

Dear Francis (cc: Sir Ronald and Nick)

We would like to thank you for your engagement over the last few months, with both the Government and the social investment sector, as you have worked to develop a proposal for the establishment of a 'Big Society Bank' as an independent private sector organisation.

As you may know, we attach the greatest importance to this work, which represents a decisive opportunity to accelerate the growth of the social investment market. We are also happy to wait for the Bank to be developed but we are getting a bit bored of the endless announcements, launches and unrealistic promises. A thriving market in social investment will enable charities and social organisations of every kind to access new capital to help them to increase their impact, doing much to build a bigger, stronger society.

We are pleased to be able to say that the proposal which you, Sir Ronald and Nick have developed and presented appears to make progress towards meeting our requirements for a 'Big Society Bank'. We do have some concerns and suggestions which we have outlined below. Under the terms of the Dormant Bank and Building Society Accounts Act 2008, in due course the Big Lottery Fund, directed by Government, would expect to capitalise an organisation with money from dormant accounts. We suggest this should be subject to the following conditions:

1. Further development work on organisational design. This will include ensuring that the arrangements you propose will appropriately safeguard unclaimed assets and fit with the principles at the heart of the Big Society idea - transparency, localism, independence and putting power in people's hands. We attach our recommendations for the design of the Bank below.
2. Satisfactory conclusion of discussions with the 'Merlin' banks (Barclays, HSBC, Lloyds and RBS) about the terms on which they will invest £200m. We suggest that should you be unable to negotiate terms which uphold the principles and purpose of the Bank, then you should walk away.
3. Approval from the CIC regulator in the instance that one of the BSB companies is to be a Community Interest Company limited by shares. If the BSB group includes other company structures their governing instruments should be subject to broader consultation and approval.
4. State aid approval from the European Commission. You are currently working to secure the state aid approvals that would be needed in order to capitalise an independent organisation with money from dormant accounts and to provide it with the flexibility it needs to grow the market. We wish you the very best of luck.
5. A fair and open process to select which organisation(s) to capitalise.

Separately, we are curious about how the Big Lottery Fund will take forward interim arrangements that will enable investments to be made as soon as dormant accounts money becomes available in the summer, using existing state aid exemptions, and how this fits with the role foreseen for the Big Lottery Fund in the enabling legislation. More widely, it would be helpful for the Government to explain the next steps in the process so others can engage constructively in the Bank's development.

We would like to thank you again for working with the Government and the social sector to take forward this important project.

Yours sincerely,

POPse!

The logo for 'popse!' is written in a bold, lowercase, sans-serif font. The letters are filled with a complex, organic, and somewhat abstract pattern that resembles a microscopic view of cells or a dense forest canopy. To the right of the text, there are several small, circular icons, each containing a different version of the same organic pattern.

RECOMMENDATIONS

1. The Office for Civil Society should publish a realistic route map for the creation of the Big Society Bank helping stakeholders to understand the timelines better and routes for engagement. Lack of clarity on 'if' and 'when' has undermined confidence and commitment.
2. The development of the BSB should include possibilities for social enterprises, intermediaries and citizens to co-design and co-deliver the BSB in line with the Big Society principles of transparency, localism, independence and putting power in people's hands.
3. If the Government cannot negotiate terms of the Merlin Bank's investment in the BSB which uphold the principles and purpose of the Bank, then they should walk away.
4. The BLF should lead a fair and open process to select which organisation(s)¹ to capitalise.
5. The Big Society Bank should not be called the Big Society Bank. It could be compromised in practice and over the longer term by association with a party political slogan. It should only be called a bank if it is a bank².
6. The mission of the BSB should be clarified as, for example, growth of the sector is no accurate reflection of impact. The objectives should also be clarified in order to, for example, establish how its mandate to improve opportunities for young people is prioritised against other objectives.
7. There has been little focus on environmental impact. The Government should clarify the relationship between the BSB and the Green Investment Bank. There is a risk that investment in community recycling, for example, could fall between the cracks. The BSB should have clear environmental impact policies and investment criteria.
8. An independent body, rather than government, should approve the BSB's investment guidelines. The mission and function of the bank should be subject to further independent oversight, beyond any FSA regulation.
9. The Bank should lead in terms of transparency for both financial and social sectors. For example, publishing terms and conditions of its investments, analysis of its portfolio,

¹ "Such a service does not necessarily need to be performed by any one institution" in *Social Investment Wholesale Banking*, Venturesome, September 2009.

