EFSI Equity Instrument

Guidance for social impact investors

Important Disclaimer

This document is for information purposes only. This document is an outline of the principal operational guidelines for the product described herein, which are subject to change and non-exhaustive.

This document is intended to provide a basis for discussions and does not constitute a recommendation, a solicitation, an offer or a binding commitment – either implicit or explicit – on the part of the European Investment Fund (the "EIF") and/or or any other person to enter into one or more transaction(s). Any finance commitment by the EIF can only be made, inter alia, after appropriate approval, conclusion of legal due diligence and finalisation of the required legal documentation. The EIF does not act as adviser to you or owe you any fiduciary duty. The EIF does not make any representations or warranties (whether explicitly or implicitly) with respect to the information contained in this document.

In this document, capitalised terms and expressions shall have the meaning attributed to them in this document and as defined in relevant documents forming part of the Call for Expression of Interest.

1. Strengthening the social dimension of EFSI

This document aims to describe the context for social impact investments that European Investment Fund ("EIF") will be seeking as part of the EFSI Equity Instrument, providing additional elements of considerations for investors operating in this space. It therefore does not replace the terms and conditions provided in the Call for Expression of Interest ("the Call") which shall remain valid.

The current context of constrained or declining public budgets in parallel to increasing societal challenges, calls for innovative solutions for addressing crucial social problems, and for making the most out of a combination between public and private resources.

In this context, social entrepreneurs are playing a major role in solving problems with entrepreneurial means, aiming to generate positive social impact tackling local and global challenges while generating profits. However, many social enterprises[1] and social sector organizations[2] are struggling to access the capital needed to establish and grow their business and they seek new, alternative financing options from the public and private sectors.

The European Commission ("EC") and the EIF as part of the newly created EFSI Equity Instrument have decided to support social entrepreneurship and the development of the European social impact ecosystem more broadly through innovative mechanisms.[3] These targeted interventions strengthen EFSI's social focus and ability to deliver on EU 2020 goals for smart, sustainable and inclusive growth.

Social enterprises and social sector organisations therefore become a key EFSI target for their ability to deliver a positive social impact in areas such as social inclusion and labour market integration, including for the benefit of vulnerable groups, for instance refugees and migrants. For instance, this may include interventions in education and skills development, elderly and childhood care, and other public services provision or socially innovative products and services, etc.

2. Investment criteria and main requirements[4]

Under EFSI Equity EIF aims to implement three social impact instruments that are mutually complementary and cover several types of financial intermediaries, final recipients and market segments (see section 3 below).

To receive social impact financing under EFSI Equity, financial intermediaries shall observe/acknowledge certain criteria, such as:

- Prioritising investments in Social Enterprises, dedicating ideally **a majority of its invested amount**
- Being **established or operating in at least one of the EU Member States**
- Committing to invest at least **2 times** the EFSI Equity Investment size into target final recipients established or operating in one or more EU Member States (in any case up to at least 2/3 of the Financial Intermediary's investable amounts)
- Carrying out activities which should not breach ethical principles or **contravene EIF restricted sectors**
- Being managed by an **independent management team**

[1] Definition of Social Enterprise is provided in the Appendix I to this document
[2] For the purpose of this document, a Social Sector Organisation is defined as an organization or a consortium of organizations, regardless of its legal form, that is responsible for social services delivery and pursues defined social missions, including social impact objectives
[3] The EFSI Equity social impact investment instruments entail a contribution from the EU Programme for Employment and Social Innovation (EaSI) and from the Horizon 2020 Programme
[4] A more comprehensive list of terms and conditions is provided in Annex II and Annex III to the Call

- Meeting at least one of the **EU Value Added indicators**[5]
- Agreeing to apply a **social impact measurement methodology**
- Committing to providing on a regular basis **data on its underlying investments**

The maximum size of a single EIF's investment is limited to **EUR 50m**, representing at least 7.5% up to typically 50%[6] of the aggregate commitments made to the financial intermediary.

