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THE DAWN OF SOCIAL STOCK EXCHANGES IN INDIA: BRIDGING THE GAP FOR IMPACT INVESTING

18 August 2022

Introduction:

The Securities Exchange and Board of India (SEBI) in order to realise the Hon'ble Finance Minister's goal of [inclusive growth and financial inclusion in her budget speech of 2019, by harnessing the powers of the capital market](#), has recently introduced a regulatory framework to allow social enterprises (SE) to raise funds through the securities market. SEBI has accordingly amended the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 (SEBI ICDR Regulations), SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (SEBI LODR Regulations) and SEBI (Alternative Investment Funds) Regulations, 2012 (collectively Amendments) to introduce a regulatory framework to set up a social stock exchange (SSE) and to enable fund raising by SEs.

Analysis:

The SEBI ICDR Regulations have defined a 'social enterprise' in broad terms, thereby permitting both not for profit organisations (NPO) and for-profit social enterprises (FPE) to register and raise funds on SSEs, subject to satisfying certain exhaustive qualifying criteria, which includes establishing primacy of social intent.

The amendments to the SEBI ICDR Regulations prescribe certain eligibility conditions for an entity to be categorized as an SE. In order to establish the primacy of social intent, SEBI has recognized a list of activities (Eligible Activities) in which NPOs and FPEs can engage. The activities of SE should be targeted towards underserved, less privileged population segment or regions recording lower performance in the development priorities of central or state government (Target Segments). SEs are also required to show that: (a) at least 67% of their customer base in the preceding three years belong to the Target Segments; or (b) either 67% of their revenue or 67% of their expenditure in the preceding three years has been derived from or incurred on the Eligible Activities.

The main concerns arising from the prescribed eligibility criteria is two-fold:

(i) Neither the amendments to the SEBI ICDR Regulations nor the amendments to the SEBI LODR Regulations clarify whether the 67% criteria is a one-time eligibility requirement or a continuing obligation / requirement. The onus on SEs changes substantially, if the criteria is of continuing nature. While social auditors are required to be appointed by SEs for the purpose of impact assessment and ensuring that

contributions are utilized for the stated objectives, the amendments to the SEBI ICDR Regulations and SEBI LODR Regulations are silent on the aspect of auditors verifying the 67% compliance. Without clarity on whether the 67% contribution is continuous or not, social auditors would not be in a position to carry out effective impact assessment; interestingly the rationale for '67%' is unknown and there is no such benchmark derived out of experience or a study.

(ii) SEs are required to target 'underserved' or 'less privileged social segments' or 'regions recording lower performance in the development priorities of central and state governments'. However, the details of the specified target segments find no mention either in the amendments to the SEBI ICDR Regulations or information available in the public domain. The open-ended understanding of target sections leads to increased uncertainty for SEs desiring to take benefit of the regulation.

Zero coupon zero principal instruments (ZCZP Instruments) is a new instrument specifically designed for SEs. ZCZP Instruments are unique in terms of raising capital, as they do not require the issuer to pay the principal or interest to the investor. However, ZCZP Instruments are permitted to be issued only by NPOs and FPEs are excluded from taking benefit of this instrument.

It is likely that FPEs could also benefit from ZCZP Instruments, if they are permitted to issue them, as they are useful for fund raising and could make use of the platform. Strangely, investors in ZCZP Instruments are not given any voting rights. It will be healthy and would act as a balancing effect, if ZCZP Instruments are permitted voting rights to the extent the use of proceeds is concerned.

Currently, the extant regulations permit only technological companies and those engaged in the use of intensive information technology, data analytics, bio-technology or nano-technology to provide products or services, to issue shares which have superior voting rights (SR Equity Shares). It will not be out of place to suggest that impact investors in instruments of SEs, will expect their invested fund to be utilized for the stated social objectives under the Eligible Activities. Hence, one could consider permitting impact investors to be issued with SR Equity Shares.

FPEs run a risk of mission drift, as there is a common pool of profit-oriented and social-impact driven stakeholders. Where impact investors are issued ZCZP Instruments for the purpose of raising funds, backing such instruments with superior voting rights similar to SR Equity Shares ensures accountability and counters the risk of mis-utilization of funds. It is suggested that an exception be created for FPEs, to enable such entities to issue superior voting rights to impact investors.

Other jurisdictions:

The hybrid structure of the social stock exchange terrain in India is in its nascent stages. One can draw inspiration from jurisdictions where similar social exchanges are operational.

With respect to the eligibility criteria, Canada's Social Venture Connexion (SVX) which was launched in September 2013, gives the companies the freedom to decide the entry level, amount to be raised and the investment terms. While the freedom is offered to companies, SVX approves only issuers (social venture, impact investing funds and non-profits) satisfying the B Corporation Standard. The B Corporation Standards are stringent and robust standards prescribing social, environmental and governance practices for businesses. Further, for profit entities in Canada are required to get Global Impact Rating System (GIIRS) rating for the purpose of listing eligibility, thereby heavily relying upon standards set by a third party.

In case of London Social Stock Exchange, the exchange provides the companies to register themselves on the platform. This, in essence, means that the platform would

serve as a 'directory' holding elaborate information that can tie in investors and investees. This option, under the Amendments, has been made available to the NPOs but should be extended to FPEs as well.

Singapore's Impact Investment Exchange (IIX) offers unique platforms like Impact Accelerator and Impact Partners. The Impact Accelerator provides seed stage SEs with mentorship and access to capital through a structured and customized process. Impact Partners on the other hand, connects accredited impact investors with selected growth stage SEs, who are seeking to raise capital.

Mauritius' social stock exchange (IX) and IIX, in addition to the usual listing disclosure and eligibility requirements, also require issuers to demonstrate positive social and / or environmental impact. Potential issuers under IX and IIX include social enterprises, social investment fund, microfinance institutions, social arms of inclusive businesses and developed finance institutions and are permitted to issue a host of instruments such as equity shares, preference shares, bonds and even units of a fund. One of the most distinguishing features of the IX and IIX from other social exchange platforms, is that each issuer is mandatorily required to appoint an authorised impact representative, to support it through the listing process and ensure compliance with various listing requirements. The aforementioned steps taken by regulators across jurisdictions creates a more inclusive space for impact investing, while simultaneously strengthening the regime through issuer specific customization process.

Conclusion:

The Amendments although are a shot in the arm for the impact investing sector but SEBI will have to fine tune these Amendments so that SEs can reap the maximum benefit from the capital markets. Although the Amendments have been brought in with benevolent intentions, SEBI should re-consider certain provisions to strike a balance between liberalisation and regulatory oversight. If implemented in the right way, this platform could provide a much needed impetus to the [SEs which are starved of funds](#).

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