

Social Stock Exchange: A Path Breaking Initiative



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The Indian securities markets witnessed two significant developments in July 2022. The first was the government notification on July 15 giving birth to a new 'Zero Coupon Zero Principal Instrument' that can be issued by Non Profit Organizations (NPOs) and listed at Social Stock Exchange (SSE). A week later, on July 25, SEBI quickly followed up with the notification of its regulations enabling the creation of SSE and its

associated eco system. These unique initiatives hold a lot of promise particularly for the NPOs in our country. This piece seeks to provide an overview of the concept of SSE and its key pillars in the broader context of the needs of our economy.

Context

Exploring innovative financial structures is crucial particularly for developing economies like ours where supply of long term patient capital is never adequate. India has committed to achieve the UN Sustainable Development Goals (SDGs) by 2030. NITI Aayog in its Voluntary National Review published in 2020 noted that India needed to increase its SDG spending by an additional 6.2 per cent of its GDP until 2030 in order to meet key goals and targets set under the SDG framework. The devastating pandemic has made the achievement of these goals even more challenging. India is ranked 121 out of 163 countries as per the Sustainable Development Goals Index, 2022¹. Another relevant data point is India's Human Development Index, 2019 ranking at 131 among 189 countries. So we have a long way to go. The question is – are the government spending and the conventional financial capital enough to meet our goals. Obviously not. We need financial capital from all sources, namely private, social, philanthropic and we need loads of it.

In this backdrop, we need to evaluate the efficacy of existing financing and reporting structures and explore new avenues to attract private and philanthropic capital for development purposes. While public equity markets have deepened and private equity has arrived, another emerging area is blended finance, which holds promise for social entrepreneurship. It aims to leverage philanthropic funds to attract commercial capital towards achieving social outcomes. Innovative financing structures available in this space include Social Venture Funds recognized by SEBI and Development Impact Bonds.

SEBI's ongoing work on creation of a SSE is relevant in this context. Social Stock Exchange is an interesting novel concept with tremendous potential for achieving

social outcomes. Creation of SSE is aimed at unlocking private capital for social enterprises comprising of both non-profits and for profit entities. SSE would bring more visibility to the social impact that social enterprises create.

SEBI's thinking in this space was kick started by the announcement of Hon'ble FM for setting up a SSE under the aegis of SEBI in her Budget Speech for FY 2019-20. The coinage has become a new entrant into the stock market lexicon since then. Setting up a SSE presented an opportunity for leveraging the strengths of a well-established securities market for the benefit of social sector. As it is a road less traveled globally, SEBI set up two expert groups to help it conceptualize and design SSE - a Working group headed by Mr. Ishaat Hussain (Director, SBI Foundation; Former Director of Tata Sons Limited) in 2019 and later a Technical Group headed by Dr. Harsh Kumar Bhanwala (Ex-Chairman, NABARD) in 2020. The vision and recommendations provided by the groups finally fructified into a framework for SSE in July 2022.

Key Pillars

The SSE is envisaged as a separate segment under the existing stock exchanges. It is more than a mere physical or virtual place that facilitates listing and trading. The typical fund-raising instruments, promising financial returns only may not work here. It has broader connotations and refers to various new structures, instruments and processes that go beyond conventional listing and trading. The framework has five key pillars.

Registration / Listing of Social Enterprises

To register on the SSE, a Social Enterprise, a NPO or for profit organization, will need to demonstrate that social intent and impact are its primary goals. The Social Enterprise should target underserved or less privileged population segments or regions and be functional in an activity that is consistent with the national priorities. The eligible activities, derived from the priority areas identified by NITI Aayog, the Companies Act and the Sustainable Development Goals include eradicating hunger, poverty, promoting health care, sanitation, education etc.

SSE would open new doors for fund raising by NPOs. NPOs desirous of raising funds on SSE will have to register with the SSE. Certain eligibility thresholds for NPOs that are proposed, include minimum annual spending of Rs 50 lakhs and minimum funds raised of Rs 10 lakhs. Registration with SSE would signal NPOs' readiness to meet higher standards of governance and transparency to the market and thereby attract investors.

Fund raising mechanisms

A number of innovative financing structures have been identified, as part of SSE. These include Zero Coupon Zero Principal (ZCZP) instruments, Social Impact Funds, Development Impact bonds, and Donations through Mutual Funds route.

Of these, ZCZP deserves a special mention. The Working group on SSE came up with the idea of this innovative instrument to enable listing of social enterprises on SSE. The instrument will be issued by non-profits for undertaking specific social development projects/activities. With zero coupon and no principal payment at maturity, the instrument is not designed to offer any financial return. It would however entail the promise of a social return to the funder and that is what would distinguish it from a plain vanilla donation certificate. NPOs shall be required to file a fund raising document with SSE for the purpose of floating ZCZP instrument. It will be interesting to see how the instrument, recently notified as a security gathers traction.

Further, Social Venture Funds under the SEBI (Alternative Investment Fund) Regulations have been reinvented as Social Impact Funds with several important tweaks. These funds have been enabled to invest 100% of their funds in NPOs registered or listed on SSE and provide social returns to its investors. Through the Mutual Fund route, the returns (with or without principal) generated on investments in a MF scheme can be routed to NPOs. We have two known examples viz. HDFC Cancer Cure Fund and Quantum Mutual Fund's SMILE facility. We need more of such schemes from the mutual fund industry.

Another blended finance instrument proposed under the SSE framework is the Development Impact Bond (DIB) which has tremendous potential. The basic principle of a DIB structure is that a grant is made to an NPO after it delivers on pre-agreed social metrics at pre-agreed costs/rates (pay for success). We have had examples of the DIB structure being successfully used in India. One successful use case in India is that of the Educate Girls DIB.

Impact Reporting and Social Audit

Social enterprises on SSE will be required to make disclosures at the initial stage as well as on periodic / annual basis on various aspects including governance,

financials and the social impact created through an impact score card. The impact report envisages measurement from the perspective of intended beneficiary which the social enterprise seeks to serve.

The impact disclosures will be mandatorily subject to social audit. Social Auditors will be required to qualify certification courses conducted by the National Institute of Securities Market (NISM) apart from empanelling with a self-regulatory organization (SRO) which is proposed to be under the Institute of Chartered Accountants (ICAI). Social impact disclosures and social audit can substantially enhance the transparency and trust between issuers and investors.

Capacity Building Fund

To improve the ability of all stakeholders, particularly of the non-profits, to navigate SSE, its process, instruments etc., a capacity building fund shall be instituted. Developmental institutions like NABARD and SIDBI have shown interest in contributing to and setting up such a fund. This fund will run programs for non-profits aspiring to be registered on SSE. The interest of smaller NGOs has been kept in mind.

Finally, to sum up, I believe we have a well thought out comprehensive framework for SSE in place which envisions to bring the social sector closer to the securities market. SSE brings in fresh air and an innovative approach to solving our developmental challenges. It will be interesting to see the final outcomes, which in turn will depend upon successful implementation of the new ideas. All the stakeholders – investors, issuers, regulators, standard setters - will have to coordinate and collaborate for successful execution.

¹ <https://dashboards.sdindex.org/chapters> (published in consultation with members of the Sustainable Development Solutions Network)