

Meeting the challenges of the evolving economic, legal and regulatory environments for impact investing

With 2 million enterprises, the Social Economy represents 10% of all European enterprises and 6% of employment in Europe. This growing sector is, in large part, composed of small and medium sized enterprises (“SMEs”), which rely on commercial activities. (Indeed, even if many enterprises, whose main objective is not to generate profit for their shareholders but to have a positive social impact, are at least partly financed by public subsidies, the sustainable development of the sector requires that they are backed up by commercial activities and private investments (including those made by socially oriented investment funds).)

Many social economy enterprises are characterised by the fact that their main objective is not to generate profit for their shareholders, but to have a positive social impact; however, they must be at least partly financed by public subsidies. The sustainable development of this sector requires that they be backed up by commercial activities and private investments, including those made by socially oriented investment funds.

Besides, in the current context of budgetary restraints, the emergence of new societal needs that are not - or are poorly - met (because the services required are too expensive, or the target audience is not sufficiently creditworthy, or because the government does not have the means or flexibility to organise them), increases the role of the economic actors who aim to support these needs, and calls for the development of private initiatives.

In that context, Europe wishes to encourage the social entrepreneurship sector and to give private actors the means to prosper. In October 2011, the European Commission released a communication entitled “Social Business Initiative – Creating a favourable climate for social enterprises, key stakeholders in the social economy and innovation”.¹ As part of this initiative, the European authorities tabled a proposal for a regulation laying down the foundations for a recognised European brand for social entrepreneurship funds (“EuSEFs”).² This proposal notably aims at creating an adequate cross-border fund-raising system by easing the process of raising capital throughout the European Union and helping investors to identify and compare EuSEFs.

To benefit from the European Social Entrepreneurship Fund or “EuSEF” designation and from the EU passport attached thereto, eligible managers will have to comply with a series of requirements set forth by the regulation. These relate in particular to the portfolio composition, eligible investment instruments and techniques, target investors, as well as to the organisation, transparency and conduct of the EuSEF.

As far as the portfolio composition is concerned, the draft regulation reserves the EU passport for EuSEFs investing essentially in undertakings complying with criteria set forth in the regulation (referred to by the draft regulation as “**qualifying portfolio undertakings**”).

In the spirit of the European Commission Social Business Initiative, Luxembourg is currently working on a new status of social purpose commercial company, not dedicated to the enrichment of its members.

The major challenges of the new status (currently referred to as the social impact company) are (i) to allow a better integration of the



social economy in our market economy, (ii) to recognise the specifics of a business model pursuing a societal impact objective and (iii) to improve access to financing for enterprises with such a business model.

This new status should make up for the current lack of a legal status that could meet the specific needs of enterprises operating in the general interest - as is widely understood - but being active in the commercial economic sector.

Rather than creating an autonomous status based on the associative model, Luxembourg would provide for the possibility to adapt existing forms of commercial companies (which in many respects are not adapted to the general interest objective and to the associative spirit characterising social enterprises) to the specific needs of economic actors pursuing a general interest, rather than the maximisation of their profits. Luxembourg does not therefore intend to create a new form of company (or association) but to allow traditional commercial companies to include different commitments guaranteeing the primacy of general interest over profit in their usual status.

The aim of this new project is to create an innovative instrument gathering different categories of financing for an enterprise pursuing mainly a general interest objective, namely gathering in one single structure (i) investors seeking social impact only, (ii) investors seeking both social impact and a financial return, as well as (iii) public or purely philanthropic funds promoting a social impact. Despite appearances, all investors in these structures would have an alignment of interests since the remuneration of investors seeking profits would in any case be subordinated to the prior realisation of the general interest objectives set out in the constitutional documents of the company.

For the sake of consistency, it is intended to harmonise the definition of this new status with the characteristics of the qualifying portfolio undertakings within the meaning of the EuSEF regulation.

An optimal conjunction of the EuSEF regulation and of the new social impact company instrument would certainly allow Luxembourg to take comfort in its positioning as a major centre for the impact investing sector.

The enactment of the law relating to the new social impact company, together with the EuSEF regulation, would no doubt enable Luxembourg to make the most of the opportunities offered by the EuSEF regulation. In order to maintain its position in the forefront of innovation in the financial sector at large and in the impact financing sector in particular, Luxembourg should therefore strive to be ready to adopt this new status by July 2013, the contemplated date for the entry into force of the EuSEF regulation.

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¹ COM (2011) 682final, 25.10.2011

² Proposal for a regulation on the European Parliament and of the Council on European Social Entrepreneurship Funds, COM (2011) 862; see also PreLex monitoring of decision-making process between institutions: http://ec.europa.eu/prelex/detail_dossier_real.cfm?CL=en&DosId=201179