² In any case, the Financial Services Authority regulate the use of the term 'bank' which is restricted to certain organisations carrying out defined functions.

summary minutes of investment committee meetings, breakdown of investments, remuneration policy and social impact.

10. There should be a clearer understanding of what is meant by “social investment infrastructure”, other than the Social Stock Exchange idea.
11. Greater consideration should be given to whether the BSB could be a leveraged institution, attracting further capital and opening up the possibility for pension funds, local authorities and citizens to invest for a primarily social purpose.
12. The BSB should probably not cover its operating costs from the return on its investments. Self-sufficiency should not be an operating principle of the BSB as this could compromise its social mission. This principle should be subject to review as the market develops.
13. Cabinet Office and other departments, NESTA, the BLF and the BSB should agree a memorandum of understanding to avoid using public or quasi-public funds in a way which undermines each other’s work.
14. There should be further thought given to whether the BSB should be a bank for civil society or a bank for social impact. In other words, which organisations are eligible for investment, and which are not.
15. There should be a further exploration of where money should be invested if sufficient demand is not forthcoming, including consideration of socially and environmentally responsible investments.
16. Social impact should not be forgotten. The BSB should seek to engrain social impact measurement into all financial flows and the BSB represents a significant opportunity to advance the discipline of social impact measurement.
17. A CIC limited by shares should be considered as the primary vehicle for the BSB. If this is not appropriate, we should know why not.
18. The opportunity presented by the BSB should be seized to demonstrate best practice in terms of employee ownership and engagement and responsibly aligning employee incentives over the long-term. The BSB should seek to harness voluntary, in kind and non-paid capacity where appropriate.
19. The BSB should include social and environmental factors when procuring partners to deliver all corporate services, such as IT, telephony, marketing, auditing and other services.
20. The BSB should be located in London’s East End or a regional financial centre, such as Leeds.

POPse! was the world’s first pop-up social enterprise think-tank, launched on 9 May 2011 and disbanded on 13 May. It sought to provide a burst of critical energy and robust analysis of social enterprise policy and practice through the publication of think pieces, pamphlets and other web-based material.

www.popse.org.uk

Annex - The Big Society Bank ("BSB")

Outline Proposal

May 2011

Introduction

The BSB should have a critical role to play in developing and shaping a sustainable market for social investment in the UK, giving social sector organisations access to new sources of finance to help increase their social impact. The BSB should also act as social investment champion with the public, stakeholders and investors.

The latest policy framework for the BSB is set out in HM Government's February 2011 document "Growing the Social Investment Market: A vision and strategy" building on a body of other work undertaken by the previous Government, the Commission on Unclaimed Assets, the Social Investment Taskforce, NESTA, Venturesome, New Philanthropy Capital, the Bank Of England and others. This proposal is presented in accordance with those documents.

We have consulted with leading organisations from a range of sectors and would like to thank all of them.

We recommend that none of the companies in the Group be named anything to do with "The Big Society". Regardless of the merits of "The Big Society", this organisation could be compromised in practice by association with a political slogan. Furthermore, it should only be called a bank if it is a bank.

Section 1 below discusses the proposed Mission, Objectives and Operating Principles of the BSB. Section 2 relates to how it would fulfil its twin objectives of acting as a wholesale investor as well as a driver for development of the sector. Section 3 considers its proposed legal structure, governance, regulatory framework and accounting policies. Section 4 looks at its proposed management team, organisation structure and the policies and procedures it will adopt. Section 5 comments on its assumptions regarding capital structure, commentary on financial outcomes and proposed interim arrangements prior to State Aid clearance from the EU.

Section 1: Mission, Objectives and Operating Principles

The social sector, through its charitable investors and social organisations, already plays a significant role in tackling social issues. Its capacity to achieve maximum social impact is, however, severely constrained by a number of factors although evidence of its inability to access investment capital has been considerably exaggerated³. In any case, these organisations will continue to work to deal with a huge range of important social and environmental issues.

The BSB Mission and Objectives

The BSB's mission proposed by the Government was to "make it easier for social ventures to access the finance and advice they need"⁴. Others have suggested it should be "to boost significantly the ability of the social sector to deal with social issues". These are not the same and this should be resolved. The BSB should support the development of a social investment market which is more effective in attracting and deploying capital to achieve social impact.

