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Executive Summary

Why are VP and social investment important for banks?

- Social finance is considered the biggest idea to renew the relevance of finance for the 21st century, representing an attempt by banks to reconsider how and why they do business at a very fundamental level
- VP and social investment are powerful new ways for banks to illustrate that they can play a fundamental role in the solution to societies challenges after the moral awakening of the global financial crisis
- Social investment could be an enormous market opportunity and many believe represents the investment philosophy of the future – banks need to understand and gain expertise in this area
- The newer activities of VP and social investment are particularly exciting for banks as they create the possibility:
  - *to integrate a social dimension within core business activities* by creating social impact initiatives which are often revenue-generating and more than CSR but which may not yet meet normal commercial criteria
  - *to harness and channel the talent of banks employees* to create positive social change using their core skills
  - *to re-invigorate and realign philanthropic activities* with a changed environment, where social enterprise is becoming an increasingly important phenomenon and the social sector is moving from subsidy to sustainability

Why are banks important for VP and social investment?

- Banks are an essential pillar of the social finance industry, as shown in the chart below, since they are fundamental actors in the broader financial services industry as well as sizeable philanthropic investors
- Banks have access to vast quantities of capital – financial, human, and social – which can be used to support, develop and grow the sector and, when it is ready, to mainstream it
  - **Financial capital:**
    - Banks' ability to use a mix of capital sources, including philanthropic, balance sheet and client capital makes them a distinctive and very valuable social investor, particularly in early-stage investments when patient capital is required
    - With their extensive client lists, both private and institutional, banks will be a key intermediary which is essential for the market to grow beyond its current scale and limitations
  - **Human capital:** banks have an enormous amount to contribute to the sector by putting their financial knowledge, innovation and structuring skills to work on internal or external social ventures as well as using their insight into investor requirements and financial markets to clarify how to create a more viable social capital marketplace
  - **Social capital:** activity in this sector by banks sends important signals to all intermediaries, managers and owners of capital which will be catalytic for increasing the supply of capital

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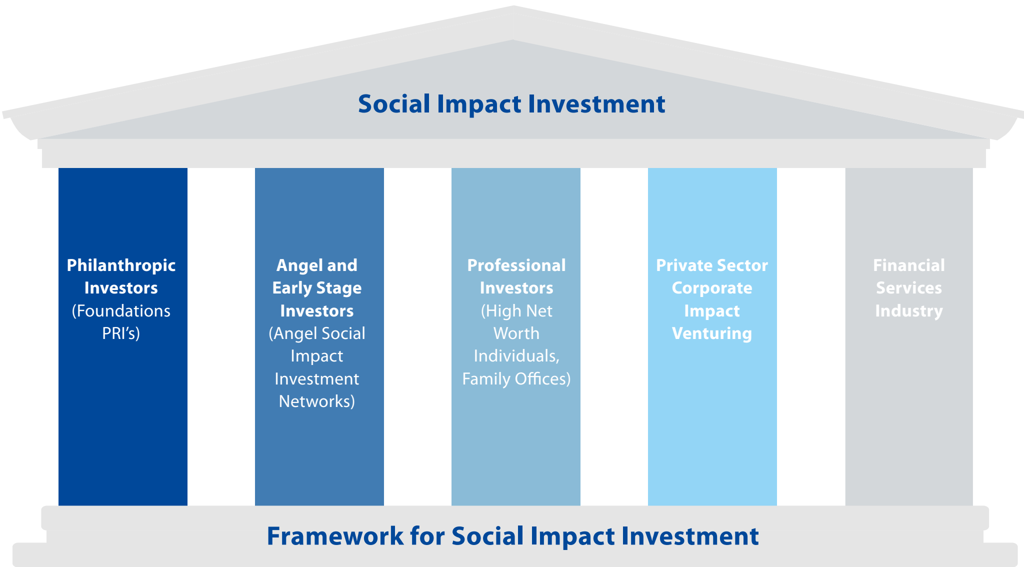

Banks are an essential pillar of the Social Impact Investment industry[3]

In what way can banks engage with VP and social investment?