All EIF's investment decisions will follow these general steps:

- Screening
- Due Diligence
- Assessment and approval in accordance with EIF's internal assessment and decision making rules
- Negotiation and signature

Prior to entering into a transaction, the selected investment proposal to be funded under the EFSI Equity shall be submitted by the EIF to its relevant decision making bodies for approval and shall be subject to such prior approval before finalising the contractual negotiation process with the financial intermediary.

3. EFSI Equity social impact investment instruments

Under the EFSI Equity Instrument, three main types of social impact investment instruments targeting financial intermediaries are brought together:

- Investments in or alongside Financial Intermediaries linked to incubators, accelerators, and/or that provide incubation services[7]
- Investments alongside Business Angels or investments in BA Funds
- Payment-by-Results/Social Impact Bond investment scheme

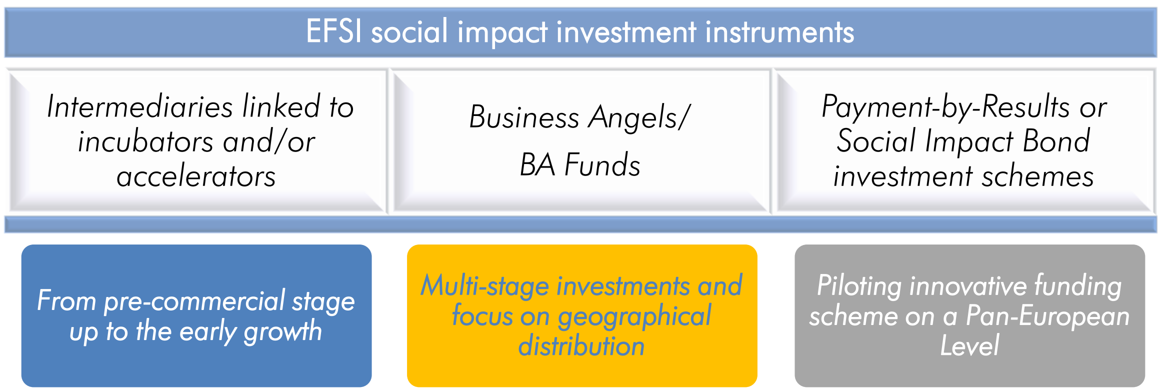

Figure 1 EFSI Equity social impact investment instruments

These types of investments will be made out of the two windows creating the EFSI Equity Instrument, namely the **Early Stage** and the **Expansion and Growth Stage windows**, either individually or by pooling resources from the two strands for multi-stage investments. The terms and conditions outlined in Annex III and Annex II to the Call respectively will therefore apply.

[5] As outlined in Section 4.2 the Call
[6] However, subject to EIF's analysis, the EIF's investment may constitute up to 100% of the total commitments
[7] Such as professional consulting, coaching, mentorship, business advice, networking

The parties EIF will seek to co-operate with shall pursue **a clear strategy aiming at delivering social impact**, where Social Impact is defined as the positive change in social terms, induced through the business activity or service provision of a Social Enterprise or Social Sector Organisation.

The three instruments are mutually complementary and cover a large spectrum in terms of financial intermediaries, final recipients and market segments targeted.

Ultimately, EFSI will therefore enable the piloting of a number of innovative instruments in support of social enterprises and social innovation. As part of its policy objective in this area, the EC aims to support also smaller investments for the benefit of Social Enterprises, including those with initial investments of up to EUR 500,000.

	Investment in or alongside Financial Intermediaries linked to incubators/accelerators	Investment alongside Business Angels or in BA Fund	Payment-by-Results
Type of investments scheme	Investment or co-investment scheme	Investment or co-investment scheme	Investment or co-investment scheme
Type of counterpart	Typically venture capital funds linked to incubators, accelerators, and/or that provide incubation services to Social Enterprises	Typically business angels or business angels funds targeting Social Enterprises	Typically investors in Payment-by-Results schemes (NPIs, PbR manager or arranger, etc.)
Type of underlying products	Long term risk capital investments in the form of equity, preferred equity, Hybrid Debt-Equity Instruments, other type of mezzanine financing	Long term risk capital investments in the form of equity, preferred equity, Hybrid Debt-Equity Instruments, other type of mezzanine financing	Long term risk capital investments in the form of equity, preferred equity, Hybrid Debt-Equity Instruments, other type of mezzanine financing, and/or debt
Type of target beneficiaries	Primarily Social Enterprises established or operating within the EU ranging from pre-commercial stage up to early growth stage	Primarily Social Enterprises established or operating within the EU ranging from seed stage up to expansion stage	Social Enterprises and Social Sector Organizations established or operating within the EU

Figure 2 Summary key terms of EIF's investment under EFSI Equity social impact investment instruments

3.1. Investments in or alongside Financial Intermediaries linked to incubators and/or accelerators

Incubators and accelerators play an important role in giving social entrepreneurs access to advice, capital, mentors, and potential investors to kick start their social business.

Incubators and accelerators are a good gateway to provide financing to Social Enterprises in their pre-seed/early stage, not investment ready yet for social impact funds.

Through EFSI Equity, EIF seeks investments in intermediaries linked to incubators, accelerators, and/or that provide incubation services whose primary objective is to support and accelerate the growth and success of new and start-up Social Enterprises during their early months or years through an array of business support resources and services. Financial intermediaries are typically venture capital funds or funds directly linked to incubators, accelerators, and/or that provide incubation services.

In order to be considered eligible for receiving investments and business support, **Social Enterprises** shall meet the requirements set-out in the Appendix I and shall be established or operating within the EU28.

Investment opportunities will be evaluated according to the principles set-out in the Call, with particular focus on the management team's track record, the strategy, pipeline and the ability to achieve social impact.

EIF typically ranks at least *pari passu* with the other investors[8].

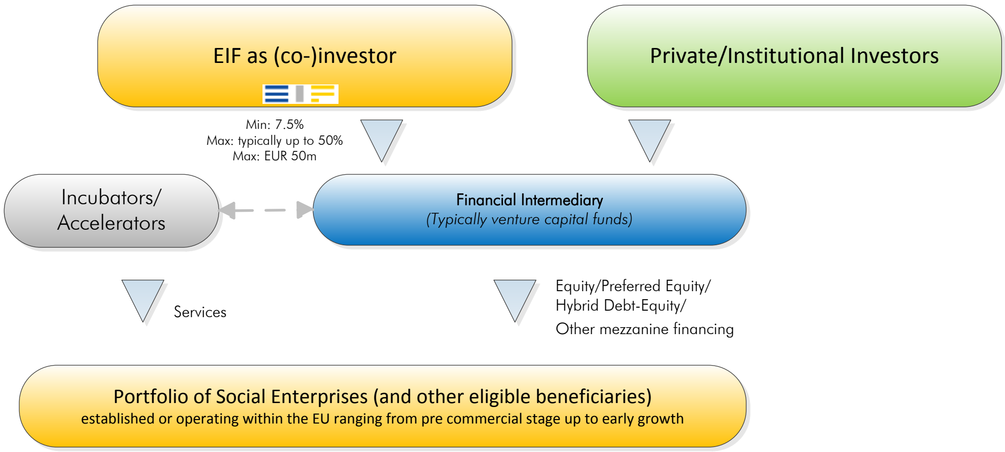

Figure 3 Investments in or alongside Financial Intermediaries linked to incubators/accelerators, and/or that provide incubation services

3.2. Investments alongside Business Angels (or in BA Funds)

Business Angels are another source of funding for young ventures, in the earliest stages of their existence and outside the realm of venture capital funds, due to a typical venture capital fund's inability to accommodate a large number of small and very early stage deals. Business Angels are showing an **increasing interest in investments oriented towards generation of social impact**, playing an important role in providing risk capital as well as contributing to economic growth.

EIF will seek primarily **co-investments with Business Angels**, namely with private individuals or non-institutional investors who invest primarily into Social Enterprises at **seed, early stage as well as expansion and growth stage** that at the core of their business model pursue social impact.

Business Angels can support Social Enterprises via long term risk capital investments in the form of equity, preferred equity, hybrid debt-equity, and other type of mezzanine financing.

Moreover, under this instrument investments with business angel funds are also envisaged.

EIF shall rank at least *pari passu* with the other investors.

[8] However, subject to EIF's analysis, asymmetric risk-sharing may apply

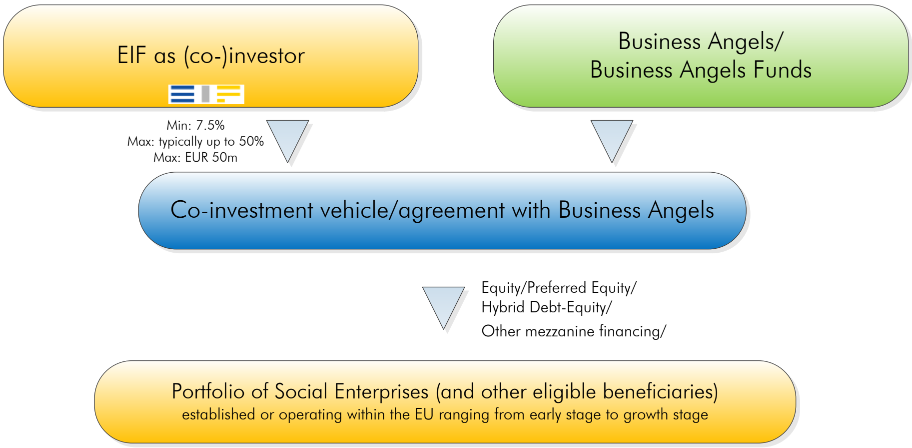

Figure 4 Typical Co-investment structure with Business Angels

3.3. Payment-by-Results[9]

Public authorities in particular are facing challenges in dealing with social issues due to limited budgets. There is especially a clear underinvestment in financing prevention actions. As a consequence, the implementation of outcome-based commissioning is an increasingly applied method of contracting third parties. Payment-by-Results ("PbR") are a form of outcome-based commissioning and a good alternative source of funding for social missions, representing "**good value for money**" since no funding will be disbursed unless success is achieved.

The implementation of PbR instruments is recommended in particular when: (i) policy areas in which target groups of the desired social intervention can be easily identified; (ii) outputs and outcomes can be measured; (iii) investors are familiar with social enterprises and social affairs.

A typical PbR scheme entails the participation of various actors:

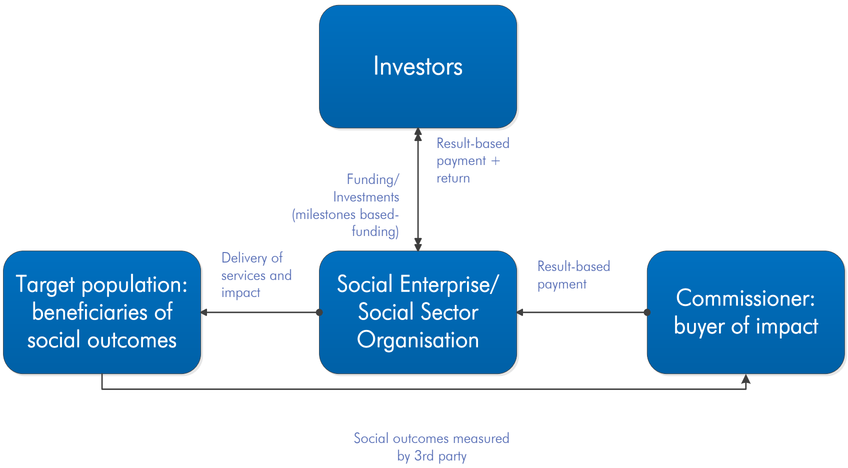

Figure 5 Structure of a Payment-by-Result/Social Impact Bond scheme

[9] Payment-by-Results include also Social Impact Bonds investment scheme

Through EFSI, **the EC and the EIF will launch a pilot of this new, innovative financial mechanism** seeking **experienced counterparts for implementing and managing PbR schemes**, aiming to:

- Test the use of PbR as instrument for funding Social Enterprises and Social Sector Organisations
- Encourage public sector to explore the potential use of PbR instruments for social service delivery, but not in view of substituting the provision of essential social services
- Facilitate knowledge transfer on design, set-up and management of PbR instruments to test market appetite
- Eventually, create investment platforms to overcome market granularity and provide access at scale for institutional investors

Investments into PbR will be typically made **via a special purpose vehicle** which provides upfront funding to Social Enterprises and Social Sector Organisations, enabling them to deliver on their social mission.

Taking into account the novelty of the instrument, EIF will **initially seek to support pilot initiatives within the EU, aiming then at scaling up its intervention.** EIF will operate through an intermediated model and therefore it will never enter into direct contractual arrangements with Social Enterprises or Social Sector Organisations.

Each investment or co-investment opportunity entailing one or more PbR projects will be assessed against a set of criteria in line with EIF's process[10], focusing in particular on:

- Ability to understand the target groups and the social issue being addressed
- Ability to assess the key risks involved in the programme
- Ability to work with local commissioners to generate pipeline and to remedy potential issues during the implementation of the PbR scheme
- Ability to provide capacity building and investment support to the Social Enterprise and/or to the Social Sector Organisation

EIF shall rank at least *pari passu* with the other investors.

EIF investments into financial intermediaries managing PbR investment scheme are only allowed under the terms outlined in Annex II to the Call.

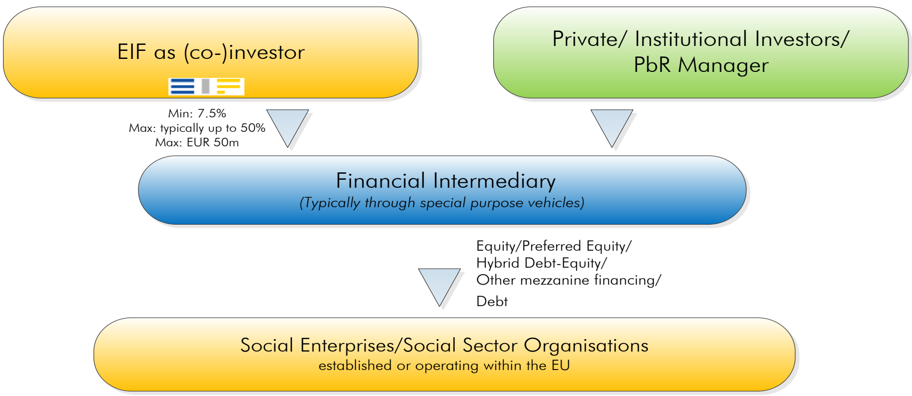

Figure 6 EFSI - Payment-by-Results investment scheme

[10] Please refer to the Call

4. How to apply

Interested parties seeking to become financial intermediaries under EFSI Equity and seeking Social Impact investments shall apply following the procedures outlined in the Call.

For further information, please send an email to efsi_equity@eif.org specifying that the query relates to the EFSI Equity Social Impact investment instruments.

Appendix I

Social Enterprise Guidance Note

The definition of Social Enterprise is based on three key pillars: the entrepreneurial, the social and the governance dimensions, which are further explained in the sections below.

