bank accounts for over 15 years, and £200 million from the UK's largest high street banks. Big Society Capital's mission is to develop the social investment market in the UK by investing in social investment finance providers and by acting as a market champion. By improving access to finance for social sector organisations, and by raising investor awareness of investment opportunities that provide a social as well as a financial return, Big Society Capital will be instrumental in connecting the sector to capital markets.

Big Society Capital expects a financial and social return from each of its investments. By May 2013 it had made over £50 million of investment commitments. A few examples of investments to date are:

- £825,000 invested in the Essex Social Impact Bond to help vulnerable young people avoid care or custody. Essex Children's Support Services (CSS) has entered into a payment-by-results contract with Essex County Council. CSS will work with Social Finance who will help manage the delivery of the contract by Action for Children, one of the largest children's charities
- £850,000 in the Social Stock Exchange to develop market infrastructure to connect socially motivated investors with social businesses that need capital

- *An increasing number of social investors and venture philanthropists*, in particular charitable foundations and high-net-worth individuals who are interested in newer ways of approaching philanthropy, as well as some growing interest from more mainstream investors who have already adopted sustainable investment strategies:
  - *Foundations*: are starting to devote the full range of their assets (balance sheet as well as income) to their mission, moving towards social and impact investment. Although a significant strategic and cultural shift is necessary, there is influential global leadership from US and European foundations who are engaging in social investment.[10] Whilst fiduciary obligation has sometimes been interpreted as a barrier, innovative work is being done to enable fiduciaries to understand and participate, for example the UK's Charities Commission Guidance (CC14) issued in November 2011 which endorses a 'mixed motive' investment
  - *Individuals:* research has identified significant latent demand for social investment among high-net-worths. For example, when financial planners in the UK were asked about the likelihood of their clients having an interest in social investment, 75% believed that there is 'possibly' or 'highly likely' unidentified client demand[11]
- *Growing financial innovation to facilitate social investment*: an example is the social impact bond which is being replicated globally. The social impact bond is a form of outcomes-based contract in which public sector commissioners commit to pay for a

9. http://www.bigsocietycapital.com/about-us
10. Such as KL Felicitas, Omidyar Network, WK Kellogg, FB Heron Foundation as well as European foundations, particularly in the UK, such as Esmee Fairbairn Foundation, Shell Foundation, Friends Provident Foundation, Young Foundation, Lankelly Chase, Trust for London and Panahpur Trust.
11. Elliott, A., Francis, G. and Knott, G. (2012), 'Financial Planners as Catalysts for Social Investment', NESTA/Worthstone.

significant improvement in social outcomes. It is an innovative way of attracting private investment which is used to pay for interventions which are delivered by service providers with a proven track record. In the UK, there are currently several social impact bonds dealing with social issues such as vulnerable children, unemployment, rough sleeping and criminal justice, as per the example opposite

### First Social Impact Bond, The ONE Service, UK:[12]

A six-year pilot scheme run by Social Finance, this aims to reduce re-offending amongst male prisoners leaving HMP Peterborough Prison who have served a sentence of less than 12 months. Social sector organizations such as St. Giles Trust, The Ormiston Children and Families Trust, SOVA and YMCA are providing intensive support to 3,000 short-term prisoners over a six-year period, both inside prison and after release, to help them resettle into the community. Early figures show that there has been more than 6% decline in the frequency of reconviction events per 100 HM Peterborough prisoners in the period 2010-12 when the bond has been operating compared with the earlier two-year period 2008-10. This compares to a 16% increase nationally from 2008-10 to 2010-12. Social Finance raised £5m from 17 social investors to fund the Peterborough SIB pilot, most of whom are charitable trusts and foundations, some of which are the giving vehicles of High Net Worth individuals or Private Banks. The UK Ministry of Justice and the Big Lottery Fund will pay investors so long as there is a measured reduction in reconviction events of 7.5% relative to the experience with a control group of short-sentence prisoners in the UK.

### How does VP/social investment fit in with impact investment, SRI and ordinary philanthropy?

Whilst there is overlap and unclear boundaries between philanthropy, venture philanthropy, social investment, impact investment and SRI, it is possible to differentiate between these movements/activities:

- *Venture philanthropy* represents a tool within the philanthropic toolbox and constitutes a small but increasing proportion of overall European philanthropic spend. The 2012 EVPA Industry Survey revealed annual expenditures of €278 million, a small but steadily growing part of the total European foundation expenditures of €46 billion by 60,000 foundations.
- *Social investment* can be practiced as part of an overall venture philanthropy strategy (as by EVPA members, over 50% of whom participating in the EVPA Industry Survey 2012 use debt and/or equity when investing) or without a VP dimension. Social investors tend to be willing to accept lower financial returns and to prioritise social returns (rather than seeing financial and social returns as of equal importance).

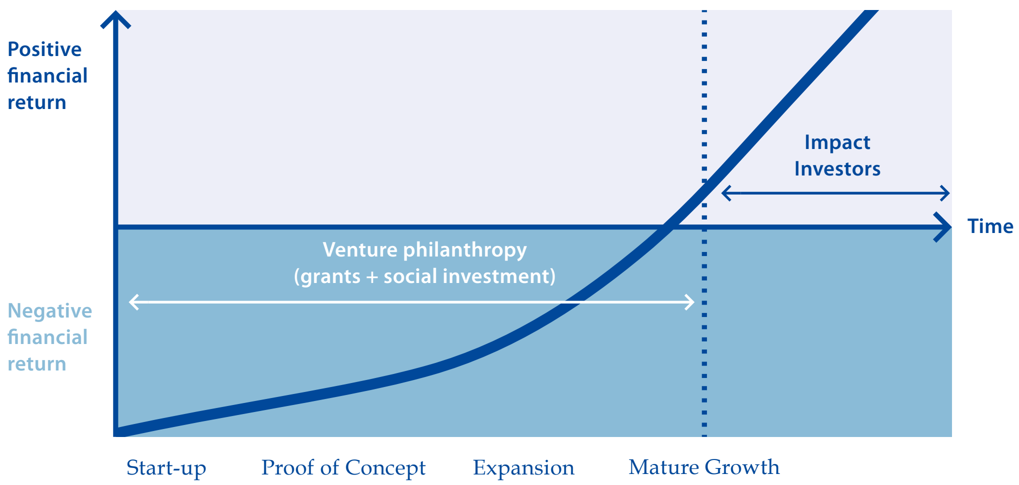
12. - http://www.socialfinance.org.uk/sites/default/files/SF_Peterborough_SIB.pdf;
    - http://www.socialfinance.org.uk/sites/default/files/peterborough_interim_reconviction_figures_june_2013.pdf

## ABOUT THE VP AND SOCIAL INVESTMENT MARKET

To expand on how VP and SI practitioners differ from other investors (particularly impact investors) using data from the recent EVPA Industry Survey:

*(i) VPOs take risks by supporting early stage, small organisations with little track record*

87% of respondents to the EVPA survey support organisations that are less than 5 years old. As the Monitor Report[13] of 2012 highlighted, 'philanthropic support can play a catalytic role in ways that investor capital cannot'. This is particularly the case in the start-up, proof of concept and expansion stages of an SPO's development, where start-up losses are incurred and the risks are perceived too large to be acceptable for impact and traditional investors.




**SPO development and venture philanthropy support**

*(ii) VPOs support a range of organisational types from NGOs to social enterprises*

The results of the EVPA survey show 39% of VPOs supporting impact first social enterprises, while 45% support NGOs either with or without revenues from some form of trading. LGT Venture Philanthropy, for example, supports via an equity investment, B2R Technologies, a business process outsourcing company based in rural North India, providing opportunities to local youth who would otherwise have to migrate to big cities for employment. At the same time they also support, via a grant, Mothers2Mothers in Africa, which provides support to HIV-positive pregnant women to deliver health babies.

*(iii) VPOs have a wide range of return expectations*

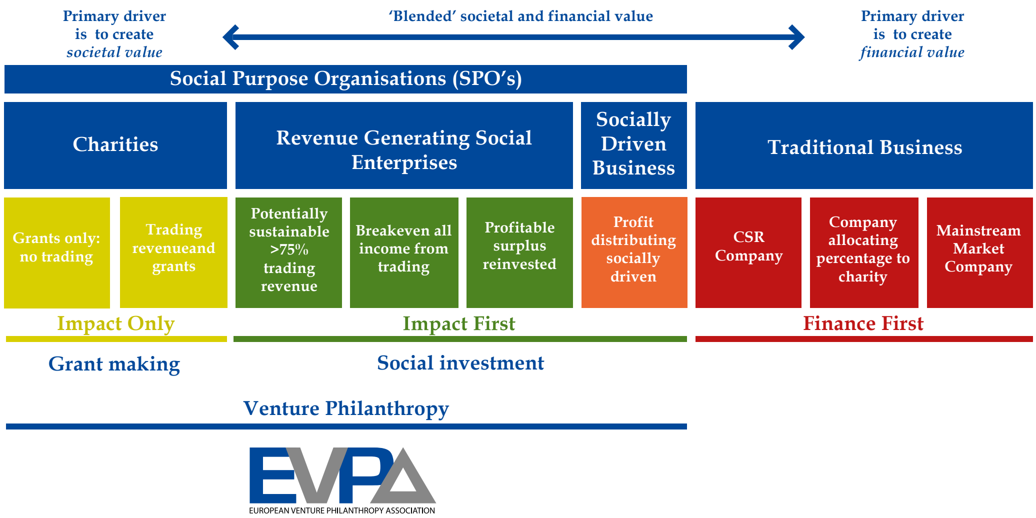
VPOs target a wide range of financial returns, with a relatively even distribution between those expecting a positive return (60% of this category expecting 5% or less), those expecting capital to be repaid and those expecting a negative return.

What unites VPOs is their focus on impact and, as a natural next step, the importance assigned to impact measurement. 90% of EVPA survey respondents measure impact on at least an annual basis and EVPA's Practical Guide to Measuring & Managing Impact[14] offers a hands-on and practical guide to help even more organisations in impact measurement.

13. Koh, H; Karamchandani, A; Katz, R (2012), 'From Blueprint to Scale: The case for philanthropy in impact investing'; Monitor Group 2012.
14. Hehenberger, L., Harling, A-M. and Scholten, P. (2013), 'A Practical Guide to Measuring and Managing Impact', EVPA.

# ABOUT THE VP AND SOCIAL INVESTMENT MARKET

- *Impact investment* is currently a \$36 billion industry[15] with rapid growth forecast of between \$400 and 1000 billion by the end of the decade.[16] There is a continuing discussion about what impact investment exactly is: an evolution of SRI and sound investment practice with consideration for social and environmental aspects or a different and distinct animal from traditional investment practice
- *SRI:* is a broad category of responsible investors factoring in social, environmental and governance risk (ESG factors). This ranges from those who 'negatively screen' harmful products or practices, to those who also address ESG risks through active ownership to a much wider universe of investors who look at ESG as part of their overall analysis of the portfolios they hold. In 2012, there were over €6.7 trillion SRI assets under management, with €48 million in sustainability themed assets and 283 million in best-in-class SRI strategies.[17] The mainstream investment community is showing serious interest in responsible investment, as evidenced by the 1225 asset owners, investment managers and professional service partners who have signed up to the United Nations Principles of Responsible Investment. Collectively they represent \$34 trillion in assets under management or 15 to 20% of the investible assets in the world[18]




**The VP/SI Investment Spectrum**

**Whilst there are significant distinctions between these movements, what is clear is that the philanthropy and investment spaces are no longer as distinct and separate as they once were, and that the 'space between' represented by venture philanthropy, social investment and impact investment is becoming increasingly important and promises to change the way both philanthropy and investment have been traditionally practiced and bi-furcated.**

**There is significant complementarity between these movements.** In particular VP/SI practitioners could help to provide the missing middle between pure philanthropy on the one hand and equity investments by impact investors on the other.

15. Martin, M. (2013), 'Making Impact Investible', Impact Economy Working Papers.
16. O'Donohoe et al. (2010), 'Impact Investments: An Emerging Asset Class', J.P.Morgan (pg.6).
17. Eurosif (2012), 'European SRI Study' (pg. 62).
18. http://www.unpri.org/news/pri-fact-sheet/

## Part 2:

# Banks' Contribution and Role within VP/Social Investment

# BANKS' CONTRIBUTION AND ROLE WITHIN VP/SOCIAL INVESTMENT

## 2.1. How banks can use VP/Social Investment as a tool within a wider social engagement agenda

Banks do have a social engagement agenda, although how deep and wide this is differs very much by bank. There is a continuing dialogue amongst bankers, civil society and governments about what exactly the social role of banks should be in the emerging financial system where the banks role for both good and for harm has been acknowledged as a result of the financial crisis. Bankers themselves have called for a profound change in culture, the need to demonstrate that they play a valuable role in society and the need to heal a disconnect between the banking industry and society.[19] Expectations are running high.

Whilst banks could operate quite profitably as it is, continuing with 'business as usual' serving high-net-worth clients, investing in government bonds and providing services to established companies in other industry sectors, they are being pressed to do and contribute more socially. This is about mitigating and managing risk (from both government regulation and reputational risk) as well as seizing the business opportunity provided by challenges to the traditional banking paradigm.

> *'For years, the City has been associated with providing capital to help businesses to expand. Today, this is about supplying capital to help society expand. Just as finance from the City has been essential to help businesses grow and take on the world, so finance from the City is going to be essential to helping tackle our deepest social problems.'*[20]
>
> David Cameron, Prime Minister of the United Kingdom,

In the light of this, it is timely that new paths are being opened up, of which VP and social investment are part of, for retail, private and investment banks to contribute to social impact, to renew the social contract and to engage socially beyond their traditional activities of philanthropy/CSR. These new paths include:

- The creation of products and services specifically for the economically vulnerable and/or socially impactful organizations, including for example directly lending to social enterprises and developing microfinance initiatives (retail banks)
- Investing in, intermediating and developing the market for socially-motivated investment products and opportunities (private and investment banks)

These newer tools for social engagement are exciting as they are bringing a social lens into core business activities, are building on the bank's existing expertise, and potentially represent a far bigger social impact opportunity than pure philanthropy ever will. Moreover,

19. See for example Deutsche Bank Corporate Responsibility Report 2012.
20. https://www.gov.uk/government/news/launch-of-big-society-capital-the-world-s-first-ever-social-investment-market-builder

## BANKS' CONTRIBUTION AND ROLE WITHIN VP/SOCIAL INVESTMENT

they represent an attempt by banks to reconsider how and why they do business at a very fundamental level. Social and impact investing have been widely perceived as the biggest recent idea to renew the relevance of finance for the economy and social progress. There is scepticism about how far these newer modes of investing, such as social and impact investing, are simply a convenient response to the need on the part of banks to appear more socially-conscious without representing a substantial re-imagination of banks' social purpose or a real commitment to the field and wider agenda. This scepticism is understandable since banks have been tip-toeing rather than diving into the deep end. Whilst it is not possible to speak about the entire European banking industry, the case studies in this report do point to a slow but serious attempt by several leading banks in different European countries which reaches beyond CSR and PR. There is a concerted attempt to understand and help to move the social investment market forwards. Whilst co-ordination is lacking, and the efforts are piecemeal, the general trend is towards deeper and more substantial involvement on the part of banks.

> *'Banks already often give grants to social projects, which is great. But in times of crisis, venture philanthropy is a good way of ensuring you get your capital back and you can then reinvest it again into social projects. This ensures that social organizations handle the money they receive more responsibly as they need to report on what they do with it and the impact they have. Venture philanthropy is very interesting both for the banks and for the social companies. It is attractive for banks as they can develop new products for their clients. And VP offers banks tools that they are more at ease with. At BBVA we are seeing that staff are very keen on using their skills in the social sector, and VP offers a very interesting possibility to do so.'*[21]
>
> Lidia del Pozo, Head of Community Involvement, BBVA

This report will outline examples of banks embracing VP, social and impact investment. These different ways to create social impact are complementary and build on existing CSR and philanthropic activities. The CSR departments are often critical in incubating and supporting initiatives on the part of business units for example to develop products or services for the economically vulnerable or to develop social investment funds and support social entrepreneurs/social enterprises. Moreover, some important VP/social investment initiatives are contained within banks' significant charitable foundations – an example where these foundations have started to experiment with different philanthropic approaches.

21. Interview with Lidia del Pozo, Head of Community Development, BBVA.

## 2.2. Banks' contribution to and role within the VP/Social Investment ecosystem

### What role can banks play?

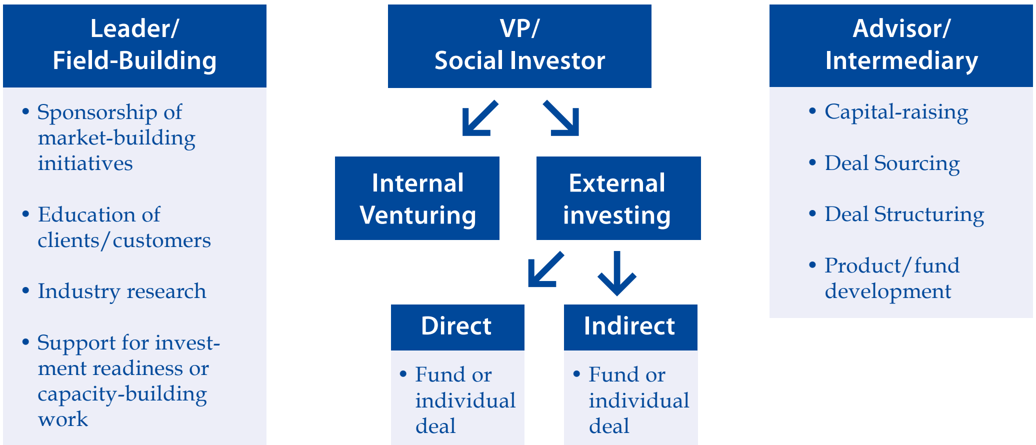
Banks bring access to vast quantities of capital – financial, human and social – which can accelerate the growth of the VP/social investment market. They can use this capital in the three roles, outlined and developed in the chart below which they can perform within the marketplace, with the activities related to each of these depending on the department/type of bank (the list of activities is exemplary rather than exhaustive):

- **As a *VP/social investor:* banks can use their own capital, either from their balance sheets or from their foundations' philanthropic capital, to invest in social purpose organisations or to create internal social investment businesses/units.** They can do this directly or indirectly, either by themselves or in partnership with other experts. They make good direct VP/social investors as their financial skills and knowledge can be used to mentor and support their investees or to set up innovative and exciting internal projects that build on what the bank already does. Moreover, because they have access to their own patient capital, they can adopt a very socially-oriented long-term investment approach, using a mix of different financing tools, involving both their foundations as well as business units. Indeed, in Europe, due to the recent privatization of banks with a proportion of the proceeds seeding endowments at charitable foundations (for example in Italy in 1990 banks converted their network of small, non-profit, quasi-public savings banks into joint stock companies but vested the ownership of the resulting stock in a set of foundations which are now larger than major US foundations such as Rockefeller and Ford Foundations[22]), banks could and should be leading VP/social investors
- **As a *leader/field-builder*, sponsoring or spearheading market-building initiatives.** Banks can take a leadership role in the development of the social investment/social enterprise and VP marketplace, which is particularly important in countries where other players are not so active (such as the government, or other intermediaries). Banks' interest in this field is likely to catalyse further activity from the entire asset management and advisory industry. Moreover banks continue to have significant political lobbying muscle and influence and can play a role in forging this new industry, in co-operation with individual governments. In particular, they could use their financial knowledge as well as insight into investor requirements to clarify how the fragments of the social/impact investment marketplace could become a more viable social capital marketplace, educating on topics such as currency and credit risk about which they are experts, and helping to conceive of and make happen new product ideas such as social impact bonds or layered financing structures[23]
- **As an *advisor/intermediary*. In the history of capital market, the role of the intermediary has been fundamental.** Banks with their enormous client lists, both private and institutional, are a key intermediary/advisor if VP/social investment as well as impact investment are to grow beyond their current limitations. Indeed, they are the key to mainstreaming of social impact investment, when this is appropriate. Although there is strong demand from SPOs for long-term capital to fund the growth of their organizations and

22. Martin, M. (2013), 'Making Impact Investible', Impact Economy Working Papers.
23. ibid.

## BANKS' CONTRIBUTION AND ROLE WITHIN VP/SOCIAL INVESTMENT

demand from investors for a range of investments blending financial and social returns, there is a market gap for intermediaries which are raising and deploying capital. Whilst opportunities for social investment are available at all levels of risk, investors need support to find the right mix of risk, return and social impact. The result of banks playing a more active intermediary role will be significant: if banks can even shift a small part of the overall investment allocation of their clients towards social investment and encourage significantly greater allocations from the philanthropic assets that they manage, an enormous amount of additional capital will flow into the sector

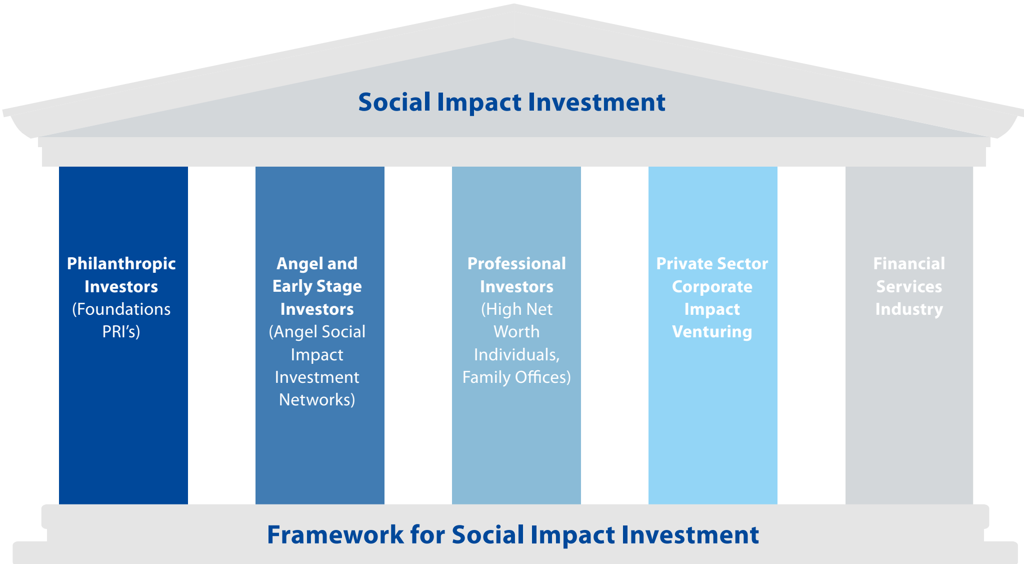



**Role of banks in VP/Social Investment**

**How do banks fit into the broader VP/SI and impact investment ecosystem?**
Banks are a crucial part of the overall social and impact investment ecosystem and need to co-operate, collaborate and work with the other players in order to aid its expansion and evolution. It is widely recognized that many different players are needed for the ecosystem to work and that their roles should be synergistic as well as collaborative. The new European Social Impact Accelerator Fund is an explicit acknowledgement of the importance of private-public partnerships. Banks need to work with the public sector (including development banks who can play a leading role in the field) and the third sector in order to develop and grow the social enterprise and social investment sectors. Indeed, recently large-scale figurehead innovative impact investment initiatives globally have been a collaboration between banks, high-net-worth individuals, foundations, the third sector and the public sector, for example the Non-Profit Finance Fund (NFF) in New York which has created an integrated grant, investment and advisory service targeting up to 100 core social services agencies in New York City that are struggling in the stretched funding climate, bringing together $50 million in loans from commercial banks and private foundations, aggregating millions of dollars of grant money from multiple funders, and drawing on a loan guarantee from the city of New York.