- The nature of engagement with VP and social investment will depend on the business model of each bank and which type of banking is included – retail, private or investment. There are specific opportunities and areas of focus for each of these different banking types
- In general, as shown in the chart below, banks can engage as leaders/field-builders and/or investors and/or intermediaries:
  - *As leaders/field-builders:* banks can be champions of social enterprise, social and impact investment and can increase the pipeline of investible organisations
  - *As investors*: banks can use their own capital, either from their balance sheets or from their foundations' philanthropic capital to invest in social purpose organisations or to create internal social investment businesses/initiatives. They can do this directly or indirectly, on an individual deal basis or through funds
  - *As intermediaries:* in the history of capital markets, the role of the intermediary has been fundamental. Although there is a strong demand from social ventures for long-term capital to fund the growth of their organizations and demand from investors for a range of instruments blending financial and social returns, there is a market gap for intermediaries raising and deploying capital

3. Adapted from: Martin, M. (2013), 'Making Impact Investible', Impact Economy Working Papers.

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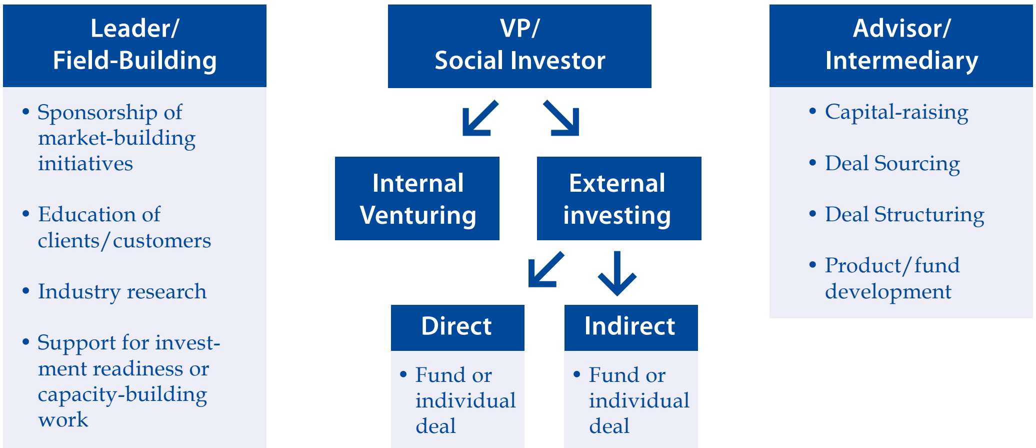

Role of banks in VP/Social Investment

What are the major drivers, challenges and benefits for banks to engage?

- Banks face significant barriers to engaging with VP and social investment, in particular:
  - the immaturity of the sector
  - cultural and organizational difficulties since implementation requires cross-cutting departmental boundaries, engaging and collaborating with many external players, developing new areas of expertise internally and potentially embracing a new banking paradigm
  - competing calls on their time and resources in difficult operating conditions after the financial crisis from initiatives which are either more urgent or which offer short-term upside
- However, there are strong drivers which are compelling banks to get more involved, for example:
  - increasing pressure from external stakeholders and civil society for banks to change and become more socially-oriented, leading to CSR interest in these newer, more innovative ways to create social impact
  - more bank staff becoming aware and involved in VP and/or social investment and acting as intrapreneurial champions to push initiatives forward despite resistance
  - market forces in the form of increasing client demand and possibility for competitor advantage to be gained by seizing some early ground in this nascent sector
- Retail, private and investment banks face different strengths for each of these major barriers and drivers as outlined in the tables below. Private banks have the strongest market drivers to engage

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	Client demand	Competitor Advantage	Personal belief	Bank Ethic	CSR interest
Private Bank					
Investment Bank					
Retail Bank					

Table 1: Drivers for Banks' Involvement in VP/SI and Impact Investment

Please note that for the tables 1-3, darker shaded boxes indicate a stronger relationship.

	Market Immaturity	Culture /organisational	Profit and priorities
Private Bank			
Investment Bank			
Retail Bank			

Table 2: Challenges for Banks' Involvement in VP/SI and Impact Investment

	Internal rewards: staff satisfaction, cross-departmental working	Improved product offering for clients	Enhanced position to exploit long-term business opportunity
Private Bank			
Investment Bank			
Retail Bank			

Table 3: Benefits of Banks' Involvement in VP/SI and Impact Investment

How are European banks currently engaging?