The BSB's objectives should be clarified in order to, for example, establish how its mandate to support the development of community-led, social enterprise initiatives to improve opportunities for young people is prioritised against other objectives. Furthermore, there has been little focus on environmental impact and this seems to be a missed opportunity.

Through its capacity to invest debt and equity, to co-invest with other investors and to protect investors against the risk of loss (subject to State Aid rules), the BSB should have the ability to accelerate the establishment of diversified social purpose funds, such as venture funds, property funds, community asset funds, microfinance funds and potentially funds that invest in social impact bonds, although they are only in their early stages and it will also be important to guard against conflicts of interest in this respect. Such funds will provide social and management expertise as well as investment capital to social ventures capable of expanding to deliver significant social impact as well as a financial return.

The BSB should spur development of the market infrastructure necessary to boost social entrepreneurship and investment by supporting the growth of existing and new intermediaries that can:

- Develop robust investment propositions with clearly articulated social and financial risks and returns;
- Provide reliable independent research on social investment opportunities and organisations; and
- Create effective financial markets to trade and issue securities.

An effective market for investment can be crucial for social entrepreneurs whether they seek to scale existing organisations, to create new social ventures or to migrate social activities out of the public sector. Making capital, expertise and management skills available to social entrepreneurs, as they have become available to business entrepreneurs, can be crucial to sustaining a powerful wave of social entrepreneurship.

Operating Principles

³ *Finance for small and medium-sized enterprises: comparisons of social enterprises and mainstream businesses*, University of Warwick Business School for the DTI and Office of the Third Sector, June 2007.

⁴ *Growing the Social Investment Market: A vision and strategy*, Cabinet Office, February 2011

We support the adoption of two and a half of the four operating principles for the BSB set out in HM Government's February 2011 document "Growing the Social Investment Market: A vision and strategy". These are: Independence from government, Acting as a wholesaler, Transparency and Self-sufficiency.

Independence

Others have made significant progress in proposing a legal and governance structure (Section 3). However, we are confused as to how the principle of independence will be reconciled with the condition you have set out that the Government must approve investment guidelines and selection process. We suggest this should be for an independent body to approve.

Transparency

The CLS should be managed according to the principles of corporate governance set out in the Financial Reporting Council Code. The BSB should publish detailed annual accounts including details of the financial and social impact of its investments and would act as a focal point for the sharing of information and expertise across the social investment sector. But this is just a starting point. The Bank should go much further than this. For example, transparency can help ensure the Bank is not unduly distorting the market against the common interest. The Bank should publish details such as terms and conditions of its investments, analysis of its portfolio, summary minutes of investment committee meetings, data on enquiries, applications, breakdown of investments by sector, geographical area, etc. It should also have clear and transparent investment guidelines, objectives and remuneration policy. Social impact should be reported in a transparent way⁵.

⁵ Growing the Social Investment Market: A vision and strategy, Cabinet Office, February 2011

Wholesaler

The proposed investment policy assumes that the CLS would invest across a spectrum of equity, quasi equity and debt in intermediaries. Under the legislation, the Bank cannot invest directly in individual social service providers. The potential for multi-million pound investments beyond the scale of existing intermediaries may arise, so the legislation may require clarification in due course. In its capacity building role, the CLS can invest directly if need be in new social organisations that add to the social investment market's infrastructure, such as impact measurement organisations, securities exchange platforms and investment portals. There should be a clearer understanding of what these might be, other than the Social Stock Exchange idea. We think greater consideration should be given to whether the BSB could be a leveraged institution, a genuine bank and raise funds from a range of sources. If we did not exploit the opportunity presented by the Bank to open up the possibility for pension funds, local authorities and citizens to invest for a primarily social purpose, this would be a missed opportunity.

Self Sufficiency

The BSB probably should not, in time, cover its operating costs from the return on its investments. Any financial modelling in this area is relatively speculative and we should admit that we cannot reliably tell from here how successful risk investments in a new market with no track record could be. There may be some attrition of the BSB's capital and self-sufficiency should not be an operating principle of the BSB as this could compromise its social mission.

Section 2: The BSB as wholesale investor and social investment champion

The BSB should have two key roles, as a wholesale investor and as a social investment champion.

Wholesale investor

The success of the BSB in achieving its mission should be driven largely by the deployment of its investment assets. It should provide long-term capital to support the growth of intermediaries and the infrastructure of an effective social investment market. Much of its investment portfolio will comprise assets whose returns are uncertain and whose liquidity is poor, making it difficult to predict financial viability with any degree of certainty. In many respects, the closest parallel is a venture capital fund. The BSB should need to set an appropriate level of investment risk to achieve its social mission, which should trump the need to make sufficient financial returns to cover its operating costs and investment losses.

