Safe in India Foundation

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To

Smt Yogita Jadhav, DGM
Shri Abhishek Rozatkar, AGM
Security and Exchange Board of India
Mumbai
India

Dear Smt Jadhav and Shri Rozatkar

Subject: Feedback on Social Stock Exchange

First congratulations to the Working Group and the supporting team for putting together this comprehensive Report, and for organising the video conference to share the Report findings and seeking public feedback. The document makes for a very thoughtful reading on a number of possibilities and lessons for both the NPOs and FPEs: a value-add in itself. This a progressive proposal aiming to improve the funding of the social sector and we would be delighted to participate in the SSE when it's ready.

As requested, here are our views, informed by our experience in both NPOs and FPEs, of starting and running our NPO, Safe in India Foundation, co-founded by three alumni of IIMA, and my personal experience as an ex-MD HSBC Group and of directorship of a number of significant FPEs in the UK and Europe (two examples: Big Issue Invest, UK "BII", and Fairtrasa International, Switzerland). BII also manages/advises USD200m+ of social sector funds, providing useful insights in the UK social markets. I have also consulted with Mr Danyal Sattar, CEO, BII and other experts in the UK (who do not wish to be named) to inform/confirm some of the UK Social Exchange (SSX) experiences below.

The use of SEBI's current platform is a great idea; one of the reasons for UK SSX failure was it's trying to create its own new platform. The proposed tax-incentives and Rs100 crore funds will clearly help promote SSE. The financial instruments innovation effort for FPEs is laudable and we believe can work well.

However, we have identified a few issues here, that we believe are material to developing a successful SSE. We have also listed our recommendations. The key principle, we hope you agree is that, **SSE should not only be highly ethical in its governance and accountability, but that these should be more and not less than the conventional stock exchange.**

We hope these are taken in the spirit of constructive criticism to make this SSE proposition better and stronger, for India/SEBI/SSE to lead this thinking globally in the long term and prove its Atma-nirbhar credentials.

Section A: NPO (first section only because NPO conversation leads the sales pitch of SSE)

1. **Should an NPO exchange exist at all or at least be separate from FPE exchange, as they are very different in their values and therefore mixing the two would muddy the waters at best, and at worst, may dis-advantage NPOs ultimately**?

   As we all know, NPOs seek only social impact, do not chase profit and were therefore the ones who save millions of lives in the past few months, feeding the hungry, as the key speaker rightly pointed out in the VC.

   FPEs can never do that as they seek profit for their actions by selling good and/or services, albeit through social impact. Global experience suggests that they, often, land up trying to maximise profit and suffer from mission-drift.

   These are very different value-orientations of these sectors, their leaders and people eg. FPEs often have a bonus-incentive for its staff, well-understood for its corporate cultural/value-implications. We have not heard of any NGOs with staff bonus schemes. FPEs are much closer to traditional businesses while NPOs stand completely apart on the spectrum. An FPE can turn into a usual business and often does, whereas NGOs almost always do not.

   The proposed mixed platform structure provides the credibility to SSE of the NPOs' size/scale/names and most importantly their irreplaceable impact. While this may help SSE start off better and increase funding for NPOs over time, we believe that the main beneficiary of this "halo" effect will be the FPEs. That may be acceptable as long as it does not dis-advantage NPOs as an industry and listed FPEs are genuine FPEs with credible social impact.

   However, we believe that, over time, this structure will move many ("less sophisticated") philanthropists from funding NPOs to FPEs as they see a financial return on their investments with professional sales-pitches by FPEs, who will be able to pay intermediaries from their profits. NPOs will not be able to match that despite the initial Rs 100 cr fund proposed. SSE could then become a reason for FPEs dominating the Indian philanthropic giving due to the professional intermediaries.

   It is also important that SSE does not end up encouraging NPOs to start playing a valuation game that eg. is possible with Impact Bonds, as it has happened sometimes in the UK. We all understand that the downside of that for the much-needed NPO culture and impact.