- Whilst there is clear potential and significant incentive for banks to play a major and distinct role in VP and social investment, across the European banking sector initiatives have to date been quite fragmented and relatively small-scale, in terms of both human and financial capital committed
- There is an R and D tone of engagement to these projects with banks exploring and experimenting with the emerging field, before deciding whether and how to participate further and more fully
- Total financial commitments by European banks surveyed in this report for investment in social enterprise/social business (excluding pure microfinance funds) is approximately €261 million[4]
- As illustrated by the time chart below with key initiatives by banks, in the last few years there has been an acceleration of activity. Whilst historic activity was predominantly a broad field-building role of championing social enterprise and social investment, banks have recently moved towards a more explicit and engaged role as venture philanthropists/social investors and/or advisors/intermediaries, bringing these social impact strategies more into their core business areas
- Banks are active from a variety of different starting points, depending on geography and business model as well as the unique circumstances of the initiatives' development. Since there is no roadmap for the creation of such initiatives, nor are there many existing examples to follow, and due to the personal nature of much of the initiative (powered by individuals belief and commitment), these projects are all bespoke and different. They

4. Includes Deutsche Bank UK Impact Investment Fund; J.P. Morgan Social Finance Unit Fund plus Global Health Investment Fund despite them being US/European; BBVA social enterprise financing through Momentum Project 2011 and 2012; BNP Paribas financing for PhiTrust Innovation Funds; ABN Amro Social Impact Fund; UBS Impact Investment Fund, LGT Impact Ventures Fund UK and Erste Bank social enterprise financing.

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range from setting up a social finance business unit within an investment bank, to creating a social bank within a commercial retail bank, to developing a social investment/VP product to sell to philanthropic private clients to setting up an internal social investment fund-of-funds run by the private equity department
- Many banks are still uncomfortable about raising client capital for social and impact investment, since the risk/return spectrum is still undeveloped
- Whilst the sums might be small and the initiatives rather fragmented, there is real cause for optimism in that banks are being very thoughtful about how and when to enter the field, have gained a huge amount of senior and internal support for existing initiatives and have garnered significant perceived benefits by those who have committed
- In addition, banks have shown themselves to be perceptive about the fact that VP and social investment require significant internal cross-departmental and external collaborative dimensions, needing new skills and expertise which they are often sourcing by engaging with external experts in the field
- What is most disappointing is that a more engaged, VP approach to social investment using the broad section of financing tools of grants, loans and equity seems to be less evident

Timeline of key European Bank Social/Impact Investment activities

2007

J.P. Morgan launches Social Finance Unit, with $100m impact investment commitment from balance sheet

2011

Deutsche Bank UK launches £10m Impact Investment Fund

RBS sets up £5m community loan fund for social entrepreneurs

Barclays, HSBC, Lloyds and RBS make £50m equity investment into UK's Big Society Capital

BBVA launches Momentum social investment project, investing in 2011 €2.5m in Spanish social enterprises

2012

BNP Paribas Wealth Management launches social investment fund product – PhiTrust Innovation 1

2013

ABN Amro launches €10m Social Impact Fund

Berenberg Bank co-founds with LGT Venture Philanthropy UK £30m fund

UBS launches $50m own-branded impact investment fund

EIF launches Social Impact Accelerator €60m fund

J.P. Morgan and the Gates Foundation announce $100m Global Health Investment Fund

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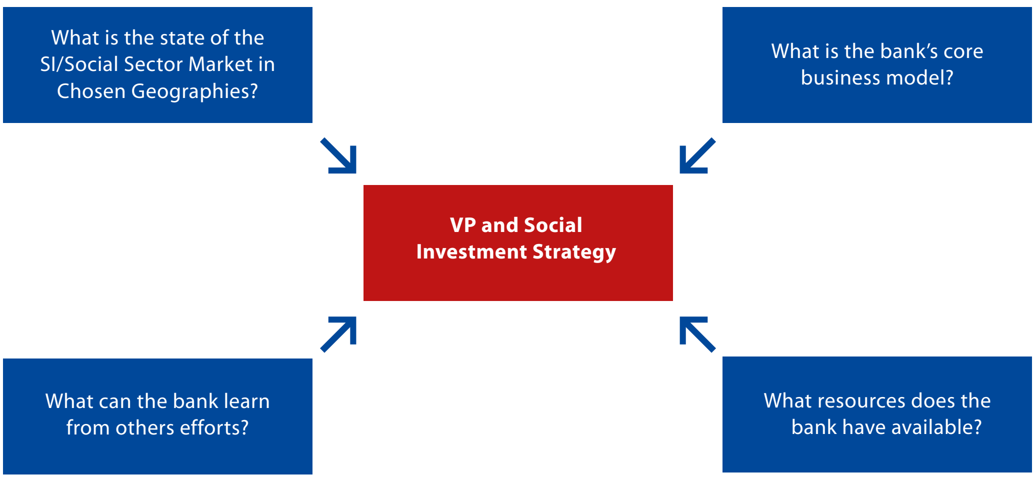
What more can European banks do?

