
**REGULATING SOCIAL FINANCE:
CAN SOCIAL STOCK EXCHANGES MEET THE CHALLENGE?**

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ABSTRACT

Social finance is fast becoming a mainstream source of funding for goods and services that target poor people across the globe. With social finance, impact investors put their capital behind enterprises that profitably cater to underserved populations by expanding access to critical goods and services, such as healthcare, affordable housing, credit, and quality employment. Social finance is hybrid in that it is driven by both social and commercial imperatives: Impact investors and social businesses want to generate financial returns alongside a positive social impact. While hybridity creates pathways for changing the role of business in society, it also creates openings for explosive conflicts of interest that can harm the very people whose lives are supposed to be improved. This article argues that social-financial hybridity presents a pressing regulatory challenge that must be addressed. It evaluates the potential for three newly established Social Stock Exchanges (SSEs) – platforms designed to connect investors with social businesses in need of capital – to bridge this regulatory gap. Treating SSEs as transnational rulemaking laboratories for social finance, this study reveals how current regulatory frameworks fall short of filling the hybridity cracks through which beneficiaries can slip and recommends measures for correcting this deficit.

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1. INTRODUCTION

Social finance makes a compelling promise: to make the world a better place by harnessing the power of the market to address pressing global social challenges—to do well financially by doing social good. In order to fulfill this promise, however, social finance—or impact investing—must strike a delicate balance between two historically opposed imperatives: profit and social benefit. And when this balance tips in favor of profitability, social finance can end up harming the very people whose lives it seeks to improve.

Because it operates at the intersection of commerce and philanthropy, social finance is hybrid in that it does not fall neatly under existing regimes for regulating charities, securities, or corporations. This article proceeds by identifying hybridity as a significant regulatory challenge that must be addressed in order to ensure that social finance keeps its social promises. It makes the case for regulating social finance and recommends that regulation be designed with an eye to maintaining a healthy balance between social and financial objectives and, crucially, to protecting the interests of the ultimate beneficiaries. It then assesses the potential for social stock exchanges (“SSEs”) to bring this regulatory project to fruition.

With social finance, impact investors put their capital behind ventures (known as “social businesses”) that profitably cater to underserved populations. These businesses provide access to critical goods and services, such as financial services, healthcare, affordable housing and quality employment to the economically and socially disadvantaged—people excluded from ordinary markets because conventional businesses view them as being too costly or risky to service or employ.

In a world of diminishing public funding for addressing social problems, governments and international organizations are evermore eager to put private investment to work in the social sphere. In a strong expression of support for social finance, British Prime Minister Cameron launched the 2013 G8 Social Impact Investment Forum, saying:

We've got a great idea here that can really transform our societies by using the power of finance to tackle the most difficult social problems that we face. Problems that have frustrated government after government, country after country, generation after generation. . . . The potential for social investment, I think, is really that big.¹

Buoyed by the enthusiastic backing of both public and private sector actors, social finance is fast becoming a mainstream source of funding for goods and services that target the global poor. Studies produced by entities such as the World Economic Forum, JP Morgan, and Credit Suisse indicate that anywhere between \$500 billion and \$1 trillion could be channeled into impact investments by 2020.² To put these figures in perspective, consider that even at the lower end of this range, impact investments would surpass Official Development Assistance – the prevailing measure of public funding to developing countries – by a factor of four.³ Since about 70% of impact investments are currently being deployed in emerging markets, the financial volumes at stake are potentially quite transformative.⁴

Social finance seeks to remedy problems that are caused or aggravated by market exclusion while exploiting the tremendous market opportunities that exist at the “base of the pyramid” (“BoP”).⁵ So far so good. However, the pursuit of hybrid returns – financial and social – on investment creates openings for conflicts of interest that, if left unchecked, can harm the intended beneficiaries. The latter are characterized by acute financial and non-financial

¹ David Cameron, U.K. Prime Minister, Opening Speech at the G8 Social Impact Investment Forum on Social Investment as a Force for Social Change (June 6, 2013) [hereinafter Cameron Speech].

² WORLD ECON. FORUM, FROM THE MARGINS TO THE MAINSTREAM: ASSESSMENT OF THE IMPACT INVESTMENT SECTOR AND OPPORTUNITY TO ENGAGE MAINSTREAM INVESTORS 5 (2013), [hereinafter WEF REPORT], http://www3.weforum.org/docs/WEF_II_FromMarginsMainstream_Report_2013.pdf.