   ***Recommendation**: We, therefore, strongly recommend either not including NPOs in the starting phase of SSE until it proves itself on its merit with FPEs, or at the bare minimum, separating the NPO and FPE exchanges.*

2. **In the same vain, will the proposed tax-incentives, if approved as proposed, incentivise FPE investments over NPOs ultimately? Is that wise given FPEs will likely never replace NPOs social impact on people, environment, etc?**

   In the UK, there are no tax breaks for FPEs, while there are for the NPOs, reflecting the very different nature of their profit (or not) motives. The paper proposes a variety of tax-incentives here. Clearly, the more the better for both.

However, NPOs need better tax-incentives than FPEs for obvious reasons: (a) NPOs need donations not investments, even if they are packaged as instruments, (b) FPEs can have mission-drift and misuse tax-breaks, much more than NPOs with their ability to pay tax-accountants and professionals like any other business, (c) NPOs are regulated entities unlike FPEs. NPO regulations are, in fact, getting stricter.

Recommendation*: Indian Policy makers (and SEBI should be party to this intention and policy for sake of Indian public) should ensure that SSE does not lead to NPOs having lower tax incentives than FPEs.*

3. **Should there not be equal participation of NPOs in the Working Group?**

The current WG is a group of very accomplished and experienced executives from FPE, Foundations, SEBI, Consultancies and Research firms. NPOs are not well represented, although the Report and the Video presentations set the scene with NPOs and only then get into FPEs. The SSE sales-pitch appears to rest on NPOs to begin with.

We do note that there has been a survey of NPOs and some of their responses are attached in the Annexures; however, it's not a robust research and NPOs do not seem to have influenced the WG discussions directly and substantially. The NPO comments in the Annexure are noted but there seems to be no change in Report as a result of those, though they may well be planned for the next version of the Report.

It is said that, in the UK, SSX idea and implementation was driven by "City People" and for some, that is one reason for its failure. We must avoid it if SSE is going to assist NPO sector in its entirety in any significant and impartial way.

Recommendation*: It's critical that WG now includes equal membership from NPOs to get their practical experiences in the discussion and approve the next iteration of this Report*.

Section B: FPE (who will thankfully benefit much more from SSE in our opinion)

4. **Why should FPEs be regulated any less than NPOs, if they seek similar impact investment and tax incentives?**

FPEs in the UK too have much lighter regulatory touch than NPOs (especially because its difficult to define FPE), but as mentioned above, FPEs don't get any special tax-breaks in the UK. If the proposal is to tax-incentivise FPEs, that is great, but subject to clearer definition and ongoing social impact evidence. However, then they should be regulated to some degree, like NPOs are.

Recommendation*: A small independent regulator, constituted of equal participation of NPOs and FPE-type executives. Funded by the Rs100 crore fund, for say the first three years, will ensure a credible SSE with the right quality of investors and investees aiding in its early success.*

5. **In absence of definition for FPEs (admittedly challenging), should there not be at least a few 'tests' defined for FPEs to list, especially given the desire to avoid imposter FPEs or have an independent Panel to approve investees?**

   The Report rightly highlights the need to avoid imposter FPEs and seeks SEBI's assessment on FPEs. This may work as SEBI does indeed manage the listing requirements in India very well. There will need to be a clear a similar clear listing requirement for SSE investees including their social impact credentials. These will need to be stipulated, checked and later monitored by SEBI.

   However, in case of NGRBC BRRs, also mentioned in the Report as evidence of SEBI's responsibility, we have been requesting SEBI to act on the gaps in the BRRs reported by five largest listed auto-sector companies for past year. We have not received a formal response but have been informally advised that SEBI does NOT review, assess, opine, act on these BRRs. They are mere public documents for investors to take a view on, should they wish. If that is SEBI's position on social responsibility of large listed 1000 companies' BRR, would or can SEBI take a position on qualifying individual NPO/FPEs' mandate/impact/etc risking its reputation in case of imposter FPEs? If SSE can do it for FPEs, would that mean SEBI should also value-judge the BRR submissions?

   Attached is a somewhat dated draft format of 'tests' used by UK SSX for FPEs'. This is only an indicative document and given SSX's failure, not necessarily best practice to be emulated eg. we think it should have a 'declaration of interest'.

   Recommendation: *We would, therefore, recommend an independent '**Admissions Panel'**, which may or may not be part of SEBI. This Panel should have independent credible members equally from the NPO and PFE world.*

   This Panel should approve investees, and review them annually, at least for the first 3-5 years of SSE, after which this process can be lightened up depending on the credibility built up by SSE in keeping the imposters away.