# BANKS' CONTRIBUTION AND ROLE WITHIN VP/SOCIAL INVESTMENT

As per the chart below, banks represent a critical pillar of the social /impact investing ecosystem, being part of the financial services industry as well as having large-scale charitable foundations which can engage in social/ impact investment (thus they are both intermediaries and philanthropic investors).




**Banks are an essential pillar of the Social Impact Investment industry[24]**

### What role are banks currently playing?

To date, banks' role in Europe has tended to be smaller and overshadowed by other players (apart from in the field of microfinance where they are very active). However, as illustrated in the chart below, they have comparative advantages, particularly in terms of the size of the capital they have available (both their own and their clients) as well as the mix of skills and expertise that they can bring to the table. Moreover, they can partner with other players (for example other experts such as boutique social investment funds and intermediaries) to successfully import the skills and expertise that they need either to become VP/SI practitioners or offer products for their clients. It is likely that as the market matures their role is bound to grow and develop and will be increasingly important market participants. The next part of the report will describe in more detail the current state of play in terms of banks engagement:

- As *VP/social investors*, banks have until recently not played such a strong role. The most significant players have been the social banks from a more straightforward lending perspective and the smaller, boutique social investment funds for more VP-type of activities coupled with growth capital. Since banks have traditionally separated their charitable activities from investment and not linked their pro-bono with their grant-making. They have practiced few VP tools
- As *intermediaries* it has been specialist organizations rather than banks who have been driving the market forward

24. Adapted from: Martin, M. (2013), 'Making Impact Investible', Impact Economy Working Papers.

## BANKS' CONTRIBUTION AND ROLE WITHIN VP/SOCIAL INVESTMENT

- As *leaders/field-builders*, banks have been more active, championing the social enterprise and social impact investment sectors, having funds available to build the market which many smaller players do not

**Banks' engagement in VP and Social Investment in relation to other major players**

| | Leader/Field-Building | VP/Social Investor | Advisor/Intermediary |
|---|---|---|---|
| Government | Very important stimulus/policy role | | |
| Social Bank | Demonstration role – social investment works! Leading by doing. | Significant social investment role, but limited VP | Significant intermediation role, but limited client lists |
| Mainstream Bank | Could be very significant leader sending signal to capital markets | Limited funds invested to date but huge potential due to patient capital availability | Key to mainstreaming of social impact investment |
| SI Fund | Limited weight/muscle but leading by doing and strong expertise | Highly significant role due to focus and expertise | Some intermediation capability, but limited client lists |
| SI Intermediary | Limited weight/muscle | | Significant role due to focus and expertise |
| Charitable Foundations | | Key VP/Social Investor: unlocking all assets for social mission | |
| Social/angel investors | | Important VP/Social Investor: backing early-stage ventures | |

# BANKS' CONTRIBUTION AND ROLE WITHIN VP/SOCIAL INVESTMENT

## Part 3:

# Current Engagement of Banks with VP/Social Investment in Europe

# CURRENT ENGAGEMENT OF BANKS WITH VP/SOCIAL INVESTMENT IN EUROPE

## 3.1. Overview

**There are signs of growing interest of mainstream banks in the field of VP/social and impact investment following the development of the market, although not in line with market 'hype'**

Over the last five years, and concentrated in the last year or two, there have been signs of real activity and commitment in terms of the development of the VP/ social investment field by banks (as per the chart below). Much of the historic activity, particularly by retail banks, has been a broad **field-building** role of championing social enterprise and social investment, with banks only recently moving towards a more explicit and engaged role as **venture philanthropist/social investors** (mostly using CSR budget, balance sheet or philanthropic capital) and **advisors/intermediaries**, bringing these social impact strategies more into their core business areas. Banks are active from a variety of different starting points, depending on geography and business model as well as the unique circumstances of the initiatives' development. Since there is no roadmap for the creation of such initiatives, nor are there many existing examples to follow, and due to the personal nature of much of the initiative (powered by individuals' belief and commitment), these projects are all bespoke and different, ranging from setting up a social finance business unit within an investment bank (J.P. Morgan), to creating a social bank within a commercial retail bank (la Caixa), to developing a social investment/ VP product to sell to philanthropic private clients (UBS, BNP Paribas Private Wealth), to setting up an internal social investment fund-of-funds run by the private equity department (Deutsche Bank UK). There is no one or right way for banks to engage in this field, and the multiplicity of activities and approaches is a reflection of both market immaturity as well as banks' different business models, capabilities and strategies.

**Whilst the converted talk about a revolution in investment thinking that impact and social investment symbolise, banks have been more cautious, with a continuing emphasis on the philanthropic rather than the investment side of the equation and social investment not yet close to being considered a mainstream activity or product.** There is an R & D tone of engagement to their projects with banks exploring and experimenting with the emerging field, before deciding whether and how to participate further and more fully. Microfinance has been the midwife and common starting-point for the more active investment and engagement by banks who have begun to lend or invest in SPOs, since they are more at ease with the paradigm shift that products with a financial and social return are potentially sustainable and attractive.

In terms of the size of banks' financial capital invested, **individual European VP, social and impact investment initiatives included in this report have tended to be relatively small** i.e. in the €5 million to 10 million range, although there are some larger initiatives, such as the recent $50 million UBS impact investment fund and the J.P. Morgan $100 million Global Health Investment Fund. Banks in general have hitherto been uncomfortable raising client capital for social and impact investment, particularly where financial returns are below-market or risky (which is the case with much social investment), although a

## CURRENT ENGAGEMENT OF BANKS WITH VP/SOCIAL INVESTMENT IN EUROPE

few private banks have begun more active client intermediation and social/impact investment product development strategies. More recent high profile initiatives in the USA, such as the launch of the Goldman Sachs Social Impact Fund with a target size of $250 million, as well as the establishment of the Morgan Stanley Institute for Sustainable Investing which seeks to drive $10billion of client assets through the Morgan Stanley Investing for Impact Platform in the next five years, is a sign that international banks are starting to be more aggressive and bold about raising private client capital to invest in social and impact investment products.

**Timeline of key European Bank Social/Impact Investment activities**

**2007**

**J.P. Morgan**
launches Social Finance Unit, with $100m impact investment commitment from balance sheet

**2011**

**Deutsche Bank UK**
launches £10m Impact Investment Fund

**RBS**
sets up £5m community loan fund for social entrepreneurs

**Barclays, HSBC, Lloyds and RBS**
make £50m equity investment into UK's Big Society Capital

**BBVA**
launches Momentum social investment project, investing in 2011 €2.5m in Spanish social enterprises

**2012**

**BNP Paribas Wealth Management**
launches social investment fund product – PhiTrust Innovation 1

**2013**

**ABN Amro**
launches €10m Social Impact Fund

**Berenberg Bank**
co-founds with LGT Venture Philanthropy UK £30m fund

**UBS**
launches $50m own-branded impact investment fund

**EIF**
launches Social Impact Accelerator €60m fund

**J.P. Morgan and the Gates Foundation**
announce $100m Global Health Investment Fund

**Whilst in Europe the sums might be small and the initiatives rather fragmented, there is real cause for optimism from those surveyed in this report in that banks are being very thoughtful about how and when to enter the field, with a huge amount of senior as well as internal support for existing initiatives and significant perceived benefits by those who have committed**. In addition, banks have shown themselves to be perceptive about the fact that VP and social investment have significant internal cross-departmental and external collaborative dimensions, requiring new skills and expertise which they are often sourcing by engaging with external leaders in the field.

**What is most disappointing, however, is that a more engaged, VP approach using the broad section of tools of grants, loans and equity seems to be less evident in these initiatives** (although there are notable exceptions), even with philanthropic private clients or foundations who would seem to be perfect candidates for such an approach. In line with general concerns outlined by leaders in the field about the lack of investors with an enterprising/philanthropic approach to develop the pipeline of investible organizations, the key questions that need to be addressed by banks are as follow

- How can banks with their commercial culture engage outside of the more developed and less risky end of the social investment spectrum?
- How can they leverage their human capital more effectively?
- How can banks work cross-departmentally and across countries to develop a more integrated VP/social investment strategy that uses a combination of approaches: grant-making from corporate foundations – as well as a more engaged debt or equity investing with a volunteering/engagement dimension from business units?

In what follows, the report outlines how different types of banks – social banks, retail banks, investment banks, private banks – have approached VP/social investment, and provides specific case examples.

## 3.2. Social Banks: Early Specialists in the Field

Social banks (otherwise known as sustainable or ethical banks) are the most significant European players in social investment and, until recently, were the only banks heavily engaged in this space. They have an intentional approach to triple-bottom-line business i.e. they don't just avoid doing harm, but they actively use finance to do good. **They are major lenders to SPOs for the less risky capital requirements**. Many of the SPOs that are turned away by mainstream banks are lent to by social banks, showing that they have a more nuanced understanding of the risk of lending to SPOs and have enough scale to have developed expertise and understanding in particular social issue areas. In addition, they have a long-term perspective and less demand on financial returns. **Some social banks also have investment arms which are active in debt and equity investment for growth capital requirements** and offer corporate finance activities for social purpose organizations (such as Triodos Bank profiled featured below).

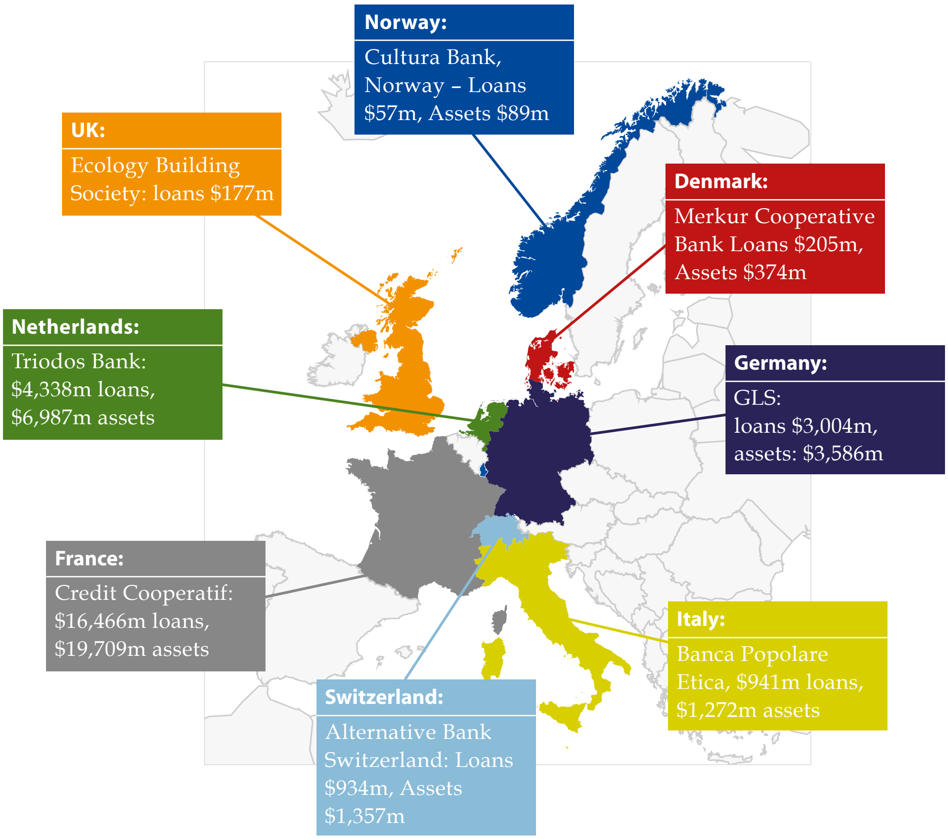
There is no universally accepted definition of what a social bank is, and some social banks call themselves sustainable banks rather than social banks, but in the Northern Hemisphere the term social bank is generally used for banks that strive for only doing business with a positive impact. Using this definition there are a small group of social banks worldwide, many of which are members of the Global Alliance for Banking on Values, which uses the term sustainable bank to describe its members. The map below shows the banks in Europe which are members of the Global Alliance for Banking on Values and their loans and total assets in 2012. The total size of the loan book in 2012 of these banks in Europe is over $26 billion, which although small relative to mainstream lending, is still a considerable market.

## CURRENT ENGAGEMENT OF BANKS WITH VP/SOCIAL INVESTMENT IN EUROPE

### Global Alliance for Banking on Values Sustainable Bank Definition[25]

The Global Alliance for Banking on Values is a membership organisation for sustainable banks which follow the following principles:

1. Triple bottom line approach at the heart of the business model
2. Grounded in communities, serving the real economy and enabling new business models to meet the needs of both
3. Long-term relationships with clients and a direct understanding of their economic activities and the risks involved
4. Long-term, self-sustaining, and resilient to outside disruptions
5. Transparent and inclusive governance
6. All of these principles embedded in the culture of the bank




**Selected European Bank Members of the Global Alliance for Banking on Values[26]**

25. http://www.gabv.org/about-us/our-principles
26. http://www.gabv.org/our-banks

# CURRENT ENGAGEMENT OF BANKS WITH VP/SOCIAL INVESTMENT IN EUROPE

*'Social banks have made serving the social economy their core business. They are the ones providing the challenge to the rest of us.'*[27]

Franz Karl Prüller, Member of the Board of Erste Foundation and Director of the Social Programme

Whilst the social banking sector is tiny compared to the mainstream banking sector, it offers **a powerful example for mainstream banks of the possibility of a banking model which combines financial and social returns.** In particular, social banks are demonstrating:

- That there are significant and growing opportunities to lend to social purpose organisations
- That there is a significant and growing appetite amongst the broad public as well as high-net-worth and institutional investors for social/ethical financial products
- It is possible to generate reasonable, sustainable returns by lending to and investing in social purpose organizations
- That good performance on both financial and social returns is being driven by a long-term relationship banking model with in-depth social sector expertise

**Indeed, it is likely that without mainstream banks moving in a more social banking direction, for example offering more explicit products with a social and ethical dimension or creating their own social banks internally, they could lose out significantly in market share in the forthcoming years.** The financial crisis and other events have resulted in exceptional growth rates for several social banks (of more than 30%). Clients of conventional banks have been tempted to move their deposits and several banking industry experts have stated that social banks could reach a market share of 10% from their current 1% in the near future.[28]

**The growth of social banks during the last few years is striking.**

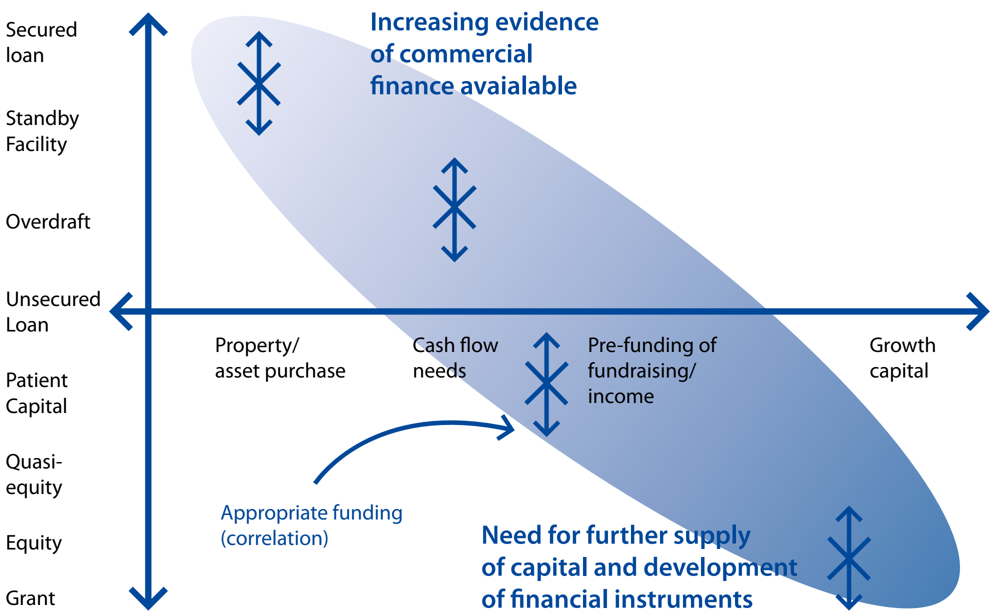
A recent report by the Global Alliance for Banking on Values comparing the performance between 2002-2011 of its global members with other peer groups[29] including GSIFIs[30] and US and commercial and retail banks with assets between $100 million and $10 billion in terms of a) commitment to the real economy; b) capital strength and quality; c) financial returns and volatility; and d) growth concluded that:

- Sustainable banks had a significantly greater proportion of exposure to customers in both deposits and loans
- Sustainable banks had relatively higher and better quality capital
- Sustainable banks had better returns on assets and equal returns on equity with lower volatility of returns
- Sustainable banks had significantly higher levels of growth

27. Interview with Franz Karl Prüller, Member of the Board of Erste Foundation and Director of the Social Programme.
28. Weber, O. and Remer, S., 'Social Banks and the Future of Sustainable Finance', World Financial Review, http://www.worldfinancialreview.com/?p=441
29. Global Alliance for Banking on Values (2012), 'Strong and Straightforward: The Business Case for Sustainable Banking'.
30. Global Systemically Important Financial Institutions (GSIFIs): Bank of America, Bank of China, Bank of New York Mellon, Banque Populaire CdE, Barclays, BNP Paribas, Citigroup, Commerzbank, Credit Suisse, Deutsche Bank, Dexia, Goldman Sachs, Group Credit Agricole, HSBC, ING Bank, J.P. Morgan Chase, Lloyds Banking Group, Mitsubishi UFJ FG, Morgan Stanley, Nordea, Royal Bank of Scotland, Santander, Societe Generale, State Street, Sumitomo Mitsui FG, UBS, Unicredit Group, Wells Fargo.

# CURRENT ENGAGEMENT OF BANKS WITH VP/SOCIAL INVESTMENT IN EUROPE

**Yet there are limits to the role of social banks in supporting and developing the social investment sector**, as they tend to have limited philanthropic funds and perhaps cannot engage in the type of nurturing and support of start-up and early-stage type of SPOs that VP focuses on. They do not tend to be big risk-takers and venturers nor do they use VP tools with their investees. In addition, social banks tend to be more focused on the less risky end of the lending spectrum and cannot meet the full demand of SPOs for early-stage or growth equity capital. As per the chart below, the supply of finance gap for SPOs is not at the low-risk end where social banks tend to operate, but rather at the higher-risk end.




**The Supply of Finance Gap for Social Purpose Organisations**[31]

## Spotlight: Triodos Bank[32]

### About Triodos Bank

Triodos Bank is a European bank with its head office in The Netherlands and branches in Belgium, United Kingdom, Spain and Germany. Founded in 1980, it is a pioneer of social banking, only lending to and investing in organizations that benefit people, environment and culture, pursuing a triple bottom-line approach. *'We believe that economic activity can and should have a positive impact on society, the environment and culture. We value people, planet and profit.'* From the start, Triodos Bank financed the renewable energy industry in its infancy and the bank's activity grew to include green, ethical, social and culture-oriented investment funds, dedicated venture capital funds and private banking services. In addition to its Dutch presence, branches in Triodos Bank Spain, Belgium, United Kingdom and Germany have been progressively established since 1993. At the same time Triodos Bank's international work expanded significantly with investments in microfinance institutions across the developing world.

31. Goodall, E. and Kingston, J (2009), 'Access to Capital, A Briefing Paper,' CAF Venturesome.
32. Sources for this case study include: interview with Whitni Thomas, Investor Relations Manager, Triodos Bank 17th April 2013; Triodos annual report 2102 and Triodos website http://www.triodos.co.uk/en/about-triodos/

# CURRENT ENGAGEMENT OF BANKS WITH VP/SOCIAL INVESTMENT IN EUROPE

**Social Investment Initiatives**

Triodos Bank is the largest social investor in Europe – in 2012 it lent €3.285 billion to sustainable projects – and it had over 450,000 accounts funding dedicated savings products or investment funds. It sees itself as a one-stop-shop for social purpose organisations which can rely on Triodos Bank for all of their capital needs. Its services range from basic lending to sophisticated investment products.

Triodos Banks approach to lending is an interesting example for other banks of how to evaluate which projects/organizations have high social returns. It:

- Identifies sustainable sectors where it can help businesses develop and innovation flourish
- Selects businesses and projects that will provide real social, cultural or environmental benefits
- Evaluates both the quality and the motivation of the people applying for loans
- Ensures selected projects meet absolute criteria, which measure their potential negative effect on people or planet
- Finances clearly defined activities or projects within each organisation
- Monitors closely how the loan is used

Its lending teams are organized by sectors which, according to Whitni Thomas, means that the relationships managers '*know the sectors that they are lending to inside and out*.' Although there are higher transaction costs for a significantly smaller average loan size than mainstream banks, the quality of the lending is high; provision for loan losses as a percentage of the outstanding loan book stood at 1.7% for the year ended 31 December 2012. Triodos Bank serves the following sectors:

- *Organic Food and Agriculture*: Triodos Bank finances the entire organic food chain, from producers and processors to retailers and restaurants
- *Energy and Climate*: by the end of 2011, Triodos Bank and its climate and energy funds financed over 360 renewables projects across Europe, including 204 wind farms, 131 solar plants and various small biomass and hydro projects
- *Arts and Culture*: Triodos Bank has invested in the cultural sector for many years, having financed 591 Arts and Culture projects. For many banks, artists represent too great a risk to issue a loan or credit
- *Microfinance*: Triodos Bank has €227 million in total assets under management in its four microfinance funds[33]

Triodos Bank´s role as a pioneer in social investment continues as it has been at the forefront of some of the more innovative trends in the social investment space, for example the issuing of charitable bonds. Most recently Triodos Bank UK worked on a charity bond for Golden Lane Housing, which raised £10 million and was over-subscribed, attracting both retail and institutional investment. With a fixed interest rate of 4% per annum for a five year term, it provided a compelling combination of financial returns and social benefit. Dan Hird, Head of Corporate Finance at Triodos Bank commented, '*This is a great result – not only for Golden Lane Housing but for the UK social investment market generally. It is clear to us that the market is ready for this kind of product*.'