³ *Aid to Poor Countries Slips Further As Governments Tighten Budgets*, OECD (Mar. 4, 2013), <http://www.oecd.org/dac/stats/aidtopoorcountriesslipsfurtherasgovernmentstightenbudgets.htm>.

⁴ J.P. MORGAN & GLOBAL IMPACT INVESTING NETWORK, SPOTLIGHT ON THE MARKET: THE IMPACT INVESTOR SURVEY 5 (2014), <http://www.thegiin.org/binary-data/2014MarketSpotlight.PDF>.

⁵ ALLEN HAMMOND ET. AL., WORLD RESOURCES INST., THE NEXT 4 BILLION: MARKET SIZE AND BUSINESS STRATEGY AT THE BASE OF THE PYRAMID 3 (2007), [hereinafter NEXT 4 BILLION], <http://www.wri.org/publication/the-next-4-billion>.

vulnerability. They, too, live at the intersection of commerce and philanthropy. With the limitations of public and philanthropic funding becoming more apparent, particularly in the wake of the global financial crisis, these individuals become evermore dependent on the market for meeting their basic needs. This dependency in turn creates new vulnerabilities at the BoP.

The history of microfinance (one branch of social finance) in India has taught us that under-regulated hybridity can have catastrophic consequences. Microfinance Institutions (“MFIs”) are founded on a strong social mission—to improve the livelihoods of the poor by making credit available to individuals who are considered ineligible for conventional financing because they lack credit history and collateral to secure the loan. But MFIs also advance a strong financial mission in the sense that the credit they make available is not free: Micro-borrowers, typically poor women, must repay the loans, often at a high rate of interest. This combination of social and financial objectives within a single business exemplifies the hybridity feature of social finance.

In recent years, many successful MFIs have seen their financing evolve from being grant-based and sourced from philanthropic foundations, to equity-based and sourced from commercial investors. Under increased commercial pressure, some MFIs in the Indian state of Andhra Pradesh prioritized expanded growth targets over social impact, effectively departing from their social mission. In a pattern reminiscent of the sub-prime crisis in the United States, MFI “lenders to the poor” became embroiled in aggressive over-lending and debt collection practices that culminated in a wave of borrower suicides in 2010.⁶

This tragic story embodies an extreme instance of mission drift, whereby an entity strays from its social mission and prioritizes “profits to the detriment of the social good.”⁷ However, the risk that less dramatic versions of mission drift will undermine the promise of social finance is endemic and must be mitigated. The influence of (existing and potential) investors on businesses that service the poor

⁶ HARVEY KOH ET AL., BEYOND THE PIONEER: GETTING INCLUSIVE INDUSTRIES TO SCALE 72 (2014), <http://www.beyondthepioneer.org/wp-content/themes/monitor/Beyond-the-Pioneer-Report.pdf> [hereinafter BEYOND THE PIONEER].

⁷ Julie Battilana et al., *In Search of the Hybrid Ideal*, STAN. SOCIAL INNOVATION REV. 52 (2012) [hereinafter *Hybrid Ideal*], http://ssir.org/articles/entry/in_search_of_the_hybrid_ideal?utm_content=bufferbf4c7&utm_medium=social&utm_source=twitter.com&utm_campaign=buffer.

requires particular vigilance. It is precisely when social businesses become successful enough to attract commercial investment that mission drift can create cracks in the social goods supply chain through which beneficiaries can slip.

The challenge for regulators is therefore to ensure that impact investors and social businesses remain firmly committed to the social mission of their enterprise. Such commitment must be resilient in the face of pressure to prioritize profit over impact or to undermine the “double bottom line.”⁸ Yet today, the investors and businesses operating within the social finance space are generally under-regulated.

Enter SSEs – new platforms designed to connect “businesses that deliver social and environmental value with investors seeking both a social and a financial return.”⁹ Businesses looking to diversify their financing and scale up operations can “list” on SSEs and transact with investors seeking some combination of financial returns and positive social impact. Like conventional stock exchanges (“CSEs”), such as the New York Stock Exchange or the London Stock Exchange, SSEs serve a regulatory function by requiring listed entities to comply with a number of rules and requirements in order to be and stay listed. For example, listed social businesses must produce (at least) annual reports that disclose their performance; however, unlike CSEs, SSEs require that these reports contain information about social, as well as financial performance.