- There is no one or right way for banks to engage in this field, and the multiplicity of existing activities and approaches by banks is a reflection of both market immaturity as well as banks different business models, capabilities and strategies. Banks should draw inspiration and ideas from the examples of banks in the role of leaders/field-builders; investors and advisors/intermediaries
- Many more banks can and should do something in this field – the size and scale of the initiative is less important than might be expected due to the immature state of the market and the reality that it is through small-scale initiatives and endeavours that new markets are built
- The key for banks is to build precedent, momentum and confidence and to feel that they are in the position to play the important role that they will increasingly be needed for as the VP and social investment markets grow
- Developing or renewing a strategy for involvement in VP and social investment will require considerable thought and attention to four factors as shown in the chart below: 1) the state of the social investment and social sector market in chosen geographies; 2) the bank's core business model; 3) learnings from existing initiatives/players; and 4) resources available for the bank



Factors for banks to consider when developing a VP and Social Investment Strategy

Conclusions and Recommendations

- As the market evolves and settles and the required infrastructure is generated, banks will increasingly enter the field in order to capture potential value. Yet their involvement is likely to lag the general market evolution, due to issues of risk and complexity of organisational structures
- There is much that banks can do to both shape and contribute to this hugely exciting new sector, but care needs to be taken that as banks do bring in more capital and help to mainstream VP and social investment, the social mission and conscience of the movements are not lost in the rush for financial returns. There is a risk that banks will just increase the supply of capital without contributing to the major issues on the demand side, in particular the lack of investible propositions and the need for engaged philanthropy to build the pipeline

Recommendations – Banks in General

- Each bank should develop a VP and social investment strategy that fits their needs and environment. No matter how small the initiative or involvement, do something
- A bank's charitable foundation is an important and relatively easy place to start with experimenting with these strategies. All banks' foundations should be exploring how they can use VP and social investment strategies to make maximum use of their income and asset base
- At some point, involve where possible core business units, since social investment strategies will achieve maximum impact if they become integrated into the bank itself
- Balance investment and/or advisory and intermediary activities with important leadership and field-building activities. Banks need to play their part in helping to create appropriate market infrastructure
- Ensure a social return focus, where efforts and capital invested produce positive social change. Beware of only cherry-picking financially attractive social investment deals. All market participants need to co-operate and find ways to help to build the pipeline of socially investible organizations
- Be open to collaboration and knowledge-sharing, even within the competitive banking industry
- Use the human capital resident within the bank to maximum use – social investment activities provide excellent staff volunteering opportunities

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Recommendations – Retail Banks	Recommendations – Private Banks	Recommendations – Investment Banks
• Consider whether more could be done to lend to social enterprises, social business and other SPOs, what the barriers to doing so are and what the bank needs to do to make more lending happen • Voluntarily track and monitor lending to social purpose organizations • Consider whether a retail ethical product is possible	• Attempt to bridge the existing internal and human capital divide between philanthropy and investment, ensuring that there are staff with expertise in VP and social investment • Educate clients, as appropriate, about VP and social investment • Educate client relationship managers, as appropriate, about VP and social investment • Consider whether individual or fund VP and/or social investment product offerings are possible, considering client appetite • Where client demand exists, create appropriate VP and/or social investment product offerings • Use clients human capital – VP and social investment activities provide excellent mentoring opportunities for clients	• Build knowledge and expertise in social investment, applying skills of financial innovation and structuring where possible • Where possible, help to create more track record around social investment funds and products by investing own capital and internally managing funds/products or appointing external managers to do so • Consider what would be required for increased institutional client demand and help the market to develop such products

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