33. http://www.triodos.co.uk/en/about-triodos/what-we-do/our-expertise/microfinance/

# CURRENT ENGAGEMENT OF BANKS WITH VP/SOCIAL INVESTMENT IN EUROPE

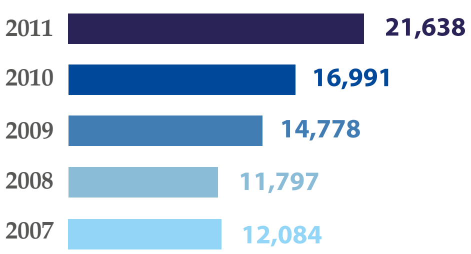
**Why are these initiatives interesting/powerful?**

- *Triodos Bank has shown impressive recent performance and growth* as shown below
- *Triodos Bank's success has been helped by industry trends* – such as increased demand from loan applicants (through growth of sustainable businesses and the reduction of lending by mainstream banks) as well as increased saver/investor interest in ethical products – *but is also related to the high quality lending model with bankers who are sector-specific and have in-depth knowledge of the issue areas, as well as a more old-style relationship approach*. A long-term relationship '*gives the bank an opportunity to make a real difference, and to co-operate in partnership and contribute ideas to help an entrepreneur achieve his or her goals in the long-term. In that process, Triodos Bank's network offers clear added value. It brings entrepreneurs together, in an environment of trust, to enable them to learn from one another*'[34]
- *Social investment as a sector-specific game*: the Triodos Bank model is a sign of how banks might evolve if they do develop their expertise and offerings in social investment. As Whitni Thomas describes it, '*the sectors within impact investment are all so different and each seem to have different risk/return profiles and different challenges/rewards. In terms of investors, this is also likely to be a sector-specific proposition. Some people care deeply about the environment. Other people care more about social justice*'
- *A high-touch relationship with investees*: Whilst Triodos Bank cannot be said to practice venture philanthropy in terms of the seven EVPA characteristics across its lending and investments, it does have a high-touch relationship with many of the organizations that it lends to and with some of its equity investments it is a very active, engaged investor taking board positions and transferring its know-how and expertise

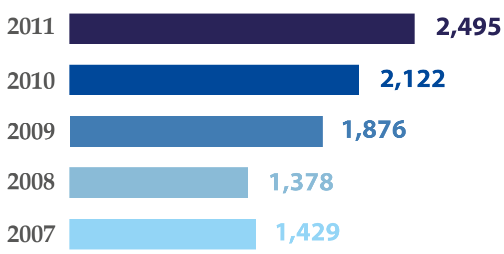
**Triodos' recent performance and growth[34]**

Amounts in millions of €

Number of depository receipts holders

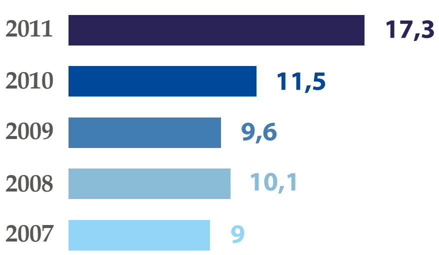



Funds under management*




*Including funds under management with affiliated parties that have not been included in the consolidation.

Net profit




34. Triodos Online Annual Report 2012, http://www.triodos.co.uk/en/about-triodos/who-we-are/key-figures/

# CURRENT ENGAGEMENT OF BANKS WITH VP/SOCIAL INVESTMENT IN EUROPE

**Perspective on the Market**

Triodos is very positive about the potential for more banks to enter the social investment/impact investment field and the likely growth of this area. According to Whitni Thomas, *'We are thrilled with the state of the market and the fact that there are so many more players out there than a few years ago. Social enterprises and charities deserve to have access to a competitive market. Triodos has seen a huge change in the last few years, with a much greater level of interest in impact investment by mainstream investors, such as institutional investors in the Netherlands. As we continue to develop the market, we need to be clear about the investment proposition and what impact investment can deliver'.*

## 3.3. Retail banks

**Retail banks/banking departments are active social investors/ venture philanthropists in microfinance, but have been slow to engage with this approach in other thematic areas**

Demand for retail bank lending to social enterprises is set to rise considerably in the next few years across Europe. For example, a report on bottom-up demand for social investment in the UK found that the demand could rise from £165 million of done deals in 2011 to £286 million in 2012, £750 million in 2015 and to as much as £1 billion by 2016 – representing a 38% year-on-year increase.[35] Much of this investment could be asset-backed capital or working capital that retail banks could provide. The current level of funding of social enterprise by retail banks is unknown since this is neither tracked internally nor required by regulators. However, it is common knowledge that retail banks have been wary of lending to SPOs, since evaluating credit risk has been challenging and the anecdotal evidence is that most SPOs applying for loan finance would be turned away before the loan process began. Moreover, many retail banks have been facing huge internal and external pressures, making such initiatives relatively low priority.

> *'The reality is that if a social business went to a local branch of BBVA, they would be turned down. The financial system is not ready or prepared for these types of hybrid companies.'*[36]
>
> Lidia del Pozo, Head of Community Involvement, BBVA

35. Brown, A. and Swersky, A. (2012), 'The First Billion, A Forecast of Social Investment Demand', Boston Consulting Group.
36. Interview with Lidia del Pozo, Head of Community Development, BBVA.

## CURRENT ENGAGEMENT OF BANKS WITH VP/SOCIAL INVESTMENT IN EUROPE

Whilst rising demand for lending by SPOs represents an opportunity for retail banks, considering they are rooted in local communities and have a track record of lending to commercial SMEs which could be adapted for social enterprises, they have not seized this opportunity. Lending to SPOs is not business as usual for the banks' credit committees and credit profiling systems, thus where retail banks have been active, they have set up specialist lending units to support social entrepreneurs or have developed discreet programmes and initiatives. Since they have found it hard to simply tack on lending to SPOs as a new business line, they have used their philanthropic or balance sheet capital to support such projects. An example is the Royal Bank of Scotland (RBS), a large international bank with its headquarters in Edinburgh and with a market share of 36% of all SME lending in the UK. In 2011, it set up a £5 million community loan fund with a dedicated team to provide loan finance of between £300,000 and £500,000 to SPOs. Whilst this unit has now been shut, social enterprises are now encouraged to apply for loans from the RBS Group Microfinance Fund (the MFF). *'The MFF supports social entrepreneurs who struggle to access mainstream finance because they rarely meet banks' normal criteria. It fulfils a need that banks traditionally haven't been able to meet. The MFF was therefore created to understand and meet the specific needs of social enterprises.'*[37] The MFF has an independent Board of Trustees and its own Credit Panel, whose members have experience in both the financial and social enterprise sectors. RBS has stated that by the end of 2015, it will support 2,500 social enterprises working in partnership with the sector to improve access to expertise, markets and finance.

Another example is BBVA, the second largest Spanish bank. BBVA has pioneered a social investment initiative, the Momentum Project, described in more detail below, which since 2011 has provided loan finance of over €4 million to Spanish social enterprises.

> *'The key driver in this emerging asset class is the demand for finance from social enterprises. Although the supply side is more mature in the UK, it is the demand side that will grow and drive the market in the Southern countries of Europe. Distress creates creativity.'*[38]
>
> Uli Grabenwarter, Head of Development – Impact Investing and Social Finance, European Investment Fund

37. http://www.inspiringenterprise.rbs.com/inspiring-social/microfinance-fund
38. Interview with Ulrich Grabenwarter, Head of Development – Impact Investing and Social Finance, European Investment Fund.

## CURRENT ENGAGEMENT OF BANKS WITH VP/SOCIAL INVESTMENT IN EUROPE

Whilst in general retail banks have been slow and reluctant to invest in SPOs, many retail banks/banking departments across Europe **have been active in microfinance lending.** This has been driven by the growing track record of microfinance as a viable, sustainable proposition as well as the financial inclusion agenda becoming increasingly important for banks. In developing countries only 26% of citizens have basic checking or savings bank accounts and in the EU-15, 3 in 10 adults are financially excluded. **The approaches towards involvement in the microfinance sector have been distinct for each bank**. Some banks are lending directly to low-income customers but the majority are lending indirectly through microfinance intermediaries. Some are focused on their home markets whilst others are primarily practicing microfinance in the developing world context where it is most mature. An example of mainstream banks investing directly in a pioneering social investment deal for a microfinance intermediary is the Fair Finance example outlined below.

### Mainstream banks invest in UK Fair Finance[39]

Fair Finance is a successful microcredit business that provides loans to some of the UK's poorest households. Set up in 2005 by Ashoka fellow Faisal Rahman, when Fair Finance started approaching mainstream banks it was a fairly small operation with 4 branches, 3,000 customers and a repayment rate of 92%. It was seeking commercial debt capital to expand its loan book, with a growth plan of opening eight more branches and making $22 million of additional lending available to some 50,000 Londoners over the next five years. It first approached retail banks for a commercial loan, but they were reticent about the credit risks associated with Fair Finance's target customer groups. However, in 2011 it was able to bring several big bank players on board, including the retail bank Santander (which provided $1.56 million of financing) as well as the investment arms of Société Générale and BNP Paribas which jointly provided another $1.56 of financing to close the first commercial microfinance investment deal in Western Europe. After being turned away by so many retail banks, Fair Finance was gratified that Santander had bought into the idea, which was partly helped by the UK government's Big Society Finance Fund committing $550,000 alongside. Fair Finance supplemented this debt financing with quasi-equity social investment from the UK's social investment body Venturesome as well as some high-net-worth social investors.

Some of the most interesting microfinance initiatives are those where the bank has created a special team or initiative primarily using philanthropic or balance sheet capital and have invested a significant amount of resources. Whilst these initiatives are under the microfinance label, they have migrated to include lending to social entrepreneurs and social businesses. For example, La Caixa's MicroBank initiative and Credit Agricole's initiative with Grameen Bank Also see Erste Bank's Second Savings Bank, outlined in more detail below.

39. Buckland, L. and Hay, M. (2012). 'Microfinance for Wealth Countries', Stanford Social Innovation Review.

## CURRENT ENGAGEMENT OF BANKS WITH VP/SOCIAL INVESTMENT IN EUROPE

### La Caixa MicroBank[40]

La Caixa is the leading savings bank in Spain, It set up MicroBank in 2007 with the vision of being the leading example in Europe of a new model of sustainable social banking. Microbank's product offerings include microfinance personal and business loans. In addition, it has designed a product to lend to social entrepreneurs as well as one specifically for the environmental sector. Between 2007 and the end of 2012 it had made 169.282 loans worth €1,045 million. Particularly exciting about the initiative is the collaboration between the mainstream bank and the social bank: MicroBank's products are sold through existing La Caixa channels (6,432 offices) and they share back-office systems and credit scoring techniques. La Caixa Foundation is also involved, for example in the development of an ethical fund product sold by MicroBank where La Caixa customers make an SRI investment (with a minimum of €600), and 25% of its commission is matched funded by the La Caixa Foundation to give to NGO projects. For Francisco de Conrado, President of MicroBank, '*what is important is that the financial sector fulfils its role of providing resources so that difficulties can be overcome and opportunities seized*'.[40]

### Grameen Crédit Agricole Microcredit Foundation

Crédit Agricole has its origins in the agricultural co-operative movement of the late 19th century and is now the leading bank in France. Crédit Agricole and Grameen Trust founded Grameen Crédit Agricole Microcredit Foundation in September 2008, with a €50 million endowment. The Foundation's main activity is to propose financing adapted to microfinance institutions and social businesses matching its geographical and sectoral priorities as well as its financial and social criteria. It offers targeted technical co-operation to its partner institutions and businesses, advising them in various areas such as their organisation, development of new products, risk management, development strategy and social performance measurement. It has invested in 30 MFIs, 7 social business projects and one fund to cover exchange risk. Its MFIS support more than 1.8 million beneficiaries. Like the la Caixa Microbank initiative, it can take advantage of the expertise and institutional support of a large banking group.[41]

**These initiatives have been a powerful example of the potential of social investment for retail banks since they:**

- *Are quickly becoming financially sustainable*, showing the viability of the financial and social return blended investment model. Erste Bank's Second Savings Bank is now self-sustaining as is Microbank
- Have provided an opportunity for the banks to use their human and social capital, since they have included an important volunteering/employee development element

40. https://www.microbanklacaixa.com/conocemicrobank/informesactividad/informeanual_es.html
41. http://www.grameen-credit-agricole.org/en/content/our-activities

In addition, **they are helping to develop the skills and experience of banks which will be important for successful engagement with social investment, including**:

- *Working cross-departmentally,* creating initiatives that may come out of the foundation/CSR department but which then become embedded or project managed within the business units of the banks
- *Collaborating with other sectors (the NGO and public sectors) as well as with other banks*

It is hoped that due to their successful forays into microfinance, retail banks will increasingly turn their attention to actively investing in social enterprise more broadly. This is particularly important in European countries where other players such as government or social investment funds are less active and the social enterprise market is less mature. A shining example of a retail bank in such a market that has moved from a microfinance focus to more broadly supporting the social enterprise market, using philanthropic as well as other financial capital and pioneering a VP approach, is Erste Bank, which is described in more detail below.

## Spotlight: Erste Bank and Erste Foundation[42]

### About Erste Bank/Erste Foundation

Erste Bank was founded in 1819 as the first Austrian savings bank, set up by wealthy Viennese citizens who donated money to help the growing amounts of working poor with no security and no access to banking. In 1997 Erste Group went public with a strategy to expand its retail business into Central and Eastern Europe. Since then, Erste Group's customer base has grown through numerous acquisitions and organic growth from 600,000 to 17.4 million and is one of the largest financial services providers in Central and Eastern Europe, focusing on retail and SME banking. Erste Foundation is the legal successor to the original savings bank and is the main shareholder of Erste Group Bank AG, controlling 24.24% of the stock.

### Their VP/Social Investment Initiatives

Erste Foundation and Erste Bank have created several joint in initiatives which are continuing the original tradition of financial inclusion of the bank and have been expanded to include social enterprise financing:

- *The Second Savings Bank*, 'Die Zweite Sparkasse', set up in 2006, which provides customers with bank accounts, no matter what their financial situation might be. An estimated 40,000 people in Austria do not hold a bank account and the Second Savings Bank currently has 8,000 customers. It operates as a separate bank, with branches offices in Graz, Innsbruck, Klagenfurt, Linz, Salzburg and Vienna and in other provinces services are offered in cooperation with the regional savings banks. The idea of a separate bank was one which Erste Foundation needed to convince the Erste Bank board about. Initially the board felt that bank accounts within the existing bank should just be given to the currently unbanked customers (i.e. they would not have to pay fees or meet the hurdles normally associated with opening bank accounts). However, the foundation felt that these customers may have been second class customers if

42. Sources for this case study include interview with Franz Karl Prüller, Member of the Board of Erste Foundation and Director of the Social Programme and Andrea Pscheid-Hintersteiner on Tuesday 9th April 2013 including follow-up e-mail correspondence and Erste Foundation website http://www.erstestiftung.org/

## CURRENT ENGAGEMENT OF BANKS WITH VP/SOCIAL INVESTMENT IN EUROPE

they were dealt with within the existing bank and given products with no special design or service. The concern was that the branch staff would not be friendly and the customers would not feel that they have been taken care of. According to Franz Karl Prüller, Member of the Board of Erste Foundation and Director of the Social Programme, Erste Foundation wanted something which would provide them with quality service and proper professional attention and thus give them the dignity everyone has a right to. Thus the Second Savings Bank was born

- *The Good.bee initiative* launched in 2008 whose mission is to '*develop and implement solutions to break down the barriers to financial inclusion for marginalized individuals and social enterprises in the Erste Group's home market in order to create positive change*.' This includes developing specific products to support social enterprises and social businesses
  - Good.bee mobile transactions provides mobile transaction banking in Romania for people in rural areas through a local bank
  - Good.bee credit provides working capital and investment microloans through a joint venture between Good.bee and a Romanian microfinance institute. It has so far disbursed 3,329 microloans
  - Good.bee provides social enterprise financing. This was has so far financed 21 organisations in Austria, Czech Republic, Slovakia, Romania, Serbia, Ukraine and Hungary with a total investment volume of €3.7 million

**Why are these inititatives interesting/powerful?**

- *Cross-departmental and joint projects between Erste Bank and Erste foundation*: the original idea and capital have tended to come from the Foundation, which is closest to the needs of disadvantaged groups. For example, for the Second Savings Bank, Erste Foundation provided the €5.8 million of starting capital and was the key driver of the idea internally. Yet, the initiatives later become implemented and managed by the bank. According to Franz Karl Prüller, '*These initiatives should be part of the bank's core business*'. The Second Savings bank is now run entirely by volunteers recruited from the ranks of Erste Bank employees and retirees. Erste Bank provides IT solutions and office space, so the Second Savings Bank has a very low cost base. The Good.bee initiative is a joint venture between Erste Foundation (holding 40%) and Erste Group but operationally sits within the bank
- *Have entailed cross-sector collaboration*, particularly with the NGO sector. For example, the Second Savings Bank has partnered up with counselling organizations, debt advisory services, welfare institutions and NGOs. This type of collaboration shows an openness which banks need in order to successfully design and manage products with a strong social component, as individual players do not have all of the skills or knowledge to operate and the ecosystem needs to work synergistically
- *Are on their way to self-sustainability:*
  - Zweite Sparkasse (The Second Savings Bank) is currently financially self-sustaining insofar as it covers its costs from two sources – interest from the original capital provided by the Erste Foundation and a small sponsoring contribution given by the local savings bank for each customer from their region taken into Zweite Sparkasse
  - Good.bee credit will for the first time post a small profit in 2013 and will be able to invest these in the improvement of services to its customers

- *Have a considerable volunteering/employee engagement element which has been very impactful for the bank*. Zweite Sparkasse (The Second Savings Bank) is staffed by active employees as well as retired employees who are all volunteering their time. According to Franz Karl Prüller, '*for the employees, it has been very satisfying that they could use their skills to help people. Being in close touch with disadvantaged people has helped them as they have brought that experience back into Erste Bank*'
- *Are potentially good business* for the bank. In the long-term, the social economy is perceived by Erste Bank as an opportunity, *'we believe that this will be an important element for retail banking i.e. financial products for the social economy, with large migrant and also rapidly ageing populations.'* For example, of the 2,000 Second Savings Bank customers who have graduated into normal banking relationships, 900 have moved to Erste Bank. Currently Erste Bank and Erste Foundation are looking to expand the social banking scheme to other countries

**Key Lessons**

- *The social enterprise market is immature and needs an engaged VP approach*, combining philanthropic funding of market-building initiatives along with active social investment. For this reason, Erste Foundation has run social business courses for NGOs and has sponsored Ashoka in Central and Eastern Europe. Franz Karl Prüller commented that, '*in this area, There is potential, dynamic and energy. There are new social businesses/enterprises as well as existing NGOs that are changing their business models, developing products services or selling their know-how to companies. There are hybrid models. However it is all in its early stages*'
- *Banks should try to develop social investment initiatives which are in line with their core business*. Since the social enterprise market is immature, Erste Foundation initially felt that equity would be the preferred social investment tool. However, whilst Erste Foundation and Erste Bank considered raising an equity fund from philanthropic corporate and private investors, it was considered problematic partly because the client demand was perceived to be lacking but also because equity investments are not part of Erste Bank's core business, unlike loans where it has the infrastructure and credit rating systems
- *Senior support sponsorship has been key with the support of Erste Bank's CEO considered a crucial factor*

**Perspective on the VP/Social Investment Market**

Franz Karl Prüller has been articulate about the role of retail banks in lending/investing for social impact:

'*Through such initiatives, Erste Bank is portrayed as a bank with a social conscience and CSR is not just a figleaf or an alibi. Indeed it goes into the core of what banking really means, that it is a service to the community and the economy. What is the role of Erste Bank? That it is a good and profitable retail bank. That means that it takes into account the needs of its communities. That it looks at social cohesion and the resilience of its communities, which are the best guarantees that this is the way to keep banks profitable. Out of that quite naturally comes an attention to the needs of the social economy.*'

# CURRENT ENGAGEMENT OF BANKS WITH VP/SOCIAL INVESTMENT IN EUROPE

**Retail banks with investment and private banking arms can be excellent and catalytic direct social investors outside of their comfort zone in microfinance**

Whilst retail banks have been wary of active social investment beyond microfinance, and have not tended to follow a VP approach, the example of BBVA illustrates how powerful it is both for the bank as well as for the sector when a bank with a large retail presence decides to launch a significant, large-scale and internally high-profile VP/social investment initiative and follows through. With their debt and lending expertise, retail banks are well placed to evaluate risk, and particularly if they can leverage their private and investment banking departments (which many of the large scale retail banks have), they are in an excellent position to launch such initiatives. They can engage with social sector experts to import the social sector knowledge and through collaboration across sectors, they can add enormously to the development of SPOs whilst increasing their own expertise in this emerging field.

## Spotlight: BBVA Momentum Project[43]

### About BBVA

Banco Bilbao Vizcaya Arentaria (BBVA) is a global retail financial group founded in 1857. It is the second largest Spanish bank and the largest financial institution in Mexico. It also has leading franchises in South America and the US Sunbelt. It has 114,245 employees, 50 million customers and is present in 32 countries. It has two cross-sectional business units: Corporate and Investment Banking and Retail and Business Banking.