No fewer than three SSEs were established in 2013: The U.K. Social Stock Exchange (“SSX”), Canada’s Social Venture Connection (“SVX”), and the Singapore-based Impact Exchange (“IX”), which is a platform of the Stock Exchange of Mauritius. Although they are still young, SSEs are actively working to fill the regulatory vacuum in which social finance currently operates. Just as CSEs did for conventional finance centuries ago, SSEs today serve as “transnational rulemaking laboratories” for social finance. They develop and test tools for distinguishing social businesses and impact investors from their conventional counterparts, establish procedures for standardizing social finance transactions, and shape

⁸ Lori Kozlowski, *Impact Investing: The Power of Two Bottom Lines*, FORBES (Oct. 2, 2010), <http://www.forbes.com/sites/lorikozlowski/2012/10/02/impactinvesting-the-power-of-two-bottom-lines/>.

⁹ Cameron Speech, *supra* note 1.

the relationships between key stakeholders—investors, issuer-businesses, and beneficiaries.

It is important to track how, and how well, SSEs are carrying out these experiments, since this work could determine the content of social finance regulation for years to come. Accordingly, this article reviews each SSE and assesses how effective it is in bringing regulatory order to social finance. It finds that so far, all are wanting.

To protect the promise of social finance, SSEs must protect the interests of beneficiaries and those of investors. However, SSEs rely too heavily on the blueprint set by CSEs, which prioritizes investors over investment-affected individuals and communities. This approach obscures the interests of beneficiaries, and therefore constitutes a dangerous foundation for social finance regulation.

To correct this deficit, I recommend injecting strong beneficiary-protections into each dimension of the SSEs' regulatory framework, including mission statements, listing and corporate governance requirements, reporting requirements, and enforcement mechanisms. For example, SSEs should require issuers to report not only on financial and social performance metrics, but also on the substantive feedback from beneficiaries. Issuers should also be required to have a Social Director whose job is to ensure compliance with the social mission and to link beneficiaries to management. To minimize commercial pressures to drift, investors must themselves be "patient" and committed to their investees' social mission.¹⁰ SSEs should therefore screen investors before granting platform access and require them to subscribe to a patient investor code of conduct. Investment exits should also be managed by requiring that impact securities be on-sold only to other (screened) impact investors.

This article proceeds in five Parts: Part I provides a primer on social finance, explaining how it works and introducing the key stakeholders—impact investors, social businesses, and the beneficiaries. It sets out a typology of beneficiaries to clarify some of the interests and vulnerabilities at stake. Part II identifies the regulatory challenge created by social-financial hybridity, in particular in the case of commercially successful social businesses, and underscores the importance of regulating against mission drift.

¹⁰ See *What Is Patient Capital?*, ACUMEN FUND (last visited Oct. 13, 2015), <http://acumen.org/ideas/patient-capital/> (explaining that patient capital is "a form of investment that has a high tolerance for risk, has long time horizons, is flexible to meet the needs of entrepreneurs, and is unwilling to sacrifice the needs of end customers for the sake of shareholders") [hereinafter ACUMEN FUND].

Part III sets the stage for understanding the role that SSEs can play in bringing regulatory order to the social finance space. It highlights the limitations of importing the CSE approach to regulation into the SSE context because that approach fails adequately to protect beneficiaries. Part IV describes the three SSEs and identifies the strengths and weaknesses of each model. Part V offers an overall assessment of SSEs' regulatory performance to date and makes concrete recommendations for improvement, with a particular emphasis on beneficiary protection.

2. SOCIAL FINANCE: A PRIMER

This Part lays the foundation for understanding the regulatory challenge that hybridity brings to bear. It explains what social finance is and introduces the main stakeholders—impact investors, social businesses, and the beneficiaries. By drawing attention to the diversity among impact investors and social businesses, in particular their varying commitment to achieving both social and financial objectives, this Part shows how social-financial hybridity creates openings for serious conflicts of interest. It offers a typology of beneficiaries in order to better understand the relationships between these individuals and the social businesses with which they transact. The typology further serves to clarify how harm can ensue if beneficiary-social business relationships devolve as a result of mission drift.

2.1. What Is Social Finance?

The pursuit of double or triple bottom line returns on investment—financial, social, and environmental—is alternately referred to as social finance, impact investing, or shared value investing, and I use these terms interchangeably. One way to understand social finance is as an alternative mode of financing for socially beneficial goods and services that have traditionally fallen within the purview of government. It involves bringing private capital and market-based business solutions to bear on the world's most pressing social and environmental problems. This article focuses primarily on the social (or human) rather than the

environmental category of problems, because, as argued below, that is where the regulatory framework for governing social finance is most lacking.