   The Panel can also approve eco-system players, with a light touch, to ensure quality and value-aligned intermediaries.

6. **Shouldn't 'tests' for listing and Minimum Reporting Standards for FPE include a robust declaration of ownership and 'interests' and salaries/compensations of owners, directors and senior employees?**

   Mis-use of some of the CSR/foundation funds in India, for family and friends, is well understood. There are a number of regulations for NPOs to control this and even they need to be improved to check these practices. One can imagine the mis-use of FPEs given the current mal-practices.

   Recommendation*: To save SSE for reputations risks and build it into an ethical exchange, any 'listing criteria' (including reporting per Annexure 2 in the Report) must include the above* *details and importantly 'declaration of interest' by owners/directors/senior executives regarding suppliers, buyers and beneficiaries, and they should be renewed at least annually.*

7. **Is FPSE (For-Profit Social Enterprise) a better name that FPEs, which sounds like any commercial enterprise, including profit-maximisers?**

   The point is not to confuse the investors. In addition, FPE investees should really always want to carry the badge of 'Social' in their acronym and live by its values and prove their genuine social impact to their audience every time.

   "For Profit" is in fact misleading and I wouldn't want my portfolio social enterprises to be called "FPEs".

Section C: Investors

8. **Was there a survey/research done of the potential investor community – both retail and institutional to assess demand for SSE? What significant value does SSE add, compared to main Exchanges for floating the proposed FPE instruments, with-out the proposed tax-incentives?**

   It is our belief that most NPO donors want close relationship with NPOs and seek to understand and monitor NPOs themselves. Most large Foundations work closely with NPOs. Corporates' with CSR departments use donations often for furthering the corporate cause through impact in their direct stake-holders. In our discussions with a few of them during this brief period indicates that they do not feel the need of SSE though of course they may be missing the potential.

   Individuals often donate only to well-known NPOs. It's well-known that the Indian retail crowd-funding platforms for NPOs add *in*significant donations from their own data-base/promotion to most NPOs and are really convenient and professional payment portals (which is good value-added too, so they are helpful).

   Isn't it better that these proposed tax-breaks to NPO donors are provided irrespective of SSE and that FPE instruments, with any tax-incentives, are floated on main stock exchanges?

   Recommendation: *A rigorous investor demand assessment now, which shows that even without these incentives of tax-breaks, SSE adds significant value for them and the nature of that value.*

9. **Is the main NPO instrument proposed "Zero Coupon Zero Principle" really a financial instrument in terms of liquidity, trading, etc, without the proposed tax-incentives, and do key Indian donors see any value in it?**

   In the proposal, this seems to be the anchor instrument for NPOs. This may work. However, given the critical nature of this instrument to the proposal, has there been any formal robust demand assessment? If not, can this really be key to this proposal?

   Our informal conversations in the past a few days with large social impact donors/impact investors lead us to believe that it would be worth-while only with new tax incentives but then those tax-incentives can be given to NPOs anyway instead of using them to promote

SSE. SSE hadsto add value by way of liquidity, depth, efficiency, reducing friction, etc and not mainly by way of tax-breaks, which should be provided to all, else SSE will end up creating an undesirable class-system among NPOs, which to labour the point, are not in the business of making money like FPEs are.

Recommendation: *Research the demand for this and other instruments mentioned in the Report with top 25-50 largest philanthropic donors and NPO donees.*

Section D: The 100 crore fund

10. **Should the Rs100 cr fund envisaged here be divided specifically for direct cost support in the NPOs, to avoid being disbursed mostly to eco-system intermediaries, who would be at the upper end of salary scale within the social sector, and therefore would end up consuming most of this fund and that too mostly supporting FPEs?**

    The Rs100 crore fund mentioned in the paper will definitely assist a lot, but once again, unless it demarcates funding for *NPO investees* and makes it practical for them to use it, there is a high probability that it will be used up mainly by FPE investees and intermediaries, who do and will have more expensive professionals within them and with hired intermediaries.