### Their VP/Social Investment Initiatives

BBVA has become a major player in VP/social investment in Spain through the pioneering Momentum Project, a joint project between BBVA, PwC and ESADE, one of Spain's leading business schools. Momentum's mission is to contribute to developing social entrepreneurship in Spain by implementing a support program and an ecosystem so that the most promising social business ventures can consolidate, grow and scale their impact. It arose out of the BBVA's Corporate Responsibility department's initial intention to sponsor a programme of ESADE, which was working with social businesses. BBVA's interest grew, particularly when they realized they could contribute to shaping the strategic mentoring programme which employees could engage in. After a short time, they also decided that they wanted to put money into the social businesses they were mentoring. BBVA saw that, particularly in Spain, the era of donations for NGOs was coming to an end and that, according to Lidia del Pozo, Director of Community Involvement, *'if NGOs don't learn to be sustainable, they won't survive. We want to help social businesses how to be sustainable, and to teach them how to make financial decisions.'*

Initially, BBVA was considering obtaining funds to sponsor the social enterprises from private clients, but in the end they decided to invest using proprietary capital. *'We thought: we are a bank, we know how to lend money. We have a risk department, we have an investment bank, and we have expertise.'*

43. Source for this case study: face-to-face interviews with Lidia del Pozo, Director of Community Involvement, BBVA and Andrés Sánchez Hontoria, Corporate and Investment Banking, BBVA on Wednesday 6th February 2013; Momentum Project website http://momentum-project.org/; BBVA's corporate website http://www.bbva.com/TLBB/tlbb/esp/index.jsp

# CURRENT ENGAGEMENT OF BANKS WITH VP/SOCIAL INVESTMENT IN EUROPE

The structure of the Momentum Project, initiated in 2011, is as follows:

- Each year ten social businesses are chosen from approximately one hundred that apply. So far (up to the 2012 intake) Momentum Project has supported 12 social enterprises from a range of sectors, many of which include an employment dimension particularly for disadvantaged and long-term unemployed (a particularly acute problem in Spain). Momentum targets social enterprises operational for a couple of years that can prove they have achieved societal impact and are in the process of scaling up. The specific criteria are listed below

| Specific criteria... |
|---|
| > 2-3 years of experience |
| > 2 employees |
| > €100.000 turnover |
| < 50% grants or donations |
| Main activity and impact in Spain |
| Meaningful social impact, financial sustainability, innovation and scale-up project |

- The ten social businesses chosen each year receive a 3 four-day training sessions led by Professors of the MBA Programme at ESADE with additional strategic mentoring from a team comprising a student from the MBA programme of ESADE, an Executive MBA which coordinates the process, a BBVA mentor and a representative from a company working in a similar field
- At the end of a year of mentoring and training, PwC conducts an independent rigorous due diligence process of the organisation and an investment proposal is prepared. Based on their business plan, financial history and social and business projections as well as their capacity to repay the loan, a proposal for investment is prepared. There is a Social Investment Day during which Momentum decides which social businesses to invest in. Each year there is approximately €3 million available for funding through a vehicle called Momentum Social Investment. In 2011, €2.5 million were invested in 6 projects, in 2012, €1.8 million was invested in 7 projects. In 2013, an estimated €1.5 million to €2.5 million will be invested depending on the number of projects selected and the size of investment chosen for each project. The Momentum Social Investment vehicle provides 8-year term loans starting with a 4-year interest- only period (no capital repayment necessary). During this period, the interest rate is very low, starting at 2% in the first two years, 4% for the years 3 and 4 and increasing a percentage point every year thereafter. BBVA is assuming the costs of the vehicle with the interest generate expected to cover any write offs.
- There is *careful monitoring and follow-up with the projects after investment*
- In 2014 BBVA plans to approach private clients about investing in the Momentum Social Investment fund. Planning and work is underway to create the appropriate client offering
- *The project has been judged such a success that it has been replicated in Mexico and Peru, showing how such projects can cross international boundaries*

# CURRENT ENGAGEMENT OF BANKS WITH VP/SOCIAL INVESTMENT IN EUROPE

- BBVA has also been experimenting with investing not just debt, but also equity, although this has been challenging because many social enterprises in Spain cannot legally accept equity. In the summer of 2013, BBVA closed its first equity transaction, investing €450k in a company called Batec Mobility for a 48.5% stake

**Why are these initiatives interesting/powerful?**

- *Momentum has leveraged a wide range of human capital, including the expertise and skills of different departments internally as well as through external partners* ESADE and PwC. This has created an impressive mix of skills and networks. It is the first skills-based volunteering at scale that BBVA has engaged in, including over 30 BBVA employees and with CSR pulling in the following different departments within the bank: Private Banking, Wealth Management, Venture Capital, Risk, HR and Communications. Lidia del Pozo, Director of Community Involvement enthuses that, *'I have people calling me begging me to let them be a mentor. People's experience has been contagious'*
- *The combination of financial, human and social capital* provided by Momentum has been very impactful for the social businesses invested in. Since receiving investment from Momentum, the social businesses have increased their EBITDA by more than 50%.
- *Momentum has had enormous senior support* and has been judged a huge success for the bank, with Momentum a powerful brand internally and externally. Lidia del Pozo notes that, *'Key executives within BBVA see this project as a way for the bank to understand and get to know new business models.'*, Andrés Sánchez who project manages the Momentum social investment vehicle describes the return for the bank as huge: *'we have a new product, we are investing with society not in an old way, but using a new approach. Everyone in the bank can take part in it. We are creating employment'*

**Lessons**

- *Considerable time and thought needed for BBVA to structure the right financial vehicle to support social businesses*
  – It was difficult to create a fund using instruments traditionally used by banks. BBVA worked out that investment in social enterprises needed a different approach. This is due to the different types of structures being invested in (co-operatives, foundations etc.) and the fact that many social businesses could not take equity. So a limited liability company was created to run the fund and invest in the Momentum Project organizations
  – The loan product was carefully constructed to meet the needs of the social businesses, with a 4-year grace period on capital repayment, no guarantee required as well as innovative ways structured so that the social business can benefit from its own success. For example, if the social business performs better than expected on EBITDA, they can repay the money in advance, with a 20% discount on interest
- *BBVA perceives that its private clients will be interested in the approach, however:*
  – It needs to feel secure in the product before offering investment opportunities to its clients. Thus it has invested its own capital for several years before actively selling to select private clients

## CURRENT ENGAGEMENT OF BANKS WITH VP/SOCIAL INVESTMENT IN EUROPE

– BBVA is likely to choose a fund strategy where investors would invest in the whole fund rather than being able to cherry-pick investment opportunities, i.e. those with high financial return probabilities. They believe that whilst some social businesses might not be so popular, they are equally worthwhile and deserve the funding opportunity

- Although the returns for the bank have been excellent, *the initiative has taken up significant time*, and the cost of financing each project is high because the size of the projects is small. These overhead costs may diminish over time as BBVA becomes more expert at dealing with this new sector
- Bank employees *needed to be sensitive and adapt their approach to working with people from the social sector*. According to Andrés Sánchez, '*we needed to find a way to work with people who were not so professional, who had a different set of skills. We needed to be flexible*'

**Despite a relatively small amount of direct, engaged VP and social investment which has become embedded in business units themselves, many retail banks have provided important philanthropic support for the social enterprise sector led by CSR departments/ foundations**

In the role as champions of the social enterprise sector, retail banks, especially in the UK have been somewhat active through their CSR departments and charitable foundations. This involvement has fallen into three broad categories:

1. ***Investment in social investment intermediaries:*** For example in the UK, Lloyds TSB Scotland plc, Barclays Business Banking, The Royal Bank of Scotland (RBS) and HSBC have invested in the major social investment fund manager Bridges Ventures. In addition, Barclays, HSBC, Lloyds Banking Group and RBS have made equity investments of £50 million each in the UK's Big Society Capital. This was part of the UK government's 2011 Project Merlin agreement when banks agreed to lend about £190 billion to businesses during 2011, curb bonuses and reveal some salary details of their top earners. Whilst some experts are sanguine about how far this investment may affect these banks understanding of and drive to be more active in the social investment arena, others see this as an exciting opportunity

2. ***Sponsorship initiatives:*** For example in 2009 RBS created a social enterprise index called social SE100 index which tracks the social and financial performance of social enterprises in the UK (it currently has 754 organisations in its index). It aims '*to forge a better understanding of the pioneering organizations involved in socially enterprising activity across the UK, to be a powerful source of market intelligence and a tool for individual social enterprises.*' Each year it provides a £25,000 prize which is shared between an RBS SE100 growth champion, social impact champion and trailblazing newcomer

3. ***VP/Grant-making programmes to support social entrepreneurs and charities:*** For example Lloyds TSB Foundation which in 2008 incubated and developed Inspiring Scotland, an innovative outcome-focused VP organisation designed and developed in response to the needs of Scotland's charities. Inspiring Scotland is now an independent organisation. Its focus is on social issues where it can leverage real and lasting change. It proactively

## CURRENT ENGAGEMENT OF BANKS WITH VP/SOCIAL INVESTMENT IN EUROPE

tackles tough social issues by investing in portfolios of charities, each addressing a different social issue. From a standing start in 2009, it has delivered almost £40 million of funding to the Scottish voluntary sector, funding 64 social ventures to tackle youth unemployment; lack of free play opportunities for children; more support in children's early years; and support for disadvantaged communities to harness their own assets

**Outside of the UK, a few banks have also, through their charitable foundations, sponsored and supported the development of the social enterprise sector through VP/grant-making programmes.** Since the social enterprise market has been relatively immature outside of the UK, and due to limited opportunities to invest via intermediaries, banks have not had the same opportunities to passively invest in the market via intermediaries or to sponsor market infrastructure initiatives. However, enterprising bank foundations have come up with valuable and meaningful programmes to support the social enterprise sector. In Spain, la Caixa Foundation has been running a social entrepreneurship programme focused specifically on start-up social enterprises. Each year it picks 20 budding social entrepreneurs/social enterprises and provides them with a four-tier package of support over a year: 1) training at IESE business school; 2) opportunities for networking amongst their peers; 3) PR and 4) Financial support of a maximum of €25,000 per project.[44]

**In a forward-looking move, some retail banks are also considering retail products and platforms with a social/ethical dimension**

Products for the retail market with a specifically social/ethical dimension are under exploration by several retail banks and is perhaps something we will see more of in the next few years. Banks could learn from and potentially replicate the success of the Calvert Foundation in the USA, profiled below, which has shown there is significant retail appetite for standardised, simple products which generate financial and social returns.

Banks are also as part of an advisor/intermediary role, developing internet platforms to intermediate their clients' donations and investment in social purpose organizations, such as BBVA's Suma which aims to promote NGO's projects and to facilitate the relationship between donors and NGOs.

### Calvert Foundation Community Investment Note[45]

The Calvert Foundation's mission is to maximise the flow of capital to disadvantaged communities in order to foster a more equitable and sustainable society. By creating innovative financial products and services, Calvert Foundation acts as a leading intermediary helping individual and institutional investors achieve 'blended value' that integrate social impact, financial return and risk management. Calvert Foundation's Community Investment Note has attracted $230 million from over 13,000 investors. Investor dollars support a diversified portfolio of nearly 200 nonprofits and social enterprises serving low-income communities throughout the US and around the world. The

44. Programa de Emprendimiento Social, Obra Social 'La Caixa'.
45. http://www.calvertfoundation.org

minimum investment is $1,000 directly or through brokerage accounts and $20 online, with financial return targeted at 0-2% at terms of 1-10 years. Over 98% of the underlying portfolio loans have been repaid and no investor has ever lost principal or interest.

## 3.4. Investment Banks

**Some investment banks/banking arms are testing the waters by setting up funds using proprietary capital to develop skin in the game and obtain a deeper understanding of the market**

Investment banks in Europe have for some years been very active in the microfinance market and have played a critical role in its commercialization. The investment banker's skills of deal and product structuring have been well-utilised to support the development of microfinance. For example, the first securitisation of microfinance loans by BRAC, a Bangladesh-based NGO with large-scale microcredit operations, happened in 2007 with the support of Citigroup. Meanwhile, Deutsche Bank created the first global subordinated debt fund for microfinance. Most of the investment banks initiatives in this field have been CSR-led and have adopted a blended social and financial return approach. Investment banks with major microfinance fund presence include Deutsche Bank and Citibank as per the table below. Banks have also been very active in community development, financing quality affordable housing, homeownership opportunities and support services. Contribution to microfinance and community development has been implemented through grants, loans and investments, working with philanthropic capital from the banks' foundations, capital from the banks' balance sheets and seeding funds to raise capital from external investors.

The investment banks' experience of microfinance and community development has been important for motivating banks to explore social/impact investment further, pointing them towards additional thematic areas for example risk capital for social enterprises, since it has:

- Shown that there is significant client appetite, from both philanthropic as well as more mainstream investment for a blended return, with larger-scale deals possible when the banks help to create structures that can accommodate the different risk/return spectrum and social/financial trade-off desires of different investors
- Proved that a blended financial and social return is viable
- Illustrated how far the sector needs the human capital resident within investment banks to structure appropriate and standardized products for the market

However, the experience with microfinance has also shown that the blended return proposition can sometimes be risky, particularly if there are external shocks affecting the overall reputation of a field, for example the microfinance backlash a few years ago.

# CURRENT ENGAGEMENT OF BANKS WITH VP/SOCIAL INVESTMENT IN EUROPE

## Examples of microfinance initiatives of major investment banks active in Europe

| | |
|---|---|
| **Citi** | Citi launched Citi Microfinance in 2005 to focus on developing commercial relationships with microfinance institutions, networks and investors around the world. It is a small, London-based unit with colleagues in New York, India and Colombia. It also works through Citi branches and business groups in a number of countries. It provides direct and structured financing, access to local capital markets, leasing, individual lending through MFI partners, foreign exchange and interest rate hedging, remittances and insurance. It serves 150 MFIs in nearly 50 countries. It has been involved in a large $350 million public-private partnership with OPIC to provide micro-lending services to borrowers, funding 38 MFIs in 21 countries which have provided small loans to more than 960,000 borrowers.[46] |
| **Deutsche Bank** | Deutsche Bank was the first global bank to create a microfinance fund over a decade ago and has continued to be an important innovator, lending its voice and using the Deutsche Bank platform to further the industry. Its activities are led by the Community Development Finance Group as part of the Bank's CSR commitment, providing loans, investments and limited philanthropic grants to the microfinance sector.<br><br>The Community Development Finance Group has launched new microfinance investment funds over the past 15 years that use innovative structures tailored to the evolving needs of the microfinance sector and has served over 120 MFIs (microfinance institutions) in 50 countries, with $215.561 million in capital benefiting as many as 23.8 million poor entrepreneurs. During a challenging period in the microfinance sector's growth due to excessive commercialization in a sub-segment of the industry, DB initiated a new industry CEO's working group of the industry's leading global microfinance institutions to co-ordinate solutions. DB also launched a $100 million fund with technical assistance targeted at microfinance institutions who were leaders in customer service – and those striving to improve.<br><br>Please refer to https://www.db.com/cr/en/society/index.htm for further details. |

46. http://www.theconcordiasummit.org/news/2013/09/16/concordia-conversations-robert-annibale/

## CURRENT ENGAGEMENT OF BANKS WITH VP/SOCIAL INVESTMENT IN EUROPE

Beyond microfinance and community development, some investment banks have demonstrated a commitment to properly explore and even drive social impact investing in the provision of risk capital to social enterprise/social businesses, despite the immaturity of the sector and the extremely small deal sizes. J.P. Morgan, profiled below, has set up a Social Finance business unit and has been engaged in social investing, advisory/intermediary and market infrastructure development. In 2010 it highlighted how investors were beginning to organise around the theme of impact investing, treating it in many ways like a distinct asset class. This move catalysed the broader investment and asset management fields to pay greater attention to this new field.

> *'For Credit Suisse, the success of the microfinance model is the blueprint for our growing commitment to provide leadership and promote social innovation to meet the diverse needs of people living at the base of the pyramid. Education, agriculture, healthcare and housing are only a few of the areas where opportunities to make a difference have been identified. On the one hand, the role of Credit Suisse will involve raising and channeling funding to promising initiatives, and delivering in-depth sector research, while on the other it will entail providing expertise and coaching through our partners and employees to support innovative business models.'*[47]
>
> Patrick Elmer, Responsible Investment and Philanthropy Services and Laura Hemrika, Microfinance Capacity-Building Initiative, Credit Suisse

Meanwhile Goldman Sachs in the USA has funded two social impact bonds in the US, including a partnership with United Way of Salt Lake and the Early Childhood Innovation Accelerator to create the first social impact bond financing early childhood education, jointly loaning $7 million to fund the expansion of a high-quality preschool programme for at-risk children in Utah. Goldman Sachs has stated that, *'we believe this model holds promise because it is scalable, replicable and sustainable. It provides a new framework for thinking about how the public and private sectors can work together to address pressing social needs in a way that results in better outcomes for children, alleviates some of the financial burden on taxpayers and generates savings for governments.'*[48] Most recently, Goldman Sachs launched a $250 million Social Impact Fund initiative which seeks to provide investors with an opportunity to deploy capital to address a range of pressing social challenges in the US whilst also seeking a risk-adjusted financial return. The investment strategy is to support neighbourhood building projects, job creation and social enterprise as well as social innovation financing including social impact bonds. The Fund will be run by the internal Urban Investment Group which has committed over $3 billion of the Firm´s capital since 2001.

47. Credit Suisse, (2012) 'Microfinance at Credit Suisse, 10 years of investing for impact' (pg.22).
48. http://www.goldmansachs.com/media-relations/in-the-news/archive/op-ed-social-impact-bond-slc-6-13-13.html

# CURRENT ENGAGEMENT OF BANKS WITH VP/SOCIAL INVESTMENT IN EUROPE

## Spotlight: J.P. Morgan Social Finance[49]

**About J.P. Morgan and J.P. Morgan Social Finance**

J.P. Morgan is a leader in corporate and investment banking, asset management and private banking and commercial banking. It is part of J.P. Morgan Chase & Co, a financial services firm with assets of $2.3 trillion. In its corporate and investment banking business (CIB), it has one of the largest client bases in the world. It serves nearly 20,000 clients operating in more than 100 countries. The Social Finance unit was launched in 2007 with the belief that the bank should play a greater role in helping to develop the financing of the impact investment sector. The unit invests J.P. Morgan's own capital in impact investment funds focused on sectors such as financial services, healthcare and agriculture, with the objective of achieving a financial return and a positive, measurable impact for under-served communities. Social Finance is now expanding its client advisory practice to respond to increasing demand from both institutional and individual clients. The unit is active globally, but is included in this report since it has a team in London and has made investments in Europe.[50]

**VP/Social Investment Initiatives**

- J.P. Morgan Social Finance activities can be split into three areas:
  1. *Thought leadership:* J.P. Morgan has issued several reports on the impact investment sector, including surveying the impact investment market since 2010 to *'shed light on this growing set of investments and the investors that make them.'* Perhaps its most catalytic contribution in terms of thought leadership was to describe impact investment as an asset class in its report, 'Impact Investments: An Emerging Asset Class' in November 2010. The concept of impact investment as another asset class is a perspective that many (although not all) other banks and investment management firms have adopted. J.P. Morgan Social Finance research, unlike most of the firm's research, is a public good and is freely available from the website. Investing in research is part of J.P. Morgan's championing of the impact investment sector, through developing market infrastructure
  2. *Investment/Capital:* J.P. Morgan has a principal investment allocation of $100 million to deploy in impact investment funds with an impact investment thesis of improving livelihoods of low-income and excluded populations worldwide by engaging these populations as consumers or suppliers. It has committed $50 million to the following investments:
     a. EcoEnterprises II (2013): Invests in environmentally-sustainable small and medium-sized enterprises that create positive social and conservation impacts in select countries in Latin America. The fund closed at just over $35 million in November 2013
     b. LeapFrog Fund II (2013): Invests in businesses providing insurance and related services to low-income and financially excluded people. LeapFrog's second fund reached a first close of $204 million in September 2013 and is targeting a $400 million final close in 2014
     c. Global Health Investment Fund I (2012): Structured and placed by J.P. Morgan alongside The Bill & Melinda Gates Foundation, the fund invests in the development of drugs, vaccines, diagnostics or other technologies that address global health challenges that disproportionately impact developing countries, such as tuberculosis and malaria. The GHIF closed at $94 million

49. Sources for this case study include: face-to-face interview with Ali El Idrissi, Social Finance Unit, 26th March 2013; J.P. Morgan Social Finance website http://www.jpmorganchase.com/corporate/socialfinance/social-finance.htm
50. http://www.jpmorganchase.com/corporate/socialfinance/social-finance.htm

## CURRENT ENGAGEMENT OF BANKS WITH VP/SOCIAL INVESTMENT IN EUROPE

d. African Agricultural Capital Fund (2011): managed by Pearl Capital Partners, primarily invests in small- and medium-sized agricultural enterprises to improve the livelihoods of smallholder farmers in East Africa. In September 2011, the Bill & Melinda Gates Foundation, the Gatsby Charitable Foundation, the Rockefeller Foundation and J.P. Morgan participated in the $25 million close of the fund
e. Bridges Social Entrepreneurs Fund (2011): Bridges Social Entrepreneurs Fund provides growth capital to support high-impact, scalable and financially sustainable social enterprises in the UK. The fund closed at £11.75 million in early 2011
f. IGNIA (2010): IGNIA is a venture capital fund based in Mexico supporting the founding and expansion of high growth social enterprises serving low-income populations in Mexico. IGNIA closed at $102 million
g. LeapFrog Financial Inclusion Fund (2010): LeapFrog is the world's first micro-insurance fund, investing in businesses providing insurance and related services to low-income and financially excluded people. The fund closed at $137 million
h. MicroVest II (2009): MicroVest II seeks sustainable solutions to poverty by facilitating the flow of capital to pro-poor finance institutions serving low-income individuals in emerging markets such as Latin America, Asia and Eastern Europe. J.P. Morgan Social Finance invested and supported the placement of the fund, which closed at $60 million

J.P. Morgan Social Finance assesses the performance of the portfolio on a blended basis – the aggregate financial return and social impact of its invested capital are considered in determining success. In practice this means it will consider returns below the threshold used internally for other businesses of the firm, if the impact objectives of the opportunity are compelling and consistent with its stated thesis. The intent of the portfolio, however, is to demonstrate that there are investable opportunities in the market with commercial or near-commercial returns that would be appropriate for institutional investors, and J.P. Morgan Social Finance assesses opportunities for their potential to deliver those returns.

3. *Client advisory:* J.P. Morgan is moving towards more active intermediation and structuring work for impact investment opportunities. The objective is to introduce clients throughout the bank (both institutional and private) to investment opportunities and channel capital to support the growth of the market. For example, J.P. Morgan, alongside The Bill & Melinda Gates Foundation, structured and placed the Global Health Investment Fund (GHIF) and announced a successful capital raise of nearly $100m in September 2013. GHIF is a new impact investment fund designed to provide financing to advance the development of drugs, vaccines, diagnostics and other interventions against diseases burdening low-income countries. The fund attracted a variety of investors, including foundations, development finance institutions, commercial financial institutions, pharmaceutical companies as well as clients from J.P. Morgan Private Bank

## CURRENT ENGAGEMENT OF BANKS WITH VP/SOCIAL INVESTMENT IN EUROPE

**Why are these initiatives interesting/powerful?**

- *J.P. Morgan Social Finance is a group that is dedicated to serving and growing the impact investment market. The group employs a global, cross-departmental approach*, with teams in London and New York working across business lines to leverage the full capabilities of the bank and reach both institutional and private clients. As the team describes it, *'it is a business that is being built internally. It is not an additional product added to an existing team'*
- J.P. Morgan's recently-raised Global Health Investment Fund shows the *importance of investment bankers' structuring skills* in developing layered structures to suit different investors, as well as their *ability to work successfully with a non-profit partner such as The Bill and Melinda Gates Foundation. 'The Global Health Investment Fund demonstrates the potential for innovative collaborations and thoughtful financial structures to mobilize new sources of capital for social challenges,'* said Jamie Dimon, Chairman and CEO of J.P.Morgan Chase & Co. '*This product brings a diverse group of investors together around the shared objective of developing life-saving technologies in a financially sustainable way*'[51]
- *Its brand has had a powerful and catalytic role on the broader investment management field.* According to David Carrington, freelance consultant and social investment expert, '*when J.P. Morgan said that impact investment was an asset class, although there was criticism about its content, the investment management industry suddenly started to say, 'there must be something in this'*
- *J.P. Morgan feels that it has benefited significantly* from its commitment to impact investment. While the business is at a nascent stage, it is rapidly growing and starting to evolve into a client-oriented business. In this respect, J.P. Morgan is benefiting from an early-mover advantage, having invested its own capital in impact funds for a few years already and established its research coverage. The bank is now leveraging this experience to reach out to clients and expand the investor universe for impact investments. It has also resulted in additional benefits as the Social Finance team is increasingly working and generating business opportunities with other parts of the bank

**Lessons**

- *Client demand is growing both from institutional and private clients, although the market is still nascent and relatively small in terms of amount of capital invested*. Demand is currently being led by socially-motivated investors (such as development finance institutions and foundations) but they are increasingly joined by institutional clients that want to play a pioneering role, some of which have already decided to make initial allocations to the sector. The high-net-worth and family offices communities have also increased their involvement in the last two years but they tend to invest smaller amounts of capital. J.P. Morgan Social Finance is building its investor base beyond like-minded investors who are interested in SRI and microfinance, and is leveraging the bank's global platform to involve commercial institutional investors and private clients. However, according to the team, '*the challenge is that a large portion of the current impact investment landscape is in illiquid private equity structures, with early-stage businesses in emerging and frontier markets, lacking track record. As the sector grows and builds its track record in the next few years, we are likely to see an increased involvement from traditional investors*'

51. http://ghif.com/press-release/

# CURRENT ENGAGEMENT OF BANKS WITH VP/SOCIAL INVESTMENT IN EUROPE

- *Given J.P. Morgan's focus on fund managers improving the livelihoods of low-income and excluded populations, the pipeline of impact investment opportunities is still limited*, particularly for high quality fund managers. J.P. Morgan assesses investment opportunities on a blended basis, looking at both financial and impact potential, and also wants to make sure the governance and monitoring of investments by impact investment funds is as robust as in other asset classes. As a consequence of these best-practice requirements and given the early stage nature of this market, the investable universe is still relatively limited, although rapidly growing

**Perspective on the market:**
According to J.P. Morgan, the impact investment market has completed an important phase of growth that started about 5 years ago. The market has attracted significant attention and new players including investment funds (asset managers) and institutional and private investors (asset owners). To enable impact investment to develop from a relatively small market to a sizeable and investable universe, in line with the magnitude of the social and environmental challenges it ambitions to tackle, there will be a need to commit not only capital but also resources and skills to structure innovative solutions and products that will meet investors demand. J.P. Morgan also thinks that there is a need to develop a deeper understanding of the various investment opportunities and how to characterize them at a more analytical level. As such they encourage investors to abandon broad debates about whether they need to trade-off financial return in exchange for impact and propose that investors rely on economic analysis on a deal-by-deal basis of the revenue potential and cost profile of the intervention they are looking to fund, and set risk-adjusted return expectations accordingly.