Definition of Social Enterprise

Means an undertaking, regardless of its legal form, which:

- in accordance with its articles of association, statutes or with any other legal document by which it is established, has as its primary objective the achievement of measurable, positive social impacts rather than generating profit for its owners, members and shareholders, and which:
  a. provides services or goods which generate a social return; and/or
  b. employs a method of production of goods or services that embodies its social objective;
- uses its profits first and foremost to achieve its primary objective and has predefined procedures and rules covering any distribution of profits to shareholders and owners that ensure that such distribution does not undermine the primary objective; and
- is managed in an entrepreneurial, accountable and transparent way, in particular by involving workers, customers and stakeholders affected by its business activities.

1. Entrepreneurial dimension

Criterion: whether the organisation is engaged in continuous economic activity, i.e. in a continuous activity of production and/or exchange of goods and/or services.

This distinguishes the social enterprise from traditional non-profit organisations / social economy entities (pursuing a social aim and generating some form of self-financing, but not necessarily engaged in regular trading activity).

According to COM Regulation 800/2008 and the court ruling Case C-205/03 P FENIN vs. Commission, an enterprise or 'undertaking' is any entity engaged in an economic activity, regardless of its legal status and the way it is financed.

There is no limitation as to the legal form of the social enterprise. A social enterprise could take the form of a traditional company with equity, a cooperative, a foundation, an association, an NGO, etc. It can also be an individual on condition that he/she signs a binding self-declaration.

2. Social dimension

a) Primary social aim

Criterion: whether the organisation delivers public/societal benefit

The key element that distinguishes a social enterprise from other types of undertakings is the purpose of the enterprise creating social value. When the primary objective of the organisation is the achievement of a long-lasting social impact (i.e. the solution of a social or environmental problem), the enterprise can be labelled as Social Enterprise.

Having a social mission as the primary goal, alongside the creation of economic value makes the difference between social enterprises and companies that achieve a positive social impact incidentally, or that have a plan for Corporate Social Responsibility, but whose primary objective is different (i.e. exclusively financially oriented).

The social mission of the social enterprise shall be either mentioned in the constitutional documents, or in any corporate documents or clarified by means of a written declaration of the social enterprise.

b) Ways of delivering the social aim

Social impact can be achieved in several ways, for example:

- Services or goods which generate a social return

  A social impact can be achieved if services or goods are addressed to persons in a situation of social exclusion, disadvantage or marginalisation, or that are vulnerable, for example affordable housing, equality and empowerment, migrants' integration etc., or if the enterprise provides goods or services directed at society at large having a pre-emptive purpose that aims at reducing the possibility of the appearance of damage in the future, for instance in the field of early childhood education and care, active employment, health education and disease prevention and life-long learning, sustainable development etc.;

- Methods of production that embody the social aim

  This is the case, for instance, where the main purpose of the enterprise is to provide people that are in a situation of exclusion, disadvantage, marginalisation or that are vulnerable, with a job or to integrate these persons in any form in the labour force. This should not occur incidentally.

3) Governance dimension

a) Profits used for the social impact

Criterion: whether an appropriate share of the social enterprise's profits is used for the achievement of the social objective.

An appropriate share of profits and other financial resources will be mainly reinvested or used with a view to ensuring the social value creation and improving the economic activities of the company.

If profits can be distributed:

- The Social Enterprise must have achieved a substantial part or all of the ex-ante defined impact;
- The Social Enterprise must have defined clear rules on the distribution of profit.

b) Social impact measurement

Criterion: whether the organisation has in place a system for measuring and reporting its social impact to stakeholders.

It is recommended that social enterprises comply with the following requirements:

- provide an explanation of outcomes and impact being targeted, for whom, and how they will be achieved;

- submit to the finance provider, a proposal for the measurement of the achievement of those outcomes (and that impact), unless such proposal is made by the finance provider;

- provide regular reports (preferably annually, but at least every two years) to the finance provider, of outcomes and impact achieved, using the measurement frameworks and indicators agreed with the finance provider;

- agree with the finance provider, any changes, if any, after reconsidering, regularly, whether the measurement framework and indicators are appropriate.