Social finance has gained a lot of traction in recent years, rising in prominence among the business, philanthropic, and development communities, as well as among domestic and international policy makers. It has captured imaginations in part because of the volumes of capital involved. Since the term impact investing was coined in 2007, we have witnessed increasing amounts of funds being channeled into social finance,¹¹ and many predict that these problem-solving capital flows will exceed Official Development Assistance (“ODA”) by 2020.¹² While the money alone is a sufficient reason to take social finance seriously, the ideas that fuel social finance may constitute an even more important reason to pay attention. These ideas have the potential to change how and which socially beneficial services and goods (e.g. housing, health, education, and electricity) are financed, and therefore to transform global social provisioning systems. This demands special consideration, especially for those interested in improving global social welfare and in using law and regulation to support that effort.

The Global Impact Investing Network (“GIIN”), an industry association for social finance, defines impact investments as follows:

Impact investments are investments made into companies, organizations and funds with the intention to generate social and environmental impact alongside a financial return. Impact investments can be made in both emerging and developed markets, and target a range of returns from below market to market rate, depending on the circumstances.¹³

¹¹ See J.P. MORGAN & GLOBAL IMPACT INVESTING NETWORK, SPOTLIGHT ON THE MARKET: THE IMPACT INVESTOR SURVEY 4-9 (2014), <http://www.thegiin.org/binary-data/2014MarketSpotlight.PDF> (presenting a survey conducted among 125 impact investors concluding that about \$60 billion was invested in 2013).

¹² See Sasha Dichter et al., *Impact Investing: Closing the Pioneer Gap*, STAN. SOCIAL INNOVATION REV. 42-43 (Winter 2013), <http://proxy.library.upenn.edu:2187/docview/1265597236?pq-origsite=summon> (providing a helpful examination of this figure); see also WEF REPORT, *supra* note 2, at 10 (establishing that the value of the impact investment market might reach between \$400 billion and \$1 trillion by 2020).

¹³ See *What Is Impact Investing?*, GLOBAL IMPACT INVESTING NETWORK, <http://www.thegiin.org/cgi-bin/iowa/resources/about/index.html> (last visited Feb. 28, 2015) (providing an outline on the definition, key characteristics, and function of impact investing).

Speaking to investors, the GIIN website goes on to explain that “investments are made into enterprises and funds that expand access to critical goods and services, and/or generate positive impact through their operations. For example, investors may seek to use investments to increase access to financial services, education, healthcare, affordable housing or quality employment by underserved populations.”¹⁴

The GIIN’s definition helps to make an important distinction between social finance and socially responsible investing (“SRI”). Specifically, impact investing or social finance can be understood as an enriched form of SRI, or as “SRI-plus.” The onus on businesses receiving impact investments is not only to avoid contributing to social and environmental harms, which is the domain of conventional SRI, but also to produce social and environmental benefits for the company’s stakeholders, who extend far beyond shareholders—the communities they work in, the individuals they employ, and the public at large. While conventional SRI screens out companies that produce social or environmental harms (e.g., tobacco, weapons, alcohol, gambling),¹⁵ impact investing seeks actively to benefit society, and to do so profitably wherever possible.¹⁶ In short, social finance is promoted precisely as a move away from the “‘social responsibility’ mind-set in which societal issues are at the periphery, not the core.”¹⁷

While the range of social finance activities is broad, two important common denominators can be identified. First, the purpose of social finance is to advance social welfare by channeling capital into businesses that fill gaps in the provisioning of socially beneficial goods and services to underserved demographics. These gap-filling activities must be carried out in a way that is at least commercially sustainable, if not profitable. The second common denominator pertains to the category of individuals who are

¹⁴ *Id.*

¹⁵ See MATT KROGH, B. CORP., CHANNELING INVESTMENT FOR IMPACT: NEW RATING SYSTEM HELPS INVESTORS MOVE BEYOND RESPONSIBILITY 17 (2009), <https://www.bcorporation.net/sites/all/themes/adaptivetheme/bcorp/pdfs/2009AP-Channeling-Impact.pdf> (elaborating on the SRI screening process).

¹⁶ Mitchell L. Strauss, *Six Questions About Impact Investing*, OPIC (June 5, 2012), <http://www.opic.gov/blog/education/six-questions-about-impact-investing>.