Whilst the ultimate goal and motivation for these investment banks is to develop products and services to sell to clients (private and institutional), there is a strong corporate responsibility dimension to current engagement and a blend of philanthropic and balance sheet capital is being used. The investment banks are learning as they go, looking to create a track record by investing their own capital, sponsoring market-building infrastructure and scoping out the field. Until recently, they have been slow to take social/impact investment propositions to clients as they don't perceive that the market timing is right, even for philanthropic private clients. An example of an extremely thoughtful market-building approach to social investment is Deutsche Bank's Impact Investment Fund UK profiled below. Whilst there is an internal belief that social investment will become a significant and mainstream investment proposition as evidenced by Deutsche Bank UK CEO Colin Grassie saying that, 'investments with single, mid-digit returns with measurable social outcomes are great products. Every model portfolio should include such assets', they are keen to build track record and experience internally first.

# CURRENT ENGAGEMENT OF BANKS WITH VP/SOCIAL INVESTMENT IN EUROPE

## Spotlight: Deutsche Bank Impact Investment Fund, UK[52]

The Deutsche Bank Impact Investment Fund UK, launched in 2011, is a ring-fenced, discrete £10 million fund set up to invest in social enterprises, primarily in the UK:

- Its development was spurred by Deutsche Bank's Corporate Responsibility department in the UK and driven by senior sponsorship from the Deutsche Bank UK Chief Executive Officer Colin Grassie keen to play an instrumental role in developing the UK social investment market
- The motivation for setting up the fund came from: a) a strong sense of values; b) a belief that a new asset class is starting to emerge which needs to be explored; c) a perspective that social issues are intimately affecting the banking model and that these can be addressed by social enterprise; and d) a UK-specific perspective on the potential of the social enterprise sector
- The fund is managed by the DB Private Equity department, which is part of the global alternative investment management business of Deutsche Bank's Asset and Wealth Management division
- It is a fund-of-funds product, since the initial vision in setting it up was that the most beneficial contribution that could be made to building the market was by sponsoring social investment intermediaries
- Due diligence on potential investments is described by Deirdre Davies, Director, Responsible Investments as '*the same as any other fund investment.*' However, investments are assessed not only for financial return, but anticipated social impact, governance and transparency of reporting as well as how a particular transaction will help to develop the overall market
- So far the fund has invested in three investments with an active pipeline

As a fund-of-funds, Deutsche Bank's Impact Investment Fund UK does not have an engaged VP approach, yet capital provision to the sector has been matched thoughtfully with the Corporate Responsibility department in the UK using philanthropic capital to sponsor market-building initiatives e.g. Inspiring Impact (a program designed to drive the development of social impact methodology) and a mentoring initiative whereby 25 of Deutsche Bank's employees are working one on one with social entrepreneurs, giving business advice and support

**What is important/powerful about these initiatives**

- *Sitting within a core business unit* means that the fund is not a cost centre, that it is developing a clear track record and that Deutsche Bank is demonstrating a commitment to social issues through core action, as part of a move to push corporate responsibility activity more into the business
- *Employee engagement through mentoring of social enterprise offers a distinct opportunity.* According to Deirdre Davies, '*people want to increase their social footprint and this is a real opportunity for people to get involved in something that uses their skills, to be a bit more strategic about their volunteering*'

52. Source for this case study include face-to-face interview with Deirdre Davies, Director, Responsible Investments, DB Private Equity and Private Markets, on 25th March 2013 and relevant parts of Deutsche Bank website.

## CURRENT ENGAGEMENT OF BANKS WITH VP/SOCIAL INVESTMENT IN EUROPE

**Lessons**

- Bank employees involved in social investment or managing social investment funds or products need to be intrapreneurs, learning and networking significantly externally, in order to identify deals as well as to evaluate the most impactful interventions for the bank

**Perspective on the market**

Tiina Lee, Head of UK Strategy, '*Over the next 5-10 years we see the social investment market in the UK continuing to grow from a small base as the positive trends continue. However, there remain several factors that prompt caution and may limit growth. Firstly, the supply of potential social investment funding (e.g. from Big Society Capital) is far greater than justified by the investment readiness of intermediaries and target social enterprises. Secondly, it is unclear at present whether and how to engage other investors (e.g. corporate, institutional, retail) beyond the traditional investor base of foundations and high net worth individuals. Thirdly, investors and intermediaries will need to be realistic about the level of financial returns from inherently risky business models that are seeking to deliver social impact. Finally, the marketplace will need to see track record and performance results from investment in social enterprises through to payment by results schemes before committing further capital*'.

In general investment banks have contributed by:

- Being involved in some of the more **innovative product and deal structures**, such as social impact bonds or layered funds. An example is the recently launched Global Health Investment Fund by J.P. Morgan profiled in this report on pg. 62
- Adopting a **fund-of-funds approach** to support social/impact investment intermediaries

What has been most impressive is **the rigour and excellence that these investment banks are bringing to the field, as well as their strong desire to understand, learn and contribute thoughtfully**. They have added credibility to the emerging sector – the investment management industry is now paying attention and the engagement of these banks is having a large catalytic and demonstration effect. Although there might be some accusations of the creation of hype, interviews with these banks illustrated quite a different tone to their engagement – excited, but also careful, cautious and aware of the challenges and difficulties in bringing the emerging field to fruition.

Perhaps disappointingly due to the lack of direct investing in SPOs since investment banks have chosen fund-of-fund structures, there has been limited VP activity in terms of engaged investing by the investment banks. Yet, they have been creative in finding ways to use their skills for social good, in terms of product innovation, conducting and publishing free research as well as more general mentoring initiatives for social enterprise which tend to be led and run by their CSR departments.

# CURRENT ENGAGEMENT OF BANKS WITH VP/SOCIAL INVESTMENT IN EUROPE

## 3.5. Private Banks

**Many private banks/private banking departments are responding to as well as shaping growing private client demand for social and impact investment**

Private banks are in the best position to play the key role of advisors/intermediaries in the social and impact investment space and external observers expect most of the banking activity and movement within VP and social investment to come from the private banking sector. At the moment, this is where the strong and growing client appetite lies (family offices, high-net-worths and foundations looked after by private banks are at the forefront of social investing) which leads to a clear incentive to get involved and to develop product expertise and offerings. Although there remain challenges in matching the product preferences of private clients (for example for liquidity) with available social investment products, financial innovation is proceeding apace and new social investment funds which offer liquidity for example around social impact bonds have recently been launched. Client demand is nascent and needs encouragement and directing, thus private banks have done considerable work in terms of client education, for example launching reports such as Credit Suisse's report on social entrepreneurship,[53] 'Investing for Impact, How Social Entrepreneurship is Redefining the Meaning of Return' as well as holding events for philanthropy clients on VP, social and impact investment.

In the US, there have been a few high-profile initiatives showing that some large brands are seriously investing in the approach, such as the launch in 2012 of the Morgan Stanley Wealth Management´s Investing for Impact Platform which explicitly offers to clients a range of products from SRI funds to impact investing opportunities, followed by the launch in November 2013 of Morgan Stanley´s Institute for Sustainable Investing which the UK´s Guardian newspaper saw as a potential sign that ´global financiers are getting serious about accommodating clients who want to invest with one hand on the heart and the other on the pocketbook´.

Yet there is a chicken-and-egg situation facing private banks: educating clients as well as client relationship managers is a long and quite lengthy process and some private banks may be reluctant to take the next step of developing or marketing specific product offerings. There remains a significant degree of uncertainty in the market, and private bankers are operating without a roadmap, grappling with several questions, and coming up with different answers outlined in the case studies below, reflecting the fact that this is a highly emergent, experimental and dynamic field.

The lack of a clear, standard approach means that it is pioneers and the believers, profiled in this report, that are moving beyond client education initiatives to actually going out and actively raising client capital and experimenting with different tools and products. Many have teamed up with experts and intermediaries as part of the product development process. The mood is quite cautious from those who have been at the coalface of fundraising – despite initial enthusiasm, it is a harder and more complicated sell than anticipated,

53. Credit Suisse Research Institute (2012), 'Investing for Impact, How social entrepreneurship is redefining the meaning of return', Thought Leadership from Credit Suisse Research and the world's foremost experts.

client mindsets remain quite separated into philanthropy on the one hand and investment on the other and the product limitations (liquidity, ticket sizes) are affecting the ability to raise significant sums.

### Questions that private banks grapple with related to social impact investing:

- Which type of client is interested in a social or impact investment proposition?
- How should social and/or impact investment be articulated and described to clients?
  - As an asset class
  - As a third pot of money, separate from mainstream investment and philanthropy
  - As a third dimension (risk, return, and impact) of a mainstream investment decision?
- How to get client/relationship managers to become enthused and confident about offering social investment opportunities to clients?

**Large private banks that have combined philanthropy and investment expertise in one unit have taken a greater initiative to explore social investment and venture philanthropy**

A few of the larger private banks have been preparing and have evolved organizationally to reflect a world that is less bi-furcated between philanthropy on the one hand and investment on the other. A few have recently formed units that are combining philanthropy, social/impact investment and SRI investing, for example UBS and BNP Paribas Wealth Management profiled below. Combining philanthropy and investment expertise in one unit has led to a greater initiative to explore different social and impact investment product offerings and to move beyond simply 'talking' and 'educating' to actually 'doing' i.e. raising private client capital for venture philanthropy funds and social investment products. BNP Paribas is playing an advisory/intermediary role encouraging investment in existing impact investment and social investment fund products with a particularly interesting social investment fund product through social investment intermediary PhiTrust Partenaires. UBS recently raised $50 million for the first private banking own-branded impact investment fund product. Both banks have encountered the highs and lows of exploring a new and emerging market space.

Considering these challenges, private banks have found more mature impact investment sectors such as microfinance or fair trade an access point to developing their credentials and generating client demand around a more certain risk/return and standardized product range. For example, Credit Suisse private bank has engaged in microfinance since 2002, when it co-founded responsAbility Investments AG, a leading independent asset manager specializing in development-related sectors of emerging economies. Today, it structures, manages and offers its clients a suite of impact investment vehicles focusing on areas like microfinance, sustainable agriculture and development of small and medium enterprises. It currently manages $2.4 billion assets and over 4,000 clients including both private

# CURRENT ENGAGEMENT OF BANKS WITH VP/SOCIAL INVESTMENT IN EUROPE

individuals and institutions who invest in its impact funds. As shown below, not only Credit Suisse's private bank is involved, but also its investment banking and corporate citizenship divisions, illustrating how social and impact investment is an integrated proposition that cuts across banking departments.

### Barriers for private banks to explore a new and emerging market space include:

- The slow and difficult process of client relationship manager education
- The difficulty converting initial client interest into capital committed, with more success at lower ticket prices
- The unpredictable nature of client demand, not necessarily tracking existing client SRI demand due to the difference in product attributes
- The internal cultural and expertise change required to offer an integrated VP/social investment solution to clients, even when the investment/philanthropy proposition is contained within one unit

**Impact Investing at Credit Suisse**

| Private Banking & Wealth Management | Investment Banking | Corporate Citizenship |
|---|---|---|
| Provising private capital via investment vehicles | Provising public capital via access to global capital markets | Providing capacity building via grants and skills-sharing |
| • Co-founder of responsAbility<br>• Product development and offering in impact investments<br>• Structuring of impact funds<br>• Administration of impact funds<br>• Market reserach | • First global IPOs<br>- Banco Compartamos<br>- Financiera Independencia<br>- SKS<br>• Innovative debt raising:<br>- FINCA International | • Complement to business commitment<br>• Capacity building initiative with leading partners in microfinance and education<br>• Skills-sharing programs in microfinance and education for Credit Suisse employees |

Aside from focusing on more mature and less-risky sector propositions, large private banks have also been meeting internal HR challenges as well as issues of track record by teaming up with specialist financial intermediaries with track record, which is perhaps a sign of how the industry will evolve in the future. Whilst private banks have the greater access to capital, they recognize their own limitations and can create strong and beneficial partnerships with the more specialized outfits, showing how the VP/social investment ecosystem could evolve. For example, the UBS impact investment product is investment managed by OBVIAM which has a strong track record. OBVIAM has been managing the Swiss government's development projects since 1999 and has achieved financial returns of over 20% for a similarly structured Swiss government fund. Meanwhile, in France BNP Paribas Private Wealth has teamed up with social investment fund manager PhiTrust Partenaires for its main VP/social investment product offering.

## Spotlight: UBS Philanthropy and Values-Based Investing[54]

### About UBS and UBS Philanthropy and Values-Based Investing Team

UBS serves private, institutional and corporate clients worldwide, as well as retail clients in Switzerland. UBS is composed of a global wealth management business, a universal bank in Switzerland, an investment bank and a global asset management business. Headquartered in Zurich and Basel, Switzerland it has offices in more than 50 countries and approximately 63,000 employees.

UBS Philanthropy and Values-Based Investing is a global team of over 30 experts providing a 'one-stop' professional approach for ultra-high-net-worth clients of the bank, delivering thought leadership, advice, products and solutions assisting clients in delivering positive change through donations or investments from strategy to implementation on the ground. The team consists of philanthropy advisors as well as the 7 people in the value-based investing unit covering sustainable investments and impact investment.

### VP/Social Investment Initiatives

In September 2013 UBS closed an own-branded $50 million impact investment fund from its own ultra-high-net-worth client base. Almost half of the fund's capital came from investors in Switzerland, while customers in the UK and Hong Kong also contributed.

The fund:

- Invests in small to medium enterprises in frontier markets in the education and health sector. It will invest in other private-equity funds taking stakes in 50-80 small and medium-sized enterprises in emerging markets, focusing on health care, education, infrastructure, agriculture and sustainable forestry
- Targets 8-10% financial returns
- Is investment managed externally by OBVIAM, the manager of the development finance arm of the Swiss government. In an innovative move that could be replicated within the field where fee structure is still uncertain/being defined, the investment manager will be remunerated on both social and financial returns
- Measures social impact using IRIS indicators as well as other factors
- Has made two investments to date of $3 million each in a fund dedicated to developing renewable power generation in Indonesia, Thailand, the Philippines and Malaysia and in a fund that seeks to improve education in India

54. Sources for this case study include: Face-to-face interview with Jaume Iglesies, Head of Values-Based Investing Unit, UBS on 13th April 2013; Relevant pages from UBS website; UBS information on impact investment fund http://www.ubs.com/global/en/about_ubs/media/asiapacific/releases/news_display_media_asiapacific.html/en/2013/09/23/2013-09-23.html

## CURRENT ENGAGEMENT OF BANKS WITH VP/SOCIAL INVESTMENT IN EUROPE

This impact investment fund initiative first arose about two years ago motivated by a desire to 'walk the talk':

- UBS opted to develop an own product because client advisors were more excited about selling a product that was exclusive
- A private equity strategy was adopted to take a significant stake or buy companies so investors could really influence the ESG credentials of the business
- An external manager was chosen to manage the fund because of the importance for UBS of having a clear track record on the part of the fund manager
- UBS has invested $2 million of its own funds to seed the fund
- Senior support was needed for the fund development and management needed to be convinced that such a product would help the positioning of the bank, as a way of offering new and different ideas to private clients

> *'This product has many innovative elements and at the beginning client advisors were wondering where it fitted within their traditional mental map of asset class, risk, return etc. Furthermore since this product was the first of its kind, it was smaller in volume than, for example, traditional private equity and there was significant work to set up the legal terms, such as the issue of how to phrase the variable performance fee based on social returns.´*
>
> Jaume Iglesies, Head of Values-Based Investing

As part of its philanthropic advisory wing, UBS also discusses strategic and venture philanthropy with clients. In addition to bespoke philanthropic advice, UBS offers a philanthropic product for clients who can invest in the UBS Optimus Foundation. Currently this is run as quite a traditional philanthropic initiative. The UBS Optimus Foundation supports the well-being of children in need through education, protection and health. UBS covers all of the administrative costs of the foundation so all client money goes directly to the projects. Clients can donate as little as 100 CHF, although the average is CHF 10,000. Contributions from over 18,000 donors have enabled the Optimus Foundation to provide more than CHF 175 million to support 245 projects in 75 countries. Interestingly UBS is in the process of moving the UBS Optimus Foundation to using more VP and social investment tools, with part of the motivation coming from the Asian market where there is recent entrepreneurial wealth that would like to engage in VP-like activities.

**What is important/powerful about these initiatives**

- *A client-led impact investment initiative:* UBS is convinced that it is important to get private capital involved in this field early, hence why it developed this client-facing product. According to

Jaume Iglesies, '*The field needs to be more client-led. Ultimately the industry will survive and grow because clients like it. There needs to be less talk and more money invested*'

- *With the goal of mobilizing both philanthropic and non-philanthropic money,* showing that some banks are betting on impact investment becoming a more mainstream and institutional investment proposition

**Lessons**

- Since UBS is the first private bank to engage in a global large-scale fundraising effort from private investors for an impact investment product, findings on the client demand front are particularly interesting:
  - It was hard to convince UBS client advisors to sell even an own-branded impact investment product: they were nervous about risking their relationship by selling a new and unknown product type, with concerns about being exposed to questions that they could not answer. According to Jaume Iglesies, '*There are some client advisors that are fully engaged, others that are less so. In the Northern countries such as Scandinavia, the Netherlands and the UK we are quite successful*'
  - Contrary to initial expectations, this impact investment fund appealed to a different set of investors than existing SRI clients. The initial hypothesis was that SRI investors would be the low-hanging fruit, but this did not prove the case, with the key challenge being that impact investment is an illiquid asset
  - About a third of UBS's ultra-high-net-worth clients are interested in sustainability in general. Whilst it was hard for client advisors to get interviews with clients to sell the new impact investment fund product, they were very successful at converting meetings into capital invested
- Developing and selling a combined philanthropic and investment product, such as VP/social investment is hard to implement practically, because employees within the private banking world seem to either know about philanthropy or investments. There is therefore a human capital issue in terms of banks developing an integrated VP/social investment solution for clients

**Perspective on the market**

For UBS, value-based investing is neither a product category nor an asset class, but an investment philosophy. The idea in the future is for sustainability to be part of every mainstream investment discussion, with sustainability as a third variable alongside risk and return.

However, the impact investment industry needs to be much better at packaging products and more proactive in creating an easy-to-understand terminology. According to Jaume Iglesies, it should learn from the problems with SRI where clients may not clearly understand the field.

Whilst UBS's value-based investment team is trailblazing the first concrete own-branded impact investment product offering, BNP Paribas through its passion investment team have also been experimenting with concrete social investment/VP product offerings to clients.

# CURRENT ENGAGEMENT OF BANKS WITH VP/SOCIAL INVESTMENT IN EUROPE

## Spotlight: BNP Paribas Wealth Management[55]

**About BNP Paribas Wealth Management**

BNP Paribas Wealth Management is part of 'Investment Solutions' which is one of the three main activities of the BNP Paribas Group (the others being Corporate Investment Banking and Retail Banking). BNP Paribas Wealth Management has 6,000 employees and has assets under management of €270 billion. BNP Paribas Wealth Management is based in 30 countries and provides advice and services to wealthy clients. The VP/social investment offerings are led by the passion investment team which is part of the Products and Services Offering teams sitting under the 700 experts within the wealth management business line that advise client relationship managers. It has 2 different departments – Individual Philanthropy and SRI and Impact Investing experts (respectively 3 and 2 people) – who advise clients who want (part of) their wealth to serve social, cultural or environmental goals.

**VP/Social Investment Initiatives**

- *Investment product offerings:* BNP Paribas Wealth Management has been active in impact investment since 2009, through its external microfinance and environment fund product offerings. Its SRI/impact investing initiative developed from research which identified the need for the private bank to develop offerings with an extra-financial return

  In 2012 it launched a social investment fund called PhiTrust Innovation 1 with social investment fund manager PhiTrust Partenaires (the result of a long-lasting collaboration), raising €2.530 million from its private clients. This has been followed up by raising €6.233 million for PhiTrust Innovation 2
  - The fund product was inspired by BNP Paribas Wealth Management clients' profiles, many of whom are entrepreneurs
  - The fund invests in social businesses using innovative technologies to generate a positive social and environmental ticket
  - It has a VP dimension because the commercial entrepreneurs investing in the funds have the opportunity to directly mentor the social entrepreneurs
  - There is a minimum ticket of €1,000 and the product benefits from two possible tax advantages: a) a deduction on 'impot sur la fortune' (wealth tax): 50% of the subscription with a maximum of €18,000 per household and b) a deduction of income tax (18% of the subscription, calculated on a maximum amount of €12,000 for a person living alone and €24,000 for a couple)
  - It has been very successful with the highest rating in terms of assets raised for an external offering

- Philanthropic offerings:
  - *Fondation de L'Orangerie for Individual Philanthropy* which was established to collect donations from clients and allocate them in the most efficient manner to transparent and original projects rigorously selected. The minimum amount donated per client is €10,000. This grant-making foundation uses the following practices in line with the VP approach: due

55. Source for this case study includes: telephone interview with Alice Martinou, Sustainable Investments and Philanthropy, 13th March 2013; BNP Paribas Corporate Responsibility Report; BNP Paribas website.

diligence process, high-engagement (capacity-building for projects), multi-year support, results monitoring, performance measurement and exit strategies

– A tailor-made advisory service to help clients develop and implement 'green-field' philanthropy projects and cover the 4 following stages: strategy, structuring, implementation and evaluation. Some clients wish to adopt VP practices for their project and BNP Paribas advises them on these practices

The development of these practices was driven by the market and the business line's desire to provide a further professional service to meet client demand. Top management's input was instrumental in creating these pioneer offerings in 2006 (SRI and Impact Investing) and 2008 (Individual Philanthropy). In particular, the former head of Wealth Management François Debiesse chaired during 15 years the corporate philanthropy foundation and was concerned with bringing concrete offerings in this area to wealth management clients. For the Individual Philanthropy Offering, he was adamant on recruiting an expert in this field, Nathalie Sauvanet with 16 years in Philanthropy Advisory to set up and develop it. Two key guidelines have led the development of the offerings: the first has been to create a real client focus/dedication (e.g. answer clients' needs individually) and the second one has been to avoid green or social washing (using rigorous methodologies of impact and professional assessment to select the products and projects).

At the group level, François Villeroy de Galhau, BNP Paribas COO, has established a 3-year plan to emphasize the Group's initiatives in supporting social entrepreneurs in France and in every country where the Group is present.

**What is interesting/powerful about these initiatives**

- PhiTrust Innovation 1 and PhiTrust Innovation 2 are *the only integrated VP/social investment product offerings on the market*, with direct engagement by clients in the social businesses offered as part of the product. It has also successfully overcome the three major constraints that had discouraged some clients from social/impact investing: the high minimum tickets; low expected financial return and the lack of tax advantage

**Learnings**

- Social/impact investment is harder to understand for the client and the relationship manager than the simpler concept of philanthropy. Even when an investor becomes interested in the field and the approach of social investment, the professionalism of asset managers and the commitment of entrepreneurs, with 'Impact First' products, track record and liquidity remain strong obstacles to subscription
- For private banks to sell social/ impact investment, a high level of knowledge and buy-in is needed by relationship managers. '*BNP Paribas WM's experience shows that the role of relationship managers is more than crucial in the development of such offerings.*' Therefore, after structuring a professionalized and dedicated offering, it has intensified communication and training efforts within the sales teams
- The link between philanthropy, impact Investing and SRI is not obvious. BNP Paribas WM has not found that a client investing in SRI will necessary end up choosing Impact Investing.

# CURRENT ENGAGEMENT OF BANKS WITH VP/SOCIAL INVESTMENT IN EUROPE

Moreover, the demand for SRI and Impact Investment products varies according to country. In France and Belgium, there seems to be quite a significant demand for such approaches. This is confirmed by the EUROSIF study which showed that in France over a quarter of investors in SRI are retail investors, significantly higher than Switzerland or Germany which are more driven by institutions. In France, this may be partly driven by the regulation since January 2010 for French companies with more than 50 employees to provide at least one socially-oriented pension scheme to its employees. These pension schemes (FCPES – Fonds Commun de Placement d'Entreprise Solidaire) invest 5 to 10% of their outstanding in social enterprises or social funds (called 'entreprise solidaire' or 'fonds solidaires' in France). As of end-2012, socially-oriented pension schemes amounted to more than €1.7 billion from which 10% are invested in social funds or social enterprises. As most of the pension funds managers do not have any experience in financing and investing in social enterprises, most of those funds go to social funds, such as le Comptoir de l'Innovation (CDI)

**Perspective on the market**

Although there are significant barriers to venture investing in social enterprises, for example the lack of definition of social entrepreneurship and track record of financial returns, the conditions are there for the market to grow. Banks have an important role to play because they have access to a large number of clients and as an intermediary they can prepare the market and investors for this approach.

**Some niche private banks have been nimble and experimental in their approach to VP/ social investment**

A VP/social investment offering by large-scale banks can encounter many obstacles and challenges, as the approach crosses departmental boundaries as well as being a sub-scale and undeveloped market. However, smaller and/or family-owned, more focused private banks have been freer to adopt a more venturing approach to exploring the market and in many countries have been leading the field. Both the Banque of Luxembourg (Luxembourg) and the Bank Degroof (Belgium) profiled below are examples of pioneers in the field. Other examples which will not be profiled in detail are the UK's Hoare and Co which has created a social investment fund for philanthropic donors as well as Berenberg Bank which has recently co-founded with LGT Venture Philanthropy 'Impact Ventures UK' which invests smart and patient growth capital into enterprises that benefit less advantaged people in the UK.

- Such banks have the luxury of adopting a long-term approach to the field, without the overwhelming commercial pressures characterizing large-scale financial institutions
- They have found it easier to combine a VP and social investment approach with their clients, as they tend to have fewer clients and client relationship managers and less stringent internal rules in terms of the types of products that they can offer
- They have more actively embraced a VP approach with an engaged investor dimension

# CURRENT ENGAGEMENT OF BANKS WITH VP/SOCIAL INVESTMENT IN EUROPE

## Spotlight: Bank Degroof[56]

**About Bank Degroof**

Bank Degroof is Belgium's leading independent private and investment bank, with 1,000 employees, managing assets of approximately €25 billion across 5 countries.

**VP/Social Investment Initiatives**

- Social/Impact investment products:
  - The bank started creating an SRI product offering in the late 1990s and became involved in microfinance in 2005, incubating Bamboo Finance in 2007 and gathering the first $12million to launch their first fund. Bamboo Finance is a commercial private equity asset manager specialising in investing in business models that benefit low-income communities in emerging markets with offices in Luxembourg, Geneva, Bogota, Nairobi and Singapore. It currently manages $250 million in funds representing two global funds and a combined portfolio of 46 investments operating in 25 emerging market countries
  - Bank Degroof is now involved in helping Belgian social businesses to raise finance through bonds or other capital structures, in partnership with the corporate finance department. The bank has been involved in intermediating two social housing projects each of €4-6 million in Belgium and is now working on two bonds of €5 million each. The financial returns on these deals offered to high-net-worths are attractive and are normally proposed at market rate. According to Marc Flammang, Founder and Manager, Philanthropy Advisory Service and Impact Investment at Bank Degroof, '*We try not to have a trade-off between financial and social returns. The philanthropic component comes with the higher level of risk taken to generate the same type of returns.*' The private wealth managers are describing these deals to their clients as investment opportunities
  - The bank has been involved in a process of both client and client relationship manager education. Marc Flammang notes that, '*we have had to educate the private bankers. At the beginning they didn't understand what impact investment was. We have launched an internal website, had a conference. It takes time, but we have time*'
  - The motivation for engaging with impact/social investment is that it is a topic for the future. '*This is CSR but it is more than that: it is a fantastic way to leverage our business model with a positive impact*'
- Bank Degroof foundation practicing VP:
  - 0.3% of the profits of the bank are given to the corporate foundation and a strategic/VP approach is used, for example with every project being supported for 3-5 years and offering the entrepreneurs behind the projects advice and networking as well as financial support
  - The bank has also helped to incubate other foundations operating a strongly strategic grantmaking approach, for example The Pulse Foundation which is a €4 million foundation investing in entrepreneurship in Belgium, jointly invested in by 10 large families
- VP philanthropic advisory
  - The philanthropy advisory service of Bank Degroof advises 70 families in 5 countries and helps to structure their philanthropy. Therefore it talks to clients about VP and even if their

56. Source for this case study include: telephone interview with Marc Flammang, Founder and Manager, Philanthropy Advisory Service and Impact Investing, Bank Degroof; Bank Degroof website.

# CURRENT ENGAGEMENT OF BANKS WITH VP/SOCIAL INVESTMENT IN EUROPE

clients do not particularly connect with the word, they are very interested in conducting their philanthropy in a more strategic way

**What is interesting/powerful about these initiatives**

- A long-term perspective has allowed Bank Degroof to explore the social and impact investment field, even if it is for the moment an unprofitable activity for the bank
- The bank is small enough to operate quickly across departments, for example the social investment capital raising initiatives involving private banking and corporate finance. According to Marc Flammang, '*Everyone knows everybody, everything goes really fast*'
- Corporate philanthropy is being used to try to help to build the social investment/social entrepreneurship market

**Perspective on the market**

Marc Flammang believes that the market needs to be approached cautiously: built through market research, rather than rushed into, with investors really understanding what they are investing in so as to avoid a new bubble.

A lot of work needs to be done to increase the pipeline of investible deals: at the moment, there are not so many quality deals in Europe – what is really needed are more social entrepreneurs as well as large-scale deals. '*Banks want to provide 10,15,20,50m € whereas a social entrepreneur is maybe interested in €500,000.*'

Whilst he senses that banks have a huge role to play in developing the market, there is an issue of cultural fit, with a potential problem in terms of aligning commercial objectives with the market.

Whilst Bank Degroof has been a pioneer of strategic philanthropy and impact investment initiatives in Belgium, Banque de Luxembourg has played a major role in developing the impact investment industry in Luxembourg, a centre of fund finance.

## Spotlight: Banque de Luxembourg[57]

**About Banque de Luxembourg**

Banque de Luxembourg is a private bank set up in 1920 which offers services to an international clientele of families, entrepreneurs, and wealthy individuals. Banque de Luxembourg has just under 790 employees and clients deposits have reached €61,4 billion (cash and securities) at the end of 2012. As the Bank is not quoted on the stock exchange, it favours a long-term approach to working with its private, corporate and not-for-profit clients.

**VP/Social Investment Initiatives**

The bank has shown a long-term commitment to the development of VP and impact investment in Luxembourg. Philippe Depoorter, General Secretary, thinks these long-term and systemic efforts have and continue to generate significant leverage for the entire philanthropic

57. Sources for this case study include interview with Philippe Depoorter, Secrétaire Général, Banque de Luxembourg and follow-up email correspondence with Diane Wolter, Conseillère en philanthropie, Banque de Luxembourg.

and impact investment sectors in Luxembourg. Through a wide range of initiatives such as well-attended conferences (**2008:** Seizing the opportunities for philanthropy; **2009:** Responsible leadership (for foundations) in times of changes; **2012:** *La philanthropie, ça marche!*; and international symposia **2010:** EVPA: Annual conference), the bank has raised awareness of these sectors with donor/investors and beneficiaries.

Relating to **philanthropy, the bank made a series of proposals to the Luxembourg government** to create a more favourable framework for corporate and private engagement in projects for the public benefit and for the promotion of impact financing in Luxembourg. These proposals have borne fruit:

- Launch of Fondation de Luxembourg (the first and only Luxembourg umbrella foundation for cultural, humanitarian and social projects)
- Progress on tax deductibility
- Amendments to the foundations law.

Relating to **impact investment, the Banque de Luxembourg initiated the European Impact Investing Luxembourg Initiative (EIIL, see below),** whose aim is to promote Luxembourg as a center of excellence in this field. The Bank is also a preferred partner of the Luxembourg Foreign Affairs Ministry and ADA, an NGO specialised in microfinance and inclusive finance, on behalf of which it co-sponsors the Midis de la Microfinance conference series.

**The Bank also provides financial support, loans and skills-based sponsoring to a selection of not-for-profit organisations**.
Together with its asset management company, Banque de Luxembourg Investment (BLI), the Bank has also **set-up and raised capital for its three microfinance and impact investing funds** (2010: €30 million; 2012: €50 million and 2014: €30 million). The Bank's for-profit and not-for-profit clients can thus combine generating a financial return and social impact on their investments.

**Impact Investment in Luxembourg**
Luxembourg already benefits from a leading position in microfinance: with 26 Microfinance Investment Vehicles registered in Luxembourg and 45% of worldwide MIV assets under management, the Grand-Duchy is the leading centre for the domiciliation of MIVs.[58]

## European Impact Investing Luxembourg[59]

This is an initiative regrouping major actors of the Luxembourg financial place such as ADA-Microfinance, Arendt&Medernach, Banque de Luxembourg, Deloitte, Elvinger, Hoss & Prussen, Ernst & Young, European Fund Administration, European Investment Fund, Impact, KPMG, Luxembourg Microfinance and Development Fund and PWC. The EIIL's mission is to play the role of an information exchange platform between stakeholders of the impact investing space. It seeks to promote Luxembourg as a hub financial centre for impact investing.

58. Radjy, T. and Cejnar. M., (2010), 'Impact Finance Survey 2010', alphamundi, http://www.thegiin.org/binary-data/RESOURCE/download_file/000/000/156-1.pdf
59. http://www.eiil.lu

## Part 4:

# Drivers, Challenges and Benefits for Banks in Engaging with VP/Social Investment

# DRIVERS, CHALLENGES AND BENEFITS FOR BANKS IN ENGAGING WITH VP/SOCIAL INVESTMENT

## 4.1. Overview

Understanding the drivers, challenges and benefits for banks engaging with VP, social and impact investment allows for a more nuanced understanding of how to motivate and incentivise the banking industry to play a wider role, as well as what levers, if any, exist to create more viable conditions for banks to get involved. In what follows, we present tables that summarise the key drivers and challenges, and elaborate on the general benefits, before we provide more detailed accounts with examples drawn from specific case studies.

**Drivers for banks to get involved with VP/SI and impact investment are** particularly strong in the case of private banks, where market forces are the most prevalent and there a clearest sense that this will be good, even essential, for business rather than simply a nice-to-have strategy. For all banks, the microfinance success story has been a very important factor in providing a tangible and concrete example of a sector which can generate both financial and social returns and which fits neatly into bankers existing expertise (than other less familiar social sectors, for example health or education). For retail and investment banks, initiatives have been based less on market forces but rather on personal belief and values of individuals as well as the bank character/and ethical approach. The next step should be for these initiatives to expand beyond the inevitable limitations of pioneering initiatives led by a few of the 'converted' in individual departments to sizeable, more established and broad-based ones with the buy-in of a significant proportion of banking staff. Table 1 summarises the key drivers of these different types of banks, with darker shades representing stronger drivers.

| | Client demand | Competitor Advantage | Personal belief | Bank Ethic | CSR |
|---|---|---|---|---|---|
| Private Bank | | | | | |
| Investment Bank | | | | | |
| Retail Bank | | | | | |

**Table 1: Drivers for Banks' Involvement in VP/SI and Impact Investment**

Please note that for the tables 1-3, darker shaded boxes indicate a stronger relationship.

Banks face significant challenges in engaging with VP/SI and impact investment, explaining why banks engagement has not been broader and deeper to date**. Mostly these challenges relate to the immaturity of the sector, with issues relating to the lack of investment opportunities; lack of standardised social impact measurement systems; lack of track record for social/impact investments; illiquidity of products and in general a weak financial infrastructure supporting these investment opportunities. This is compounded by the reality that for many banks, social investing is unfamiliar and unknown territory from a cultural perspective, requiring new skills, knowledge and expertise, with many people operating well outside their comfort zone. Whilst the concept and idea may be attractive, implementing social and impact investment initiatives internally is hard**

## DRIVERS, CHALLENGES AND BENEFITS FOR BANKS IN ENGAGING WITH VP/SOCIAL INVESTMENT

**work, requiring cross-departmental as well as senior support and often bumping up against the reality that many banks have become more conservative rather than more innovative in terms of taking on new projects, as well as the fact that for the moment, there is not much (if any) hard bottom-line profit involved in pursuing these opportunities. Involvement in VP, social and impact investment by banks requires a belief in the long-term market opportunity as well as the bandwidth to experiment in the field, a luxury that many banks do not seem to have at the moment.**

| | Market Immaturity | Culture /organisational | Profit and priorities |
|---|---|---|---|
| Private Bank | | | |
| Investment Bank | | | |
| Retail Bank | | | |

**Table 2: Challenges for Banks' Involvement in VP/SI and Impact Investment**

**And yet, the benefits of engaging in strategies for social impact are many and significant, including internal rewards and business benefits.** The internal rewards include increased staff satisfaction, particularly where volunteers have engaged in pro-bono work associated with social entrepreneurs as well as encouragement to work cross-departmentally. This is important in the context of the war on talent that banks are engaged in. External rewards are reaped in terms of improved brand and reputation. Moreover, there are business benefits, particularly for private banks, where client retention has been enhanced by the banks having a VP/social investment or impact investment offering. In addition, those who have been pioneering in the retail and investment bank space stand to be in the best position to dominate the field as the market grows and matures.

| | Internal rewards: staff satisfaction, cross-departmental working | Improved product offering for clients | Enhanced position to exploit long-term business opportunity |
|---|---|---|---|
| Private Bank | | | |
| Investment Bank | | | |
| Retail Bank | | | |

**Table 3: Benefits of Banks' Involvement in VP/SI and Impact Investment**

# DRIVERS, CHALLENGES AND BENEFITS FOR BANKS IN ENGAGING WITH VP/SOCIAL INVESTMENT

## 4.2. Retail Banks

### Drivers of involvement

Retail banks involvement in the VP/SI field has mostly been driven by **CSR and stakeholder management strategies**, with the lead coming from the retail banks foundations and CSR departments. There has been a sense that this is the right thing for banks working with the real economy to do, in the light of tarnished reputations after the financial crisis. It potentially strengthens their licenses to operate, facilitates relations with broader stakeholders including shareholders, lenders and government bodies (particularly the case for banks that have been partly nationalized and have significant governmental oversight, for example in the UK). There has been quite a strong marketing and branding component to retail banks sponsorship of the up-and-coming social enterprise sectors, with an awareness that it is a popular media topic. This is not to say that there has not been a very thoughtful and serious engagement with VP and social investment where practiced, but rather that the business case is more led by brand benefit which is relevant to the bank's clients as well as other stakeholders. Indeed, large retail banks such as those in the UK have been strongly encouraged through their investment in Big Society Capital to get involved in the sector.

> *'Businesses have a strong incentive to get involved, not just because of altruism or to rehabilitate themselves after the crunch, but because customers are demaking responsible corporate citizenship. Philanthropy on its own will not – and should not – restore the damage to the reputation of banks or rebuild their moral capital: the scale of that task should not be under-estimated. But, along with a commitment to best business values, it has a part to play for companies wanting to regain the trust and respect of communities in which they operate.'*[60]
>
> Sir Victor Blank, ex-chairman of Lloyds Bank

Additional impetus to be involved is particularly strong by European banks with **a social ethic and character** (such as Erste Bank profiled in this report) emerging from original savings institutions, where supporting and servicing the social economy is considered part of the core business of the bank.

In terms of a real business opportunity presented in particular by social investment strategies in the medium or long-term, this is still quite vague and undefined. Some banks do see **microfinance and the development of products for the social enterprise sector** as a

60. The Telegraph (2011), 'We need a new philanthropy for the 21st century'.

## DRIVERS, CHALLENGES AND BENEFITS FOR BANKS IN ENGAGING WITH VP/SOCIAL INVESTMENT

financially self-sustaining social impact strategy, but they are definitely engaging primarily for social rather than profit-oriented reasons. Yet there is a general sense that the importance of social enterprise and social business is on the rise due to larger macro-trends in health, education etc. and that banks need to be able to understand these business models of the future. As with private banks, there is an opportunity to gain a first mover advantage in really understanding an emerging sector that banks have a sense they will need to embrace/work with and which could provide a new and exciting source of demand for products. Moreover, increasingly retail banks are aware of the gains being made by social banks, who are forecast to take more of the mainstream banks market share by offering ethical products and only using deposits for ethical lending purposes.

### Barriers to involvement

The key barrier to involvement for retail banks is perhaps time (**profit and prioritization barrier**): in the crisis facing the financial sector, priorities have inevitably faced elsewhere and resources have been restricted. It is the retail bank's foundations and CSR departments that have had the time, resources and energy to start to contribute and understand the social enterprise and social investment sectors, but this has not yet really challenged the existing modus operandi within the retail banks core business units. In particular, retail banks have not shown many signs of adapting their credit policies to encourage lending to social enterprise, which may be related both to **cultural/organizational barriers** (where 'social' is treated with some suspicion) and the **market immaturity**, particularly in certain countries in Europe where social enterprise and social investment are still nascent, undefined and relatively poorly understood.

> *'Key executives within BBVA see social investment as a way for the bank to understand and get to know these key new business models.'*[61]
>
> Lidia del Pozo, Director of Community Involvement, BBVA

### Benefits

Although retail banks may have been slow to embrace active VP/social investment, once they do so they tend to see the benefits most clearly, **particularly in terms of brand enhancement** as well as **internal skills development** and **cross-departmental co-operation**. For example, in Spain, both la Caixa and BBVA have seen that their involvement in VP, social entrepreneurship and social investment have provided a huge and much-needed internal and external boost. For relatively small sums of money, these banks have been able to show in a concrete way to their customers that they are deeply interested and engaged in improving society, and are actually adapting their business models to generate social impact. In addition, for retail banks there is also a long-term market opportunity in developing knowledge about the social economy experience in lending to and investing in it, as it is spend on these sectors (health, education, ethical consumerism) that is forecast to grow.

61. Interview with Lidia del Pozo, Head of Community Development, BBVA.

## 4.3. Investment Banks

### Drivers of involvement

Investment banks tend to be cutting-edge workplaces where financial innovation is embraced and celebrated. It is the **culture of and ethic** of investment banks, who in general favour new ideas and trends, that may be the key to understanding why social and impact investment have been embraced. Investment banks have also come under enormous public pressure and have been vilified by the media, such that there is enormous reputational work to be done to fix this negative image, with social and impact investment being one way of proving that investment bankers can also create social good.

In addition, some investment banks do seem to sniff **a business opportunity,** particularly in impact investment. This is related again to macro-trends, particularly the growing importance of bottom-of-pyramid opportunities which much impact investment is aimed at. Certainly there has been significant success by investment banks structuring and selling microfinance products and this has perhaps convinced them that social impact investment is a potential new investment paradigm that needs to be nurtured. However, **client demand** is low-level and quite uncertain (although many investment banks have private banking departments and are therefore developing expertise to offer a product to private clients in the long-term and therefore do have some of the same motivations as covered in the private banking section). Most investment banking clients, such as large-scale institutions, have to date been quite wary of this unstructured, illiquid space but institutions are slowly moving into the field and investment banks may be taking a bet that since institutions are large buyers of SRI products they will be large buyers of social impact investment once the market develops.

Additionally in the heady, competitive world of investment banks ideas spread fast, and there is a desire to keep up with other banks as well as to **differentiate from competitors**. Investment banks like to be leaders in the field, and early movers such as Deutsche Bank and J.P. Morgan have been bold players in the new, emerging marketplace. In addition, the 'war on talent' affecting the top financial institutions favours the development of opportunities for staff to work on and get involved in social issues and challenges. Social finance has proved very high-profile and popular internally within investment banks. After J.P. Morgan set up the Social Finance Unit, thousands of e-mails flooded in from staff excited to participate or help and the Deutsche Bank UK's Impact Investment Fund has proved one of the most high-profile internal initiatives among staff surveyed.

Yet, as with other types of banks, of enormous importance have been individuals who have a **personal belief** and mission to move their banks forward in terms of social and impact investment strategies. Where they have been able to **get senior support**, bold actions and activities have resulted.

# DRIVERS, CHALLENGES AND BENEFITS FOR BANKS IN ENGAGING WITH VP/SOCIAL INVESTMENT

### Barriers to involvement

Because institutional client demand is not clear and present, investment banks may feel that the social and impact investment space does not warrant a significant amount of attention, as yet **(profit and prioritization barrier)**. Indeed, amongst investment banks there is a 'wait-and-see' approach operating, related to the **immaturity of the market**. Once there are possibilities of bigger social and impact investment deals, perhaps with more layered structures offering different risk/return profiles, investment banks are likely to get more involved and active. Another turning point in terms of investment bank's involvement could be when more standardised and tradable social investment products become available, opening up possibilities to sell to the institutional market. The social impact bond could be such a product, although it is in its early stages of development. There is also a question of where such initiatives sit (**cultural/organizational barrier**), if they are not simply CSR strategies – unlike with private banks where the philanthropy or SRI departments are more obvious places to house them. Moreover, the need to collaborate and work cross-sectorally with the public and third sectors in order to develop and participate in the market could be perceived as a real challenge for investment bankers – skills of patience, collaboration and consensus needed are not those normally associated with the fast-paced, quick decision-making investment banking environment.

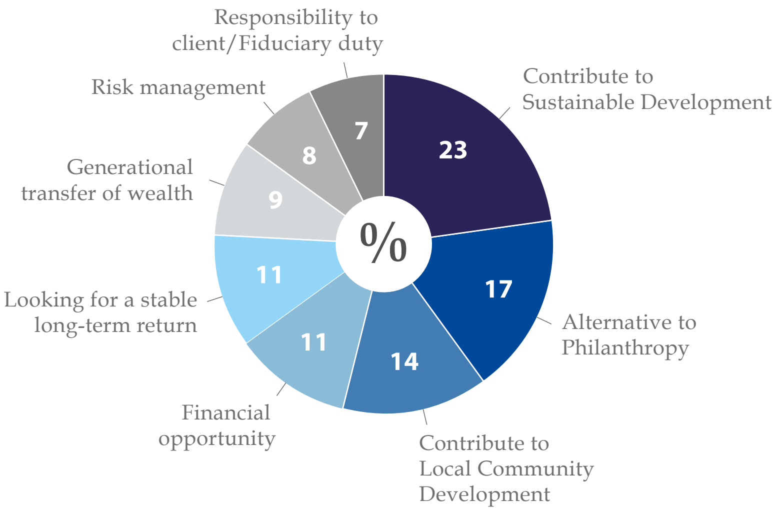
### Benefits of involvement

At the moment, the key benefit for investment banks from VP, social and investment activities derives from boosting the culture internally as the bank is involved in a socially-beneficial activity, as well as providing employees the opportunities to use their talent for social good. In addition, there is an external re-branding dimension to such activities. For the moment, the business benefit outside of such 'soft' benefits is not tangible, but will become increasingly so as the market matures. First movers in the investment bank field believe that this is an internal investment they can reap later.

## 4.4. Private Banks

### Drivers of involvement

For private banks, **potential client demand is the major driver for setting up VP/SI initiatives.** There is a growing importance of social/impact investment amongst the high-net-worth community, as confirmed by Eurosif's recent report, 'HNWI and Sustainable Investment Study 2012', which showed impact investment has doubled in size among high-net-worth investors since the previous year and was mentioned as the sector most poised for significant growth (see chart below which outlines high-net-worth motivations for impact investment). In addition, venture philanthropy strategies are a particularly good fit for entrepreneurial wealth, which is a growing segment of private wealth being managed, as well as for much of the foundation sector whose assets are also often managed by private bankers. As outlined in the Eurosif study, high-net-worths see VP, social and impact investment as a more business-like approach to philanthropy. The 'entrepreneurial spirit' of a family and its business can be continued through philanthropic activities. Interestingly, and supporting the use of engaged philanthropic strategies, a UK report has illustrated that UK social investors are particularly motivated by the ability to get involved and support their investees and projects,[62] showing the important and growing desire on the part of clients for more engaged, VP type of approaches. Moreover, the performance measurement and accountability of VP practices are attractive to high-net-worths who often have a suspicion about third sector effectiveness.




**Motivations for Impact Investing from Eurosif study[63], 2012**

There are significant differences in high-net-worth client appetite for social and impact investment by country, with the impact investment market in certain countries such as France, Belgium and the UK being more driven by individuals whereas in Switzerland and Germany it is more driven by institutional funders. Private banks have found that it is

62. Elliott, A. (2012), 'The Big Society Finance Fund, 'Investing for the Good of Society, Why and How Wealthy Individuals Respond'', The Fairbanking Foundation.
63. Eurosif (2012), 'HNWI and Sustainable Investment Study', (pg. 22, figure 22).

## DRIVERS, CHALLENGES AND BENEFITS FOR BANKS IN ENGAGING WITH VP/SOCIAL INVESTMENT

tricky and time-consuming raising capital for social and impact investment funds or products, as described in the previous section. Private bankers interviewed who have raised funds for social and impact investment describe how critical it is to target clients carefully. Moreover, there is significant work to convince the client relationship managers who are the gatekeepers about these newer investment concepts. Many are skeptical and resistant to social impact investment.

*'Ultimately the industry will survive and grow, or not, because clients like it.'*[64]

Jaume Iglesies, Head of UBS Values-Based Investing Unit

Yet, many private bankers do feel that **social impact investing is a key trend for the future**, and one that they need to understand better in order to keep up with and to be in a position to capitalize on when the market matures. Commentators have noted that engaging with social/impact investment is the equivalent to hedging strategies or emerging markets or high-tech. In each of these cases, the market efficiency and information gains went to those that were first. At work is also a fear of the cost of not having significant expertise and a client offering in the social/impact investment space. Some private bankers interviewed felt that clients were leaving the bank because of a lack of a coherent offering.

*'The motivation for doing something is to build knowledge inside the bank as we believe that this is a key topic for the future.'*[65]

Marc Flammang, Philanthropy Advisory Service and Impact Investments at Banque Degroof

*'We are convinced that social impact investing will shape the way many people invest in the future.'*[66]

Richard Pelly, European Investment Fund Chief Executive

64. Interview with Jaume Iglesies, Head of Values-Based Investing, UBS Wealth Management.
65. Interview with Marc Flammang, Philanthropy Advisory Service and Impact Investments, Bank Degroof.
66. http://www.eif.org/what_we_do/equity/news/2013/social_impact_accelerator.htm

## DRIVERS, CHALLENGES AND BENEFITS FOR BANKS IN ENGAGING WITH VP/SOCIAL INVESTMENT

Thus, although sizeable client demand is latent rather than actual, since the banking industry is as competitive as it is, and with private bankers finding it increasingly hard to distinguish themselves from others due to underlying products being commoditised, **social and impact investment strategies can help with competitive differentiation.** Private banks can attract clients in a crowded marketplace and may increase their client retention rate, since these conversations provide the possibility of deepening the client relationship and engaging with clients in a broader, values-based agenda. The thinking goes that if a private banker can capture or manage a client's assets committed to charitable or social goals, these philanthropic commitments may lead to a later flow of money into more conventional portfolios which are more profitable for the bank. **Microfinance has been important in providing an entry point to discussions about social impact investment product offerings.** Most interviewees noted that the bank has started with microfinance fund product offerings as a 'safe bet' since they could be more confident about risk/return before moving into less chartered/riskier territory of other social impact sectors.

Yet because the business case for social and impact investment is largely speculative, initiatives within private banks **have been driven forward by key individuals with a passion and understanding of the field**. In the absence of hard data and a developed market infrastructure, these individuals have been prepared to experiment and move forward despite obstacles and frustrations. In particular, some of the smaller, more nimble and independent private banks have been more able to take the long-term, patient view of the market which is required.

### Barriers to involvement

The major barrier to involvement relates to the **immaturity of the social and impact investment market.** This manifests itself in a lack of the right type of offerings to go to clients with, due to:

- *A lack of track record:* financial performance data of historic deals is limited by the private ownership of much of the social and impact investment market, with the resulting lack of clarity about financial performance, goals and results. One of the reasons that microfinance funds have been so successful is that there is now a clear track record
- *A lack of investment opportunities of the right size:* it is widely recognized that the top challenge of growth for the social impact investment market is the shortage of high-quality investment opportunities that fit the investment criteria of banks
- *Lack of liquidity:* liquidity in mainstream markets is commonly linked to an opportunity to realize capital gains which is largely absent from the social investment field
- *Lack of familiarity of products:* if social and impact investment is able to obtain a greater share of mainstream investors' wallets, they will need to look and feel more like a traditional investment product
- *Lack of common vernacular for talking about social and impact investing:* research has shown that wealthy individuals who are interested in social and/or impact investments can find it difficult to classify them initially. For impact investment, some of the industry has moved towards classifying it as an asset class in the hope that this will help to tighten

## DRIVERS, CHALLENGES AND BENEFITS FOR BANKS IN ENGAGING WITH VP/SOCIAL INVESTMENT

definitions whereas other players talk about social/impact investment opportunities across existing asset classes

- *Lack of formal infrastructure:* in mainstream markets, formal market infrastructure facilitates the flow of funds, with a good level of understanding of how the different players overlap and interrelate and an ability to match and syndicate capital To date, such a formal infrastructure has not emerged for social and impact investment.
- *Struggles with impact measurement:* there is still no unified way to measure impact, although this is an area that many people are working on

Associated with the market immaturity is the uphill struggle to convince client relationship managers to start the conversation about social investment with clients – a key **cultural/organisational barrier** that needs to be managed. Much client demand is an internal communication issue and during interviews with those responsible for social and impact investment at private banks was a widespread frustration at the ability of relationship advisors to include this new type of investment in their conversations with clients. As one interviewee stated, '*How can clients demand something when they don't know that it exists*'. The nature of client demand is complex and relies not only on the pull of clients demanding social and impact investment products (which relies on their prior knowledge of such opportunities) but also on private bankers educating their clients which traditionally they have been quite slow to do.

An elephant in the room is, of course, **the lack of ability for private banks to generate significant fees or profit from social and impact investment transactions** (**profit and prioritization**). Private banks who are engaged see this as an investment that they hope will pay off in the long-term, but right now interviewees have stated that any product offerings or deals they have engaged in are washing their faces financially at best. The issue of profit is particularly acute for social investment, where financial returns may well be more limited. Private bankers might be keen to sell only the very best, most profitable deals to clients, but these are not necessarily the ones that will move the market forwards, and they may leave out the very valuable VP/SI strategies which are impact-first. It is likely that private clients, particularly foundations, may actually be willing to take on more risk and will accept lower financial returns to generate higher social returns than private bankers realize. Recognising this, there is a strong role for banks' foundations to become involved in social investments where significant financial returns are not possible, This is where co-ordination between the banks' foundation as well as the business units is required in order to develop a coherent strategy which meets the needs of the bank as well as contributing to building the overall social investment market and supporting individual social enterprises/businesses which may not be able to offer market-rate financial returns.

### Benefits of involvement

Private bankers articulate the benefit in terms of their engagement with VP, social and impact investment strategies as largely related to client satisfaction, retention and delivery. Where there was a VP component to the social investment client offering, the originality and quality of the offering in terms of developing the clients relationship with the bank was particularly deep (as was the case with the BNP Paribas Social Entrepreneurship Offering through PhiTrust and the Bank Degroof activities in incubating and setting up with clients innovative foundations practicing VP tools).

*'If you differentiate yourself by including the philanthropic angle when talking about money, people will like that, and very naturally they will give you access to more of their own money…..I clearly see that has a business opportunity, even if you can't link it one-on-one. The non-financial return will feed into the financial bottom line.'*[67]

Jerg Zeitner, CEO of UBS Wealth Management

67. http://www.alliancemagazine.org/node/4180

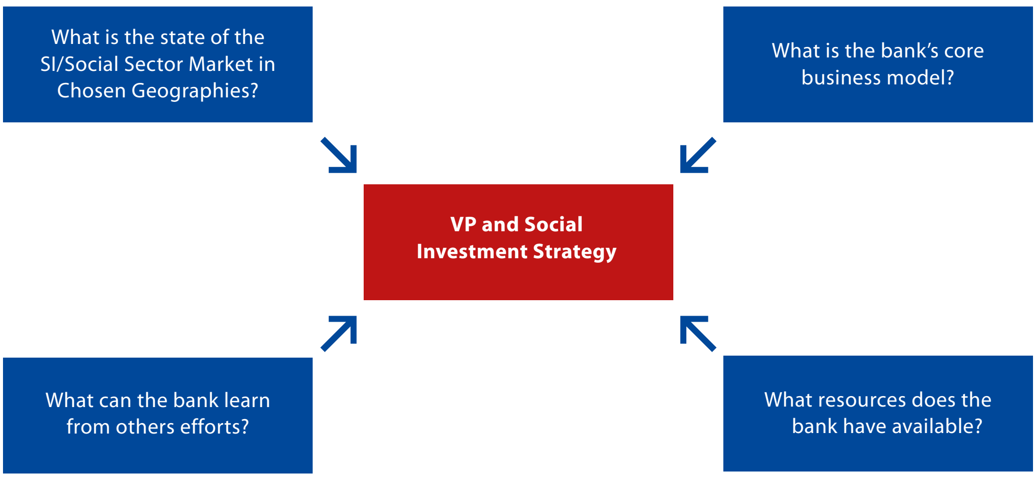
## Part 5:

# Practical Strategies for Engagement

# PRACTICAL STRATEGIES FOR ENGAGEMENT

For banks looking to enter the field of VP and investment or for banks wondering how to build on or adjust what they are already doing, there are many different ways of approaching new or increased participation. The message from the field is to do something and start somewhere, with the size and scale of the initiative less important than might be expected due to the immature state of the market and the reality that it is through small-scale initiatives and endeavours that new markets are built. Indeed, social investments are likely to develop from individual transactions to boutique offerings to funds and funds of funds and, eventually, a fully tradable or 'liquid' marketplace. The key for banks is to build precedent, momentum and confidence and to feel that they are in the position to play the important role that they will increasingly be needed for as the VP and social investment markets grow. Whilst banks are somewhat in unchartered territory in these early days of experimentation, there are some excellent practical resources to draw upon, particularly from the standpoint of those considering investing (social investors can draw on the literature developed for impact investing).[68]

Developing or renewing a strategy for involvement (**what and how**) will require considerable thought and attention to four factors as shown in the chart below: 1) the state of the social investment and social sector market in chosen geographies; 2) the bank's core business model; 3) learnings from existing initiatives/players; and 4) resources available for the bank. These are explained in more detail.




**Factors for banks to consider when developing a VP and Social Investment Strategy**

1. *State of the Social investment, social enterprise and social sector market in chosen geographies:* the needs of the social investment, social enterprise and social sector in the areas that the bank operates in or would like to get involved should be a major determinant of where the bank can most usefully play a role. For those banks who are relatively new to the field, engaging with experts as well as talking to representatives in different sectors

68. See for example J.P. Morgan Social Finance Research (2012), 'A Portfolio Approach to Impact Investment: A Practical Guide to Building, Analysing and Managing a Portfolio of Impact Investments'.

## PRACTICAL STRATEGIES FOR ENGAGEMENT

(public, non-profit etc.) will be crucial in terms of developing a strategy that will have most social impact. There is a need to understand what other parts of the ecosystem are doing, so that the bank's initiative can be most synergistic and complementary for the overall development of the field. For example, if the market is already fairly developed in terms of suppliers of capital to social enterprise and SPOs, but there is a huge gap in the demand-side capacity building, then perhaps the bank might focus and prioritise this area, either doing this themselves or sponsoring others to do this. Or if there is significant capital already in existence for growth-stage social ventures, perhaps the bank should focus on providing riskier early-stage capital

2. *Bank's core business model:* this will define what type of activities the bank can most usefully engage in or direct its attention to since it will build on existing expertise and knowledge and will enable the initiative(s) chosen to potentially influence business units and to prosper within the bank itself. This is most pertinent for initiatives which will move beyond a charitable or corporate foundation. For example, if a bank would like to invest in SPOs, but the bank does not have significant direct investment capabilities, then it may not want to directly invest but may rather fund social investment intermediaries if they exist. To a certain extent this is about what is the mix of product lines – retail, private or investment banking – and where the bank's focus is in terms of geographies, types of clients etc.

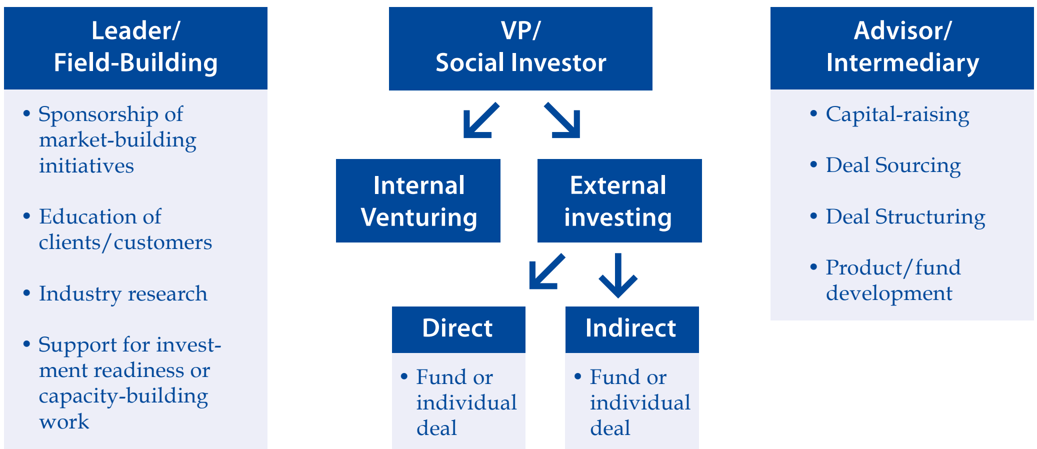
3. *Learnings from others:* This report is intended to be a starting-point for information and knowledge sharing within the banking sector about VP and social investment initiatives. Existing initiatives can be replicated and adapted by other banks. Confidence can be generated that these initiatives have proved powerful, successful and sustainable – and banks can also be aware of the most common pitfalls. And these case studies can provide clues to pressing issues for banks, for example whether and in what form client demand from private banking customers exists for social investment and how best to harvest it

4. *Resources and support available:* since it is financial, human and social capital that the banks have to contribute to the field, it is worthwhile determining what exactly these are in the case of each bank, as they will differ. In terms of financial capital, there are CSR budgets, philanthropic capital, balance-sheet capital as well as client capital to draw on. Banks should be encouraged to really put to work human and social capital and to be creative and innovative in finding ways to do this, particularly through volunteering and mentoring schemes. All of the initiatives included in this report have found ways to leverage internal human capital, even from retired bank employees, and many internal social investment projects have been made possible and financially sustainable through using employees existing skills and a certain amount of their time. Internal business units and initiatives have tended to use most internal resources, but even if the initiative is an external one, investing for example in social enterprises, there are plenty of excellent opportunities to put to work the talents of banking staff. Yet there is also a need for banks to be realistic, even pragmatic about what is possible in terms of resourcing as well

## PRACTICAL STRATEGIES FOR ENGAGEMENT

as what is available internally in terms of skills. Some initiatives do require significant human resources as well as expertise and skills, particularly in terms of familiarity and understanding of social sector challenges and needs, and it may be that the bank decides either to form a strategic alliance or joint venture with an external expert partner to implement an initiative or to make additional hires internally

**The development of a VP and social investment strategy for each bank will require decisions as to the 'what' in terms of engagement and participation**. These are outlined in the following chart, explained in more detail below, which follows the schema adopted throughout the report of the potential tri-partite role of banks as leaders/field builders; VP/social investors and advisors/intermediaries. Banks have normally (although this is not always the case) started by adopting a leadership role, then moving into some investing and finally, in a few cases, becoming advisors and intermediaries. What is recommended is that banks do not shirk from wider responsibilities in terms of developing the market and its infrastructure, simply chasing a potentially profitable opportunity without considering its role within the broader market ecosystem.




Role of banks in VP/Social Investment

- *Leader/field-building*: each bank needs to determine what type of leadership role it can and would like to play. In each country there will likely be a range of ideas and initiatives out there on social enterprise and social investment which the bank could get involved in or sponsor. Some banks, for example, feel very strongly that a key to unlocking social investment capital is for performance measurement and tools for social returns to be improved. Thus, they have sponsored initiatives in this field. Others feel that the greatest role they can play at this point is educational: for example holding forums on venture philanthropy and social investment for private banking clients, or writing and issuing reports on social impact investment and social enterprise which will put these newer types of investment strategies on the map

## PRACTICAL STRATEGIES FOR ENGAGEMENT

- *VP/social investor*: there are many different options for how banks can be VP/social investors
  - Will this be an **internal** social innovation initiative creating a new internal business line or product and/or realigning existing core business or will this focus on funding existing **external** social ventures. There is no right answer here and indeed banks can do both, such as Erste Bank which has set up an internal project – the 'Second Savings Bank' – providing products to the poor and unbanked, but which also funds external microfinance intermediaries and social enterprises. Banks may decide to fund external social ventures because their funding need is significant and/or because there is no real entrepreneurial appetite internally or business opportunity to set up social innovations from the inside. If incubating a new social business/innovation internally, the bank should have a relatively high risk tolerance and the skills and capabilities to translate ideas into business ventures
- If focusing on funding existing external social ventures, will this be **indirect** investing via intermediaries or will this be **direct investing**?
  - Direct investment is clearly the most active way in which to engage with the field but it requires a high level of involvement, particularly in terms of sourcing and closing transactions as well as distinct skills in terms of diligencing and engaging with social purpose organizations. Direct investment can be done as an active/lead investor or if a lower-overhead way is required, as a participating co-investor. Direct investment can be particularly fruitful and beneficial as a way of involving bank staff (as shown by the BBVA Momentum case study)
  - Indirect investment has the benefit of offering the opportunity to make larger individual investments which require a lower level of ongoing involvement and also of leveraging the skills of as well as supporting social investment intermediaries/funds already active in the field. Some banks, particularly investment banks that have entered the impact investment field, have chosen an indirect fund-of-funds approach, which makes sense considering that they will be looking at some stage to offer such a product to institutional clients. However, the opportunities for indirect social investment are still small in certain European countries, due to lack of intermediaries
- Key questions that investors, whether direct or indirect, will need to consider are:
  - what their **target market might be in terms of sectors or geographies**, if they do want to restrict this. Note that most of the investing done to date by banks has not been sector-specific, apart from microfinance activities, since it is perceived that the social business/social enterprise opportunity is not substantial enough to allow for sector-specific funds/strategies. This will likely change as the market grows and matures and the Triodos Bank example shows that if there is scale in social investing, it may be most efficient and impactful to organize by sectors, both in terms of obtaining a deep understanding of individual social issues as well as allowing for investors to pick to support theme areas which are of importance to them individually. This trend is corroborated by the experience of dedicated VP/SI organisations in Europe that have become increasingly focused on specific social sectors throughout the maturity of the sector[69]

69. Hehenberger, L. and Harling, A-M (2013), 'European Venture Philanthropy and Social Investment 2011/2012 – The EVPA Survey', EVPA.

## PRACTICAL STRATEGIES FOR ENGAGEMENT

– what **the impact orientation of the social enterprises or intermediary** that they are funding is. What type of social returns is being generated and how will social returns be measured? At the moment, banks seem to be taking a bespoke approach to evaluating and measuring the social returns of their investments. Please see the EVPA's recent report on impact measurement, 'A Practical Guide to Measuring and Managing Impact'[70], outlined below, for best practice recommendations. In addition, there is much work being done at the moment within the impact investment field to create more standardized metrics

### About EVPA's Practical Guide to Measuring and Managing Impact:[71]

The Practical Guide is a comprehensive resource that distils best practice in impact measurement into five easy-to-understand steps and provides practical tips and recommendations for how to implement impact measurement at the level of the social investor and in the social sector organisations that they support. The guide then goes a step further by focusing on how impact can and should be managed by organisations to achieve even greater impact.