Drawing on the experience of the small number of financial intermediaries currently active in the sector and taking into account the investment proposals made to NESTA's Big Society Finance Fund, we believe it is not possible to estimate with any degree of certainty the financial returns of the BSB. The proposals to NESTA demonstrate that most demand in this area is new or unproven and requires soft, equity-like investment. NESTA conclude that "The evidence from the pilot investments suggests that a 'development bank' will find it difficult to meet the needs of the emerging social investment market and deliver rates of return on its capital that might be considered 'market-rate' or commercial"⁶. We should not pretend that the vast majority of these 20 proposals could absorb truly commercial capital. New Philanthropy capital concur "By far the majority of demand for capital is for soft capital"⁷.

Nor should the BSB be a conventional grant-making organisation. Funds deployed should seek a combination of social returns and not preclude financial returns. It is expected, however, that the

⁶ *Twenty catalytic investments to grow the social investment market*, NESTA, April 2011.

⁷ *Understanding the demand for and supply of social finance*, New Philanthropy Capital, April 2011.

BSB will often partner with grant-making institutions such as the Big Lottery Fund (BLF), NESTA and foundations that share the BSB's objectives. This makes it all the more important that Cabinet Office and other departments, NESTA, the BLF and the BSB should agree a memorandum of understanding and division of labour in order to avoid using public or quasi-public funds in a way which undermines each other's work as they each seek to build the social investment market.

In this regard, for example, the Government should clarify:

- whether once the BSB is up and running that it will provide any subsequent additional investment in , for example, CDFIs, credit unions and other government investment funds for social enterprise?
- what consideration it has given to using the outstanding value of existing investment funds and other assets to help capitalise the bank?
- the relationship between the BSB (a.k.a. the Social Investment Bank) and the forthcoming Green Investment Bank, particularly given many social enterprises focus on environmental objectives?

We are mindful of the need for a wide regional spread of investments across the UK and this should be a factor in decision-making. There should be further thought given to whether the BSB should be a bank for civil society or a bank for social impact. Or, in other words, which organisations are eligible for investment. For example, would a mutual building society be eligible? What about Tesco Bank, Baxi Partnership, Serco or the Ecology Building Society?

It would be brave to make confident assumptions about demand and returns. For example, it is too early to conclude that social impact bonds will establish a track record and are likely to enjoy strong growth⁸. They may. They certainly have significant potential. But it is far too early to have that level of confidence in any emerging products. We have split the demand for capital into 3 categories. Investment (through debt, equity, guarantees, underwriting or innovative hybrid / quasi-equity products) into:

1. Funds;
2. Intermediaries; and
3. Infrastructure organisations

1. Funds

The BSB should help fund-raising by acting, where appropriate, as a cornerstone investor in funds. Returns will vary widely.

2. Intermediaries

The BSB should strengthen the balance sheets of intermediaries. Returns will vary widely.

3. Infrastructure organisations

It is critical if the BSB is to achieve its mission that it invests in the infrastructure of the sector. This requires the investment of long term capital. Given the risks and long holding periods associated with such investments, they are likely to be structured as redeemable equity whose returns are dependent on revenues or profits. Returns will vary widely.

⁸ "There is the potential for a number of these early pilots falling flat on their faces", Toby Eccles of Social Finance providing oral evidence to the House of Commons on 8 March 2011.

There should be a further exploration of where money should be invested if sufficient demand is not forthcoming, including consideration of socially and environmentally responsible investments and how these relate to the BSB's primary investment activity.

Social investment champion

The BSB should aim to create a market environment in which mainstream investors can find easy access to social investment vehicles and social organisations can attract capital from varied sources. Achieving these objectives may necessitate accelerated product innovation, process standardisation and a common understanding of best practice.

The Government has suggested that success of the BSB would be judged on "the growth and sustainability of the social investment market and the social impact of the investments the Bank makes"⁹. Others have proposed that the long term success of the BSB should be measured by "the amount of capital it succeeds in attracting to social investment as well as the growth and sustainability of the social investment market". But the social impact should not be forgotten and cannot be measured by the growth of significant intermediaries or growth in the number and scale of social organisations. For example, if a charity finds a way to solve a social problem and then closes, that could represent positive social impact. So growth of the sector is no accurate reflection of impact. The BSB should seek to engrain social impact measurement into every financial flow. Social impact measurement is not straightforward, to say the least, but the BSB represents a significant opportunity to advance this discipline.

The BSB should consider how best it can support information sharing and networking, research, capacity building, promoting best practice and market development.

Section 3: Legal Structure, Governance, Regulation and Accounting

We are not making specific proposals on legal structure partly because we have not had the resources to consult lawyers on the matter. However, we would make the following suggestions, in order to ensure the proposed structure responds best to the legal and governance requirements pertaining to the BSB.

First, a CIC limited by shares should be considered as the primary vehicle for the BSB, instead of a traditional company limited by shares. If this is not appropriate, then an explanation should be provided by those proposing otherwise.

Second, while there is currently no intention to offer shares to the public at large, this should not be precluded in future. The BSB represents an opportunity to demonstrate the way in which financial institution can be democratically owned and participative in terms of its governance. The development of the BSB should include possibilities (as well as consulting on the business plan or directions to the BLF) for social enterprises, intermediaries and citizens to co-design and co-deliver the BSB in line with the Big Society principles of transparency, localism, independence and putting power in people's hands.

The structure of the £200m investment to be made by the Merlin banks (Barclays, HSBC, Lloyds and RBS) remains to be finalised. We commend the principle that the Merlin banks should supply long term permanent capital. We suggest that should the Government only succeed in negotiating terms

⁹ *Growing the Social Investment Market: A vision and strategy, Cabinet Office, February 2011*

which would undermine the principles and purpose of the Bank and the needs of the market, then they should walk away.

It is not clear why the Merlin banks' capital should be senior to the unclaimed assets in the event of liquidation. If this is proposed, then this should be explained.

Company structure

Each company in the Group should give due regard to the balance of Board member expertise in social and financial matters and to the expertise required for a financial institution operating in the sophisticated social sector.

The Investment Committee

This group should comprise executives of the CLS and external members and observers in line with the principle of transparency.

The Remuneration Committee

The Remuneration Committee would be completely transparent. The remuneration policy for all staff would be designed to attract a diverse range of individuals who are highly motivated by the BSB's social mission. The opportunity presented by the BSB should be seized to demonstrate best practice in terms of ratios of highest to lowest paid, paying a living wage to administrative and service staff, the principles of employee ownership and engagement and responsibly aligning incentives over the long-term, with incentives linked to the social, not financial mission of the BSB. Details of remuneration levels paid to all staff over the average national wage should be disclosed in the Annual Report as would any remuneration paid to non-executive directors. Staff should reflect the diversity of the social sector.

The Group should produce an Annual Report to help set the highest standards for both financial and social sectors. The BSB should include social and environmental factors when procuring partners to deliver all corporate services, such as IT, telephony, marketing, auditing and other services.

Section 4: Management and Organisation Structure, Policies and Procedures

Organisational structure

It is premature to describe an organisational chart before the activities of the BSB have been established. For example, State Aid rules may restrict the operations of the Bank compared to how it is currently envisaged by some. The BSB should seek to harness voluntary, in kind and non-paid capacity where appropriate, especially if this can encourage a more representative and diverse mix of staff.

Section 5: Capital Structure, Operating Costs, Financial Modelling, Interim Arrangements

Capital Structure

It is our understanding that the Minister for the Cabinet Office will instruct the BLF to transfer unclaimed assets to a new organisation(s). This should be done following either a full, open, fair and transparent competition or alternatively, following agreement around a model of inclusive collaboration. It is not clear how the current arrangements to capitalise an organisation meet these models and therefore, run the risk of legal challenge.

Operating costs

It is hard to predict at this stage the number of staff required when fully operational. The possibility of performance based pay linked to the social mission of the BSB should be further explored.

Any costing of premises should assume a location in London's East End, or with offices in a regional financial centre, such as Leeds.

Financial modelling and possible outcomes

Modelling returns is a speculative exercise at this stage and we should be honest about that. We can model returns but as we say above, they are very uncertain.

In the longer term, it may be appropriate to leverage the institution. So we should not rule that out.

Interim Arrangements

It is understood that an interim committee will be established by the Big Lottery Fund to make investments from dormant account monies during the period prior to State Aid approval. We are curious about how this fits with the role foreseen for the Big Lottery Fund in the enabling legislation. More widely, it would be helpful for the Government to explain the next steps in the process so others can engage constructively in the Bank's development.