INVESTING *FOR* IMPACT

POLICY BRIEF

Social Proofing, Impact Measurement and InvestEU

The InvestEU regulation proposal specifies that financing and investment operations above a certain size shall be screened in three areas: environmental, climate and social impact. This means that large investments will have to prove that they are not harmful for people and the planet, and to show whether they have a positive societal impact if they want to receive support through the InvestEU programme. But how will the European Commission check this? Social impact is not easily defined and measured, since its interpretation can differ across contexts, and mean different things to different people. Investors *for* impact know well how hard it is to measure and manage impact, given their extensive experience in providing high-risk patient capital to support the development of innovative solutions to pressing social problems. That's why, through this policy brief, EVPA wants to share the past experiences of investors *for* impact on how to measure and manage impact, hoping to give insights and guidance that can help the process of setting up a social proofing system.

THE MULTIANNUAL FINANCIAL FRAMEWORK AND INVESTEU

As part of the next EU budget (2021-2027), the InvestEU Programme will continue the work started with the Juncker Plan, directing additional funds towards reaching EU policy goals such as competitiveness of the Union, sustainability of the Union's economy and its growth, and social resilience and inclusiveness[1]. Overall, the draft regulation establishing the InvestEU Programme[2] addresses the environmental, climate and social impact generated by, and having effect on, the investment projects. The assessment of whether (or not) an investment meets the social sustainability criteria is referred to as "social sustainability proofing."

InvestEU is one of the funds of the Multiannual Financial Framework (MFF) 2021-2027 , the next EU long-term budget that will target a budget of roughly €1.3 trillion across a broad range of different policy priorities. Bringing under one roof a range of EU financial instruments that are currently available, the InvestEU Fund will target investments in four different policy windows: (i) **Sustainable Infrastructure**, (ii) **Research, Innovation and Digitisation**, (iii) **Small and Medium Businesses**, and (iv) **Social Investments and Skills**. The last one is of most importance for the Venture Philanthropy and Impact Investment ecosystem, financing projects in skills and education, social housing, schools, social innovation, healthcare, microfinance, social enterprises, and integration of vulnerable people, etc.

Overall, the proposed budget for the InvestEU Fund is €38 billion provided through an EU guarantee, which, by implementing de-risking and risk-sharing instruments, is expected to unlock €650 billion of private investments. More specifically for the Social Investment and Skills window, the EU guarantee is proposed to amount up to €4 billion, thereby mobilising €50 billion of external investments. The mechanism of the InvestEU guarantee is visualised in **Figure 1**.

The partial agreement on the InvestEU Programme was reached in April 2019. Given that the regulation adoption is foreseen between November and December 2019, the budget allocation of the Programme is not yet set in stone, although the text is as good as fixed. On January 1st 2021, InvestEU will enter into force and it will be active until the end of 2027.

1 For more information on the InvestEU Programme: European Commission, 'The InvestEU Programme, Questions and Answers', April 2019.

2 European Commission, 'Proposal for a Regulation of the European Parliament and of the Council Establishing the InvestEU Programme', June 2018.

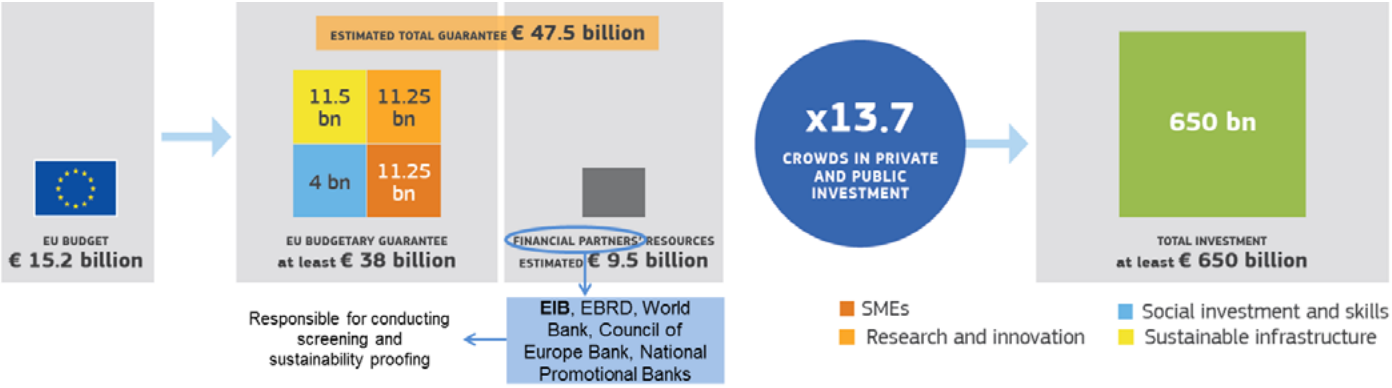

Figure 1 - Mechanism of the InvestEU Fund

SOCIAL SUSTAINABILITY PROOFING WITHIN INVESTEU

Within the MFF 2021-2027, the European Commission proposes that all major EU spending programmes include sustainability or climate proofing provisions. In the case of InvestEU, the programme should contribute to building a sustainable finance ecosystem in the Union, supporting the re-orientation of private capital towards sustainable investments.

Article 7(3) of the InvestEU regulation proposal specifies that financing and investment operations above a certain size shall be screened in order to determine if they have an environmental, climate or social impact, whether that is positive or negative. If the project has an impact on one or more sustainability aspects, it shall be subject to climate, environmental and social sustainability proofing, with the aim of minimising potential detrimental impacts and maximising benefits on the climate, on the environment and on society. The reasonable interpretation of this provision is that InvestEU will consider projects that (i) target a positive financial return for the investor, (ii) are not harmful for people and the planet, and, (iii) preferably have positive social, climate and environmental impacts. Projects under all four windows of InvestEU will be subject to the screening, and the screening responsibility, as well as the burden for conducting the sustainability proofing, lies with the implementing partners, such as the European Investment Bank (EIB) and national promotional banks.

The sustainability proofing is required only at the application stage, and no further reporting on the achievement of the expected impact has to be done once the project has been approved for funding and is ongoing.

The European Commission will provide guidance on how to proceed with the sustainability proofing. The Commission's guidance will follow the three dimensions: **climate**, environment and social. First, through a climate vulnerability and risk assessment, the Commission will ensure that the projects are resilient to the potential adverse impacts of climate change. Second, the guidance will allow to account for significant impacts on the **environment**, including impacts on air, water, land, nature, biodiversity and the effects on human health. Third, the guidance will allow to estimate the **social** impact that projects have in terms of, among others, gender equality, the social inclusion of certain areas or populations and the economic development of areas and sectors affected by structural challenges such as de-carbonisation. Moving along the three dimensions, from climate to environmental and social, the sustainability proofing becomes increasingly subject to conceptual challenges. Whereas climate impact can be measured by straightforward metrics, such as the amount of greenhouse gases in the atmosphere, **social impact is not that easily defined and measured, since its interpretation can differ across contexts**, and can mean different things to different people.

Investors have the power to influence decisions of corporations and other economic players by directing their investments towards activities that have a positive impact on climate, the environment and social areas. For this reason, it is crucial to **develop a system of social sustainability proofing that avoids investments to derail into social impact washing.**

To advance in the right direction with the social sustainability proofing, we believe that it is useful to learn from the experience on impact measurement and management developed by social impact investors, as a first step to better address the social issues into the InvestEU framework.

PAST EXPERIENCE FOR FUTURE IMPLEMENTATION

The European Investment Fund (EIF) is already applying an impact measurement methodology as part of the Social Impact Accelerator (SIA)[3]. SIA is a €243 million pan-European public-private partnership that provides equity finance to social enterprises. Operating as a fund-of-funds, SIA invests in social impact funds across Europe. In order to measure the impact of the supported projects, the EIF applies a framework for quantifying and reporting on social impact metrics. The EIF uses a pragmatic definition of what "impact" is, specifying that it is about (i) intentionality of achieving positive social impact, (ii) scalability of the social innovation, and (iii) a positive correlation between impact and financial performance.

Each fund that is invested in by SIA is subject to social impact measurement using the SIA framework. As part of this framework, each fund is required to define one to five impact indicators per portfolio company. For each indicator, the fund needs to develop a specific target which is validated ex-post by the EIF's investment committee. The system used to measure and manage impact by the EIF generated a number of learnings and can contribute to the Commission's guidance on sustainability proofing.

LESSONS LEARNED FROM THE EIF'S IMPACT MEASUREMENT AND MANAGEMENT SYSTEM

(1) It is important to take on a **bottom-up approach** when defining impact indicators. Under SIA, each fund has to specify one to five indicators per portfolio company, making sure that the indicators are closely linked to the company's business model. Doing so, the indicators are meaningful and the objectives are easy to track. Therefore, there is no predefined list of impact indicators to choose from and the indicators can differ greatly depending on the social enterprises.

(2) The EIF encourages the fund managers to define **not only quantitative, but also qualitative indicators** in order to better grasp the social impact generated by the investments. For example, a volume indicator, such as the number of jobs generated by a specific social enterprise, could be accompanied by a qualitative indicator, such as the type of job contracts or the satisfaction of those newly-employed, which can be measured through a satisfaction survey.

(3) It is **hard** for the funds that invest in early-stage social enterprises to **define outcome indicators**. The difficulty stems from the fact that social enterprises with an innovative business model in the early stage of their development fail to create a full Theory of Change and to clearly identify the causal links that connect certain outputs with the relative outcomes. Thus, for these social enterprises it is easier to identify outputs, and to connect them to outcomes at a later stage. **Capacity building and non-financial support** provided by the investor can help the social enterprises in defining the concepts of outputs, outcomes, impacts and the resulting Theory of Change.

(4) When it comes to the reporting on the different indicators, the funds under SIA can do this freely without any control mechanism, since there are **few social auditors** in the market. The lack of a feedback loop from auditors implies that funds are not given advice on how to improve their measurement and management systems.

(5) In an ever-changing world, defining the targets for the different indicators up front for years to come is a delicate challenge. Therefore, the EIF has adapted its approach by introducing **tuning targets**, meaning that the targets are tuned to the market reality and represent the social enterprise's Theory of Change more accurately.

3 For more information on the Social Impact Accelerator by the EIF: Social Impact Accelerator

EVPA'S REMARKS

At this point in the InvestEU Programme negotiations, a clear understanding of how social proofing will work is needed. Today, the European Union is facing many challenges, many of which are climate- and environment-related. However, when tackling climate change and environmental challenges, the social dimension needs to be at the core of EU policy.

Reaching common social policy goals depends also on the effective use of the financial resources available and on investing them in a way that is closely aligned with long-term goals[4]. The next EU budget offers a great opportunity to put this into action. Indeed, the social compartment of the EU budget can and does provide vital contributions to social assistance and social investment programmes.

Apart from the sustainability proofing under InvestEU, the European Commission, determined to reach a more social Europe, has already expressed its intentions to develop a **Social Taxonomy**. The social taxonomy is a framework that lists economic activities and their contribution to social policy objectives, thereby facilitating the transition to a more social economy. Along the same lines, the European Commission is already working on a classification system at EU level to provide clarity on what is "an environmentally sustainable economic activity", the so-called "sustainability taxonomy ".

Having an EU Social Taxonomy puts clear boundaries on which activities qualify as social, thereby posing a threat to innovation. At this point, we believe it would be more useful to learn from the experience of investors *for* impact, before diving into the development of a full social taxonomy.

MORE INFORMATION

In June 2019, EVPA organised a **webinar** titled "Social Proofing, Impact measurement and InvestEU". The webinar started with an introduction of InvestEU and the need for impact measurement and social sustainability proofing within that programme by EVPA's Policy Manager, Bianca Polidoro. Afterwards, Nicholas Costello, deputy head of unit of DG Employment, Social Affairs and Inclusion, went into detail about the regulation of InvestEU, thereby focusing on the sustainability proofing. Cyril Gouiffès followed with a practical view on impact measurement by the European Investment Fund (EIF). The session ended with many questions asked and a fruitful discussion by the speakers.

A recording of the webinar is available on EVPA's website here.

Moreover, EVPA organised a webinar on "InvestEU – what's in it for Venture Philanthropists and Social Investors" and published a policy brief on the next EU Multiannual Financial Framework for 2021-2027. Both can be found here.

EVPA's Policy team is also available to provide more information on these or other policy-related topics.

Do not hesitate to contact the EVPA Policy team at policy@evpa.eu.com.

4 Lázló Andor, 'A Timely Call for a Social Union', January 2019, Institut d'Études Européennes.

This document was made possible with the financial support of the European Commission