– as well as **what type of investing they want to participate** in. There are a variety of different approaches and financing tools for different types of SPO, with players choosing segments to operate in. This will of course differ for each geography, but the chart could be a useful tool for creating investment positioning. Another consideration is the stage of enterprise development to be targeted. Early-stage VP and social investing can have very different implications on risks and financial returns than growth-stage investing

- In addition, banks will have to decide **whether to set up a fund or whether to invest on an individual deal** basis:
  - **A fund approach** is particularly suitable if external client investment is being sought or is likely to be sought in the future. Funds allow smaller amounts and different types of capital to be pooled in one place to create more capacity to invest and direct capital which in turn means more and different types of investors can participate. Funds can also enable different types of investments to be made out of one pool, so a range of investments can be made with different risk, return and impact, provided that the profile of the aggregated, or total, pool of investments is acceptable
  - **Individual, bespoke deals** may be more suitable for banks starting to experiment and explore the field where there is limited deal flow to support a fund structure or where the regulatory environment makes creating fund structures too complex
- *Advisor/intermediary:* banks can play an active role in bridging the gaps between VP/SI demand and VP/SI supply. The questions are:
  - How to source investible propositions?
  - What product/offering to go to the market with?
  - Whom to target?

70. Hehenberger, L., Harling, A-M. and Scholten, P. (2013), 'A Practical Guide to Measuring and Managing Impact', EVPA.
71. ibid.

## PRACTICAL STRATEGIES FOR ENGAGEMENT

– How to target them?
– How to communicate the strategy to clients and client relationship managers?

Capital-raising from private capital sources for VP/social investment is still in the early stages by banks, there is no blueprint for how, when and what to go out to the market with. From the case-studies, we have seen the following options:

**Options available to raise capital from private sources for VP/SI**

| Type of Bank | Option | Comment | Example |
|---|---|---|---|
| **Retail** | Develop intermediating internet platform | Low-cost, democratic way to intermediate | BBVA |
| | Create retail ethical/social product | Excellent way to involve retail and aggregate funds for social investment | Triodos Bank |
| **Private** | Create bespoke VP/social investment product(s) for clients | Allows lower-ticket aggregation of client funds | BNP Paribas, UBS |
| | Obtain client funding for individual deals | Less complexity (regulatory, other) | Bank Degroof |
| **Investment** | Approach institutional and private clients with individual deal/offerings | Understand investor appetite across various investor groups while the market opportunity is expanding and while developing a principal investing track record and expertise | J.P. Morgan |

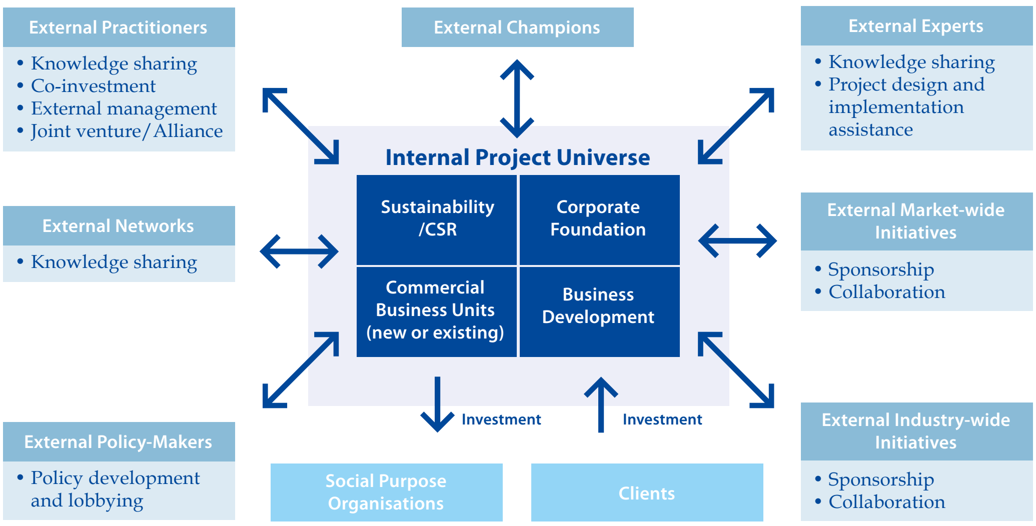
**The 'how' of engagement and participation is also a crucial component of developing a VP/SI strategy, considering the resources available.** As the chart below shows, there are a range of external and internal actors to consider in terms of where the project/initiative will sit and who will be involved in order to make it successful:

- *Internal universe:* there should be intra-bank collaboration efforts around the project/initiative, including the commercial business units which house a depth of technical expertise on engaged investing as well as client relationships if client capital is being

## PRACTICAL STRATEGIES FOR ENGAGEMENT

sought; sustainability/corporate social responsibility which has expertise in engaging to generate positive social and environmental impact; the bank's charitable foundation which provides funding sources that carry significantly less pressure; and business development which can support product innovation, the project management and the development of new VP/SI initiatives[72]

- *External VP/SI market universe:* comprises many players and initiatives which the bank will need to be familiar with, including external practitioners (who the bank might want to co-invest or have manage the VP/SI project); external champions; external experts; external networks (of which EVPA is the major European one for VP/SI) and external market and industry wide initiatives which the bank might want to collaborate in and potentially sponsor. With all of these external players there is a need to knowledge-share.




**Internal and External Actors to Consider when Developing VP/SI strategy**

From the case studies, we see that banks have three options in terms of how to manage a VP/SI initiative: 1) Internally manage through an existing business unit, the CSR department or the Bank's charitable foundation; 2) Internally manage through a new business unit; and 3) Have the initiative externally managed. These three options are described more in the table below.

In addition to thinking about who is going to run, manage and be involved in the project, there are also the softer issues of how to obtain senior support within the bank and how to communicate the VP/SI project initiative internally and externally. Banks involved in the field who have been interviewed for the field commented that generating a culture of excitement is crucial for the success of the initiative.

72. For more detailed information on the how for corporations and investors engaging with social enterprise, please see 'A Framework for Action: Social Enterprise and Impact Investing', United Nations Global Compact and Rockefeller Foundation, June 2012. This outlines several distinct models for investors: institutional impact investing: externally focused models; institutional impact investing: internally focused models; as well as a range of models for corporations involved in social enterprise development including an investment model, a strategic alliance model and an incubation model.

## PRACTICAL STRATEGIES FOR ENGAGEMENT

| Type | Comment | Example |
|---|---|---|
| Internally manage the VP/SI project initiative through an existing business unit and/or the CSR department and/or charitable foundation, collaborating with external actors and bringing in the required skills where necessary | Significant internal costs. High strategic value as obtaining valuable knowledge and experience internally. Particularly significant if core business involved. Large opportunities for staff involvement and development. Collaboration skills required. | Deutsche Bank, BBVA, Bank Degroof |
| Internally manage the VP/SI project initiative by setting up a new business unit | Provides key visibility and profile as initiative obtains its own dedicated resourcing. Business unit can operate cross-departmentally and cross-functionally. Develop a strong expertise and track record on a nascent market through 'skin in the game' approach. However, could potentially become a silo/isolated. | J.P. Morgan, Erste Foundation |
| Have the project/initiative externally managed | Drawing on existing skills, experience and track record which the bank might not have internally.<br><br>Particularly relevant if the project beneficiaries will be in the developing world, where the bank may not have the infrastructure internally to manage such an initiative | UBS |

# PRACTICAL STRATEGIES FOR ENGAGEMENT

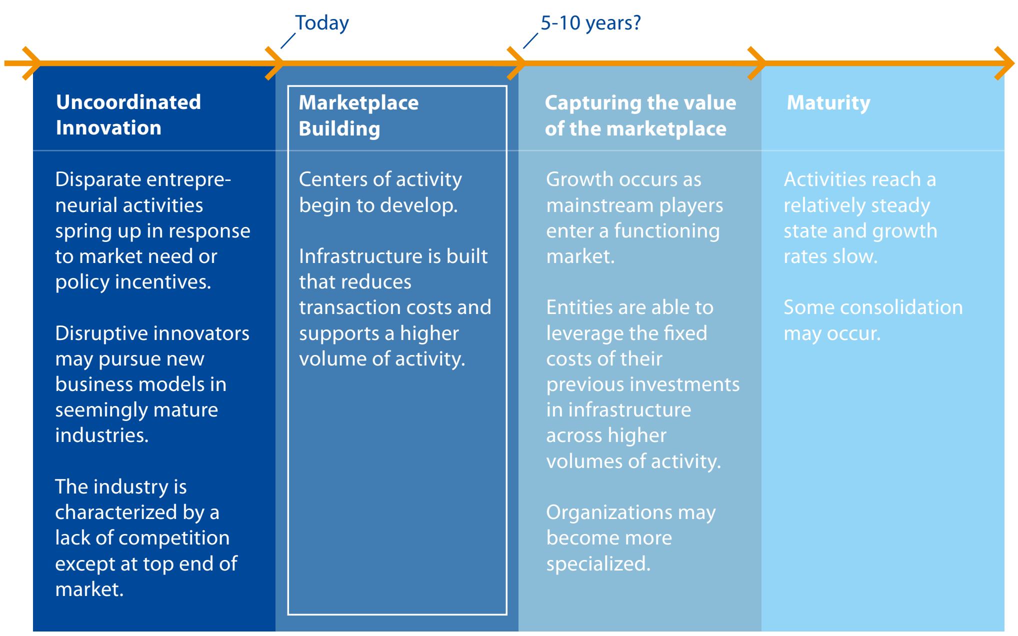
## Part 6:

# Future of Banks Engaging with VP/SI Strategies and Recommendations

# FUTURE OF BANKS ENGAGING WITH VP/SI STRATEGIES AND RECOMMENDATIONS

### The future for banks in VP and social investment

Perhaps the key to understanding the banking industry's current and future engagement with the newer strategies of VP and social investment is that of market maturity, which can explain much of banks' behaviour in the past as well as provide a guide to how banks will become involved the future. In general, drivers to get involved have so far been mostly 'soft' ones, through ethic, personal beliefs and a general sense of opportunity, which is not tangible or really proven. The landscape has been therefore filled by pioneers. Increasingly, however, the market is evolving (as per the chart below) and there is more possibility and probability that in the not too distant future value particularly around social investment opportunities can and will be captured. Thus more banks are currently entering the field and the likelihood is that this will increase exponentially as the market settles and infrastructure is increasingly generated. This has been the case with microfinance – nearly all banks now have some presence in the microfinance market, whether through core business or CSR strategies.




Phases of industry evolution[73]

Clearly, there is a long way to go for the European social investment market to be a well-functioning, mature one. The UK CAF Venturesome's report on the four key pillars for the development of a robust UK social investment market is useful in identifying what is needed:[74]

73. Freireich, J. and Fulton, K., (2009), 'Investing for Social and Environmental Impact: a design for catalyzing an emerging industry', Monitor Institute.

74. Goodall, E. and Kingston, J (2009), 'Access to Capital, A Briefing Paper', CAF Venturesome (pg.3).

# FUTURE OF BANKS ENGAGING WITH VP/SI STRATEGIES AND RECOMMENDATIONS

## Four pillars for a robust social investment market:[74]

**Pillar 1: Confident and informed demand from the voluntary and community sector** (VCS). VCS organizations fail to adequately distinguish between revenue and capital; rather they tend to focus on income and costs, with a corresponding lack of knowledge about, or confidence in, asset management, capital investment and identifying financing needs and options. VCS organizations have a perceived cultural aversion to debt funding.

**Pillar 2: Efficient matching of supply and demand:** with a lack of effective intermediaries, inefficiencies in social capital markets inhibit matching of supply and demand. Social capital markets are often still defined by 'fragmented demand and supply, complex deals, and a lack of understanding of risk'; compounded by a typical small deal size.

**Pillar 3: Variety of investment mechanisms:** the range of funding and investment mechanisms in the UK social investment market is limited and remains dominated by a static grant funding pool; this reflects a lack of established relationships between risk, return and pricing for the sector.

**Pillar 4: Resilient supply of finance:** a mix of private, commercial and public funding from both retail and wholesale sources is needed for a robust marketplace

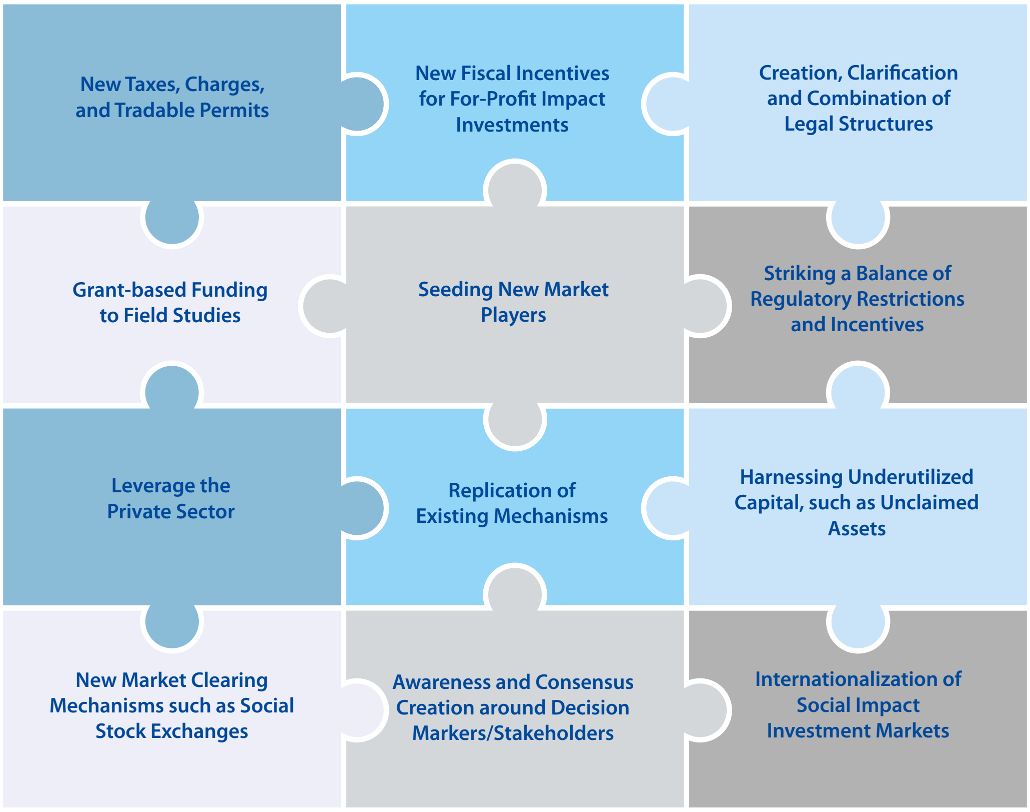
The banking sector can and is playing a role in building all of these pillars, through capacity-building of social purpose organizations (Pillar 1); identification of intermediation opportunities (Pillar 2); financial and product innovation and packaging (Pillar 3); and supply of finance from its own sources as well as client funds (Pillar 4).

There is a very complex and intricate task ahead for governments to create the right enabling environment for asset owners and managers to operate in. This complexity of their task is well represented by the jigsaw puzzle below, taken from the recent report by Impact Economy called, 'Making Impact Investible'.[75]

If the market evolves appropriately and the environment becomes more welcoming and enabling for social investment, banks are increasingly likely to dedicate more resources to it. However, their involvement is likely to lag the general market evolution, due to issues of risk and complexity of organizational structures. It will be market forces, including stakeholder pressure, that will above all drive the majority of banks outside of the early adopter segment to act. On the one hand, this is about increased client demand whether high-net-worth and charitable foundation demand driving private banks to develop VP and social investment offerings or retail bank customers demand for ethical social products driving lending to social enterprises and businesses. On the other hand, this will be about having

74. Goodall, E. and Kingston, J (2009), 'Access to Capital, A Briefing Paper,' CAF Venturesome (pg.3).
75. Martin, M. (2013), 'Making Impact Investible', Impact Economy Working Papers.

more saleable and sustainable (and potentially even profitable) social investment products to offer. This will be in terms of a) size – once there are possibilities of bigger social impact investment deals, perhaps with more layered structures offering different risk/returns for different investors, investment banks are likely to get more involved and active b) standardization and liquidity – investment and private bank's involvement in social investment will accelerate when standardised and tradable social investment products become available, which is a major barrier particularly to unlocking institutional funds (the social impact bond could be just such a product); and c) track record.




**Building blocks to create an enabling environment for Social Impact Investment[76]**

### Recommendations to catalyse bank's involvement in VP and social investment

*For banks in general*

1. Each bank should develop a VP and social investment strategy that fits their needs and environment. No matter how small the initiative or involvement, do something
2. A bank's charitable foundation is an important and relatively easy place to start with experimenting with these strategies. All banks' foundations should be exploring how they can use VP and social investment strategies to make maximum use of their income and asset base

76. Adapted from: Martin, M. (2013), 'Making Impact Investible', Impact Economy Working Papers.

## FUTURE OF BANKS ENGAGING WITH VP/SI STRATEGIES AND RECOMMENDATIONS

3. At some point, involve where possible core business units, since social investment strategies will achieve maximum impact if they become integrated into the bank itself
4. Balance investment and/or advisory and intermediary activities with important leadership and field-building activities. Banks need to play their part in helping to create appropriate market infrastructure
5. Ensure a social return focus, where efforts and capital invested produce positive social change. Beware of only cherry-picking financially attractive social investment deals. All market participants need to co-operate and find ways to help to build the pipeline of socially investible organizations
6. Be open to collaboration and knowledge-sharing, even within the competitive banking industry
7. Use the human capital resident within the bank to maximum use – social investment activities provide excellent staff volunteering opportunities

*For retail banks*

8. Consider whether more could be done to lend to social enterprises, social business and other SPOs, what the barriers to doing so are and what the bank needs to do to make more lending happen. Voluntarily track and monitor lending to social purpose organizations
9. Consider whether a retail ethical product is possible

*For private banks*

10. Attempt to bridge the existing internal and human capital divide between philanthropy and investment, ensuring that there are staff with expertise in VP and social investment
11. Educate clients, as appropriate, about VP and social investment
12. Educate client relationship managers, as appropriate, about VP and social investment
13. Consider whether individual or fund VP and/or social investment product offerings are possible, considering client appetite
14. Where client demand exists, create appropriate VP and/or social investment product offerings
15. Use clients' human capital – VP and social investment activities provide excellent mentoring opportunities for clients

*For investment banks*

16. Build knowledge and expertise in social investment, applying skills of financial innovation and structuring where possible
17. Where possible, help to create more track record around social investment funds and products by investing own capital and internally managing funds/products or appointing external managers to do so
18. Consider what would be required for increased institutional client demand and help the market to develop such products

## FUTURE OF BANKS ENGAGING WITH VP/SI STRATEGIES AND RECOMMENDATIONS

*For the VP/SI industry*

19. Create opportunities for the banking industry to become involved by actively approaching banks with social investment deals and ideas as well as joint ventures and alliances
20. Create opportunities for banking industry-specific discussion and debate
21. Celebrate and widely publicise the banking sector's involvement and successes in the VP, social and impact investment fields
22. Develop initiatives which will help to create the product attributes critical for banks greater involvement (liquidity and standardization, track record and size) as well as products suitable for institutional investors
23. Ensure the banking industry (and not just the large, global banks) are involved in key debates and conferences and that they have an active and substantial voice at the table
24. Conduct and publicise research assessing client demand for social investment

*Policy-makers*

25. Explore and implement, where possible, tax incentives and other policies to encourage and enable social investment
26. Ease any regulatory hurdles to the development of social investment funds and products by banks and other intermediaries

## Part 7:

# Conclusion

# CONCLUSION

**Social investment is the biggest opportunity to have emerged in recent years for finance and the role that banks can play in developing and then mainstreaming it is enormous**. Signalling just how seriously the potential of social investment is being taken and how global enabling actors are starting to coalesce to further build the market, a whole day was dedicated to social impact investment at the recent G8 conference in London in June 2013, with several initiatives agreed to breakdown some of the barriers to its development. 'Social impact investing' was heralded as a transformative tool with the ability to reshape global capital markets in the years to come. The banking industry was represented at the meeting by some of the major banks – Citigroup, Credit Suisse, Goldman Sachs, J.P.Morgan, Morgan Stanley and Deutsche Bank – and the CEO of Deutsche Bank UK, Colin Grassie, addressed the forum describing social impact investment as '*a new model of sustainable capitalism*', with '*every asset manager having a social investment fund*.'

*'There is nothing more powerful than an idea whose time has come'*

Victor Hugo

As this report has illustrated, the banking industry has started to experiment and explore the terrain of VP, social and impact investment with an array of different initiatives and efforts. There is activity not only in the UK, where the social investment market is more mature and higher profile, but across many other countries including France, Austria, Germany, Spain, Italy and the Netherlands.

But there is no doubt that much more can be done by banks. Collectively they have enormous human, financial and social capital, only a very small proportion of which is being dedicated at the moment to VP and social investment. There is a huge road still to be travelled before VP and social investment reach their potential and the banking industry has an increasingly strong and essential role to play in this journey. Real and concerted collaboration with other banks as well as other players in the social investment value chain is critical. Banks cannot operate as silos, pursuing their own discreet agendas and initiatives. But the prize for developing the market will be massive. Not only in social returns. Or in a new business opportunity. But in renewing the relevance of finance for the 21st century.

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- Lidia del Pozo, Head of Community Development, BBVA
- Patrick Elmer, Responsible Investment and Philanthropy Services and Laura Hemrika, Microfinance Capacity-Building Initiative, Credit Suisse
- Franz Karl Prüller, Member of the Board of Erste Foundation and Director of the Social Programme
- Marc Flammang, Philanthropy Advisory Service and Impact Investments, Bank Degroof
- Ulrich Grabenwarter, Head of Development – Impact Investing and Social Finance, European Investment Fund
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- Jaume Iglesies, Head of Values-Based Investing, UBS Wealth Management
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**The European Venture Philanthropy Association (EVPA)**

Established in 2004, EVPA aims to be the natural home as well as the highest-value catalytic network of European Social Investors committed to using venture philanthropy and social investment tools and targeting societal impact.

EVPA's membership covers the full range of venture philanthropy and social investment activities and includes venture philanthropy funds, social investors, grant-making foundations, impact investing funds, private equity firms and professional service firms, philanthropy advisors, banks and business schools. EVPA members work together across sectors in order to promote and shape the future of venture philanthropy and social investment in Europe and beyond. Currently the association has over 160 members from 23 countries, mainly based in Europe, but also outside Europe showing the sector is rapidly evolving across borders.

EVPA is committed to support its members in their work by providing networking opportunities and facilitating learning. Furthermore, we aim to strengthen our role as a thought leader in order to build a deeper understanding of the sector, promote the appropriate use of venture philanthropy and social investment and inspire guidelines and regulations.

http://www.evpa.eu.com

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