    Recommendation: *This fund should be clearly demarcated for uses especially in direct cost increase within NPOs to use SSE. It can also pay for an independent "Admissions Panel" as mentioned above.*

Section E: SSE

11. **Is there a view on typical expected cost of transaction and therefore minimum deal-size?**

    The eco-system needed for transactions is not cheap and can be a deal-breaker many a times. The intermediary professionals will probably be some of the highest paid executives in the sector. Without this context, it's difficult to evaluate the proposal and its opportunities.

    This will also raise the question whether these transactions will be viable without eco-system players (IRs, social auditors, MF asset managers, etc) created by socially minded individuals/organisations. They should want to avoid mission-drift, and therefore take some ownership of the impact-promise and not take a transactional approach. All this while charging lower than market costs, or subsidised for say at least 3-5 years post-SSE launch.

    Recommendation*: Suggest please add an annexure with these expected cost ranges and deal-sizes for investor and investee participants to better understand the cost-benefit of this proposal.*

12. **Does the eco-system come before or after the launch of SSE and of what nature?**

    One of the key reasons for failure of SSE-equivalent in the UK is seen to be the lack of eco-system *before* the exchange was formed. This is indeed a debatable point and we do understand that it's a 'chicken and egg' question. Many in the NPO sector believe that they already have a fairly good supportive ecosystem and what they need is to strengthen these already existing players, with say the above Rs100 crore fund, rather than make their improvement contingent upon creating an SSE. The Report needs to cover this alternative, with its risks and mitigant actions.

Recommendation: *Create an inventory of current eco-system players, identified the FPEs/NGOs in them, who would prefer funding only to strengthen them irrespective of SSE or are at least in-principle supportive of SSE and will undertake the required activity when SSE is launched with a few anchor clients. There can also be one or two case-studies here to showcase the possibility and challenges. We recommend that these are done now to plan better and for early success of the SSE.*

13. **What are the impact-measurements of SSE, to be reported at least annually, like its social-sector investees?**

SSE itself should operate as an FPE/NGO with clear social impact goals and staff that lives the social impact values. The measures chosen are important for not only reporting progress, but measuring social impact of the factors assumed to be the drivers/reasons for launching SSE.

Recommendation: *SSE to recommend a set of short term and intermediate social impact measures in line with its recommendations to investees. Eg of output metrices below given that outcome will be difficult to begin with (or indeed even in 2-3 years):*

- funds raised for FPEs, NPOs, etc (more and better than before SSE)
- evidence of increase in philanthropy in India as a result of SSE
- NPO sector sees SSE and its progress positively for itself
- improvement in the ecosystem
- typical exchange success metrics
- Negative externalities (not usual in the sector but may be SSE can lead this)
- recruitment of senior and junior credible staff from social sector
-etc

Section F: Process of Approval before the launch of SSE

14. **Is this document the final proposal, which once approved, will be used to launch SSE? Will there be a second document for discussion before SSE is agreed by all stakeholders?**

In my belief and having discussed with a few large Indian NPOs, this document is an excellent "first stage" (a phrase, rightly used by one of the speakers in the VC, for current stage of process) document, with many good proposals and pre-conditions that first need to be approved/declined/amended before one can take a view on the attractiveness of the resulting net proposal. It will be implementable only after those proposals eg. tax, SEBI process, etc are detailed and approved.

Recommendation: *SSE launched after much better clarity on its final rules and framework, which should be circulated again in public domain for feedback with clearly shown changes from this proposal.*

15. **Therefore, are the conditions precedent for approval of this proposal clearly listed and will be met *before* the SSE is launched?**

The document has a number of proposals and its attraction, and indeed chances of success, change if they are not achieved eg:

a) Final status of tax-incentive proposals' approval and no negative impact of those on the proposal as confirmed by the WG and SEBI.
b) Approval of Rs100 crore fund, with final conditions that are practical, as confirmed by WG and SEBI.
c) Research findings as above supporting the case
d) WG including equal NPO sector participation
e) etc

16. What are the next steps, defined to ensure that the risks pointed out by the NPO/FPE community are mitigated/addressed before it is launched?

These, we suggest, should be clearly enumerated eg:

a) Review of this proposal based on feedback received and changes circulated for feedback.
b) Conditions Precedent in the above proposal to be met.
c) Launch, etc.

We would be delighted to discuss any of the above further should those be not clear and look forward to a constructive engagement.

Wishing you all success in launching a highly ethical and socially impactful SSE.

Yours Sincerely

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