¹⁷ Michael Porter & Mark Kramer, *The Big Idea: Creating Shared Value*, HARV. BUS. REV. (Jan.-Feb. 2011), at 64.

supposed to see their lives improved as a result of social finance — namely, the poor, who are referred to as beneficiaries.

Often referred to as an “industry,”¹⁸ a “movement”¹⁹ or an “asset class,”²⁰ social finance and impact investing are umbrella terms that describe a type of economic activity that seeks to do more than simply make money. Drawing on the legacies of community development finance,²¹ social finance seeks to address social problems through market-based solutions. These solutions differ fundamentally from those supported by philanthropy in the sense that they are designed to be commercially sustainable. Thus, while philanthropy involves money gifts that are finite and uncertain, social finance seeks out investment opportunities that can generate self-perpetuating income streams.

The social businesses that receive impact investments are just that: businesses. Their operations are financed through their revenues. As such, they are different from non-profit organizations that often depend primarily on charitable contributions and grants to fund their work.

Sir Ronald Cohen, chairman of Big Society Capital, the U.K.’s recently established social investment bank, explains that, “most charitable organizations are small and have no more than a few months of funding at their disposal. Yet there is one resource — vastly bigger than the resources currently available to either government or the social sector — that has remained largely untapped for social purposes: the capital markets.”²² The market, private capital, and business acumen are increasingly being called

¹⁸ *Id.* at 67.

¹⁹ JESSICA FREIREICH & KATHERINE FULTON, MONITOR INST., INVESTING FOR SOCIAL AND ENVIRONMENTAL IMPACT: A DESIGN FOR CATALYZING AN EMERGING INDUSTRY 9 (Jan. 2009), <http://www.monitorinstitute.com/impactinvesting> [hereinafter MONITOR].

²⁰ NICK O’DONAHOE, ET AL., J.P. MORGAN & ROCKEFELLER FOUND., IMPACT INVESTMENTS: AN EMERGING ASSET CLASS 24-29 (2010) [hereinafter EMERGING ASSET CLASS], <http://nonprofitfinancefund.org/files/11-29-10jpmorganchaserockefellergiin-abl.pdf>.

²¹ Community development uses tax incentives to attract investment into underserved areas to increase the availability of affordable housing, for example, and Community Development Financial Institutions provide credit and financial services to underserved markets and populations. *Id.* at 7.

²² Sir Ronald Cohen, *Big Society Capital Marks a Paradigm Shift*, STAN. SOCIAL INNOVATION REV. 21 (Summer 2012), http://www.ronaldcohen.org/sites/default/files/3/Summer%202012_Big%20Society%20Capital%20Marks%20a%20Paradigm%20Shift.pdf.

upon to supplement public and philanthropic initiatives to solve social problems.²³ Faced with a problematic combination of dwindling resources and serious global social problems, government, international development organizations, and foundations are under pressure to identify ways to crowd in private investment in order to finance social goods.²⁴

Market-based approaches to social problem solving are promoted on the view that public spending on social welfare, development assistance, and philanthropy are generally ineffective:

Traditional approaches tend to address unmet needs for health care, clean water, or other basic necessities by setting targets for meeting those needs through direct public investments, subsidies, or other handouts. The goals may be worthy, but the results have not been strikingly successful. A market-based approach . . . looks for solutions in the form of new products and business models that can provide goods and services at affordable prices Perhaps most important, traditional approaches do not point toward sustainable solutions – while a market-oriented approach recognizes that only sustainable solutions can scale to meet the needs of 4 billion people.²⁵

Commercial sustainability is a very important pillar of social finance. When an impact investment generates a financial return

²³ Mirjam Schöning et al., *Taking a Realistic Approach to Impact Investing: Observations from the World Economic Forum's Global Agenda Council on Social Innovation*, M.I.T. INNOVATIONS J. 168-69 (2011), http://www.weforum.org/pdf/schwafound/TakingARealisticApproachToImpactInvesting_MIT_Innovations.pdf.

²⁴ See Jean-Michel Severino & Olivier Ray, *The End of ODA: Death and Rebirth of Public Policy* 5-6 (Ctr. for Global Development, Working Paper No. 167, 2009), available at http://www.cgdev.org/sites/default/files/1421419_file_End_of_ODA_FINAL.pdf (detailing the expansion of non-governmental actors in the funding of international development); see also WEF REPORT, *supra* note 2, at 4 (“Social issues continually present significant fiscal challenges for governments of developed, emerging and frontier economies Philanthropic organizations – while noble and needed – will not be able to solve the most pressing social problems alone due to their limited resources Impact investing offers an opportunity to creatively fund projects that may otherwise go unfunded, while also helping to scale organizations with viable business models”).

²⁵ NEXT 4 BILLION, *supra* note 5, at 11, 6-7 (defining the base of the economic pyramid, or “BoP,” in the context of emerging markets, as “those with annual incomes up to and including \$3000 per capita per year,” which, when combined, constitutes a \$5 trillion global consumer market).

sufficient to sustain itself, it has done what philanthropy and public assistance cannot: It has tapped into the forces of market, ownership, and innovation to create the means for its own reproduction, and reduced (ideally, eliminated) the dependency on “free” money.²⁶ As exemplified by microfinance, one strand of social finance: “For many, the revolutionary appeal of the microfinance movement was that poverty might be alleviated in a way that does not require continuous subsidies.”²⁷

The policy of privatizing public goods (e.g., energy and water, healthcare, and policing) has been pursued in many economies for a long time and has been subject to both positive and negative critiques.²⁸ In a sense, social finance takes privatization to a new level by reframing social problems as market opportunities. In fact, social finance creates a new market where social impact is transformed into a commodity that can be invested in and traded. This is both promising and problematic. This is promising because additional money and innovation are being deployed in the service of solving a wide range of social problems. This is also problematic because establishing a new market for social impact creates openings for new types of market failures that can cause harm to social finance beneficiaries, as discussed below.

Some worry that by injecting market logic and expectations of return into the social goods arena, social finance will negatively alter the framework for making decisions about what problems to solve and what initiatives to finance. To clarify, with social finance, capital chases enterprises that generate both financial and social returns; this creates a concern that initiatives that produce only (or mostly) social returns will become under-funded. The same concern applies to initiatives that produce social impact over a long period of time or in a way that isn’t easily measurable. For example, critics like Michael Edwards fear that the marketization of social impact

²⁶ See, e.g., WEF REPORT, *supra* note 2, at 4 (presenting how free-cash flow enables the evaluation of a company’s financial performance); see also SOCIAL FINANCE, A NEW TOOL FOR SCALING IMPACT: HOW SOCIAL IMPACT BONDS CAN MOBILIZE PRIVATE CAPITAL TO ADVANCE SOCIAL GOOD 7 (2012), http://www.socialfinanceus.org/sites/socialfinanceus.org/files/small.SocialFinanceWPSingleFINAL_0.pdf (explaining that “Unlike public sector or grant funding, impact investments produce financial returns that can be reinvested in the social sector”).

²⁷ *Hybrid Ideal*, *supra* note 7, at 52.

²⁸ See generally JODY FREEMAN, GOVERNMENT BY CONTRACT: OUTSOURCING AND AMERICAN DEMOCRACY (Martha Minow eds., 2009).

and the attending emphasis on measurable returns will sideline the less-quantifiable work of civil society and non-profit groups that have proven successful in bringing about lasting social change.²⁹

Edwards cautions that institutionalizing market approaches within the social provisioning sphere can narrow the social problem-solving toolkit in a way that favors marketable solutions rather than impactful ones: “[P]hilanthropy was valued precisely because of its ability to fund organizations and activities that did not make . . . returns and whose success could not be measured by short-term standard metrics.”³⁰ He adds that a serious problem arises when “one particular approach dominates all others so that the tools of business and measurement are conflated with the underlying ideologies of the market and technocracy . . . with the result that equally-valuable alternatives are being displaced and delegitimized, leaving large areas of work unsupported or under-funded.”³¹

Social finance and impact investing have tremendous potential for bringing more self-sustaining capital and initiative to bear on solving pressing social problems. However, establishing a market for social impact—a project in which SSEs actively participate—also creates new risks of market failure that matter for both investors and beneficiaries. As explained below, these risks must be addressed in order to protect investor and beneficiary interests, as well as the integrity of the market.

2.2. *The Business Side: Impact Investors and Social Businesses*

So how does social finance work? There are a few models but the one that is most relevant for our purposes involves impact investors putting their capital behind businesses that interface directly with under-served populations by making socially beneficial goods and services—including quality employment—available to them. This model introduces the three main protagonists in the social finance

²⁹ Michael Edwards, *Who Gains, Who Loses? Distributional Impacts of the New Philanthropic Marketplace*, in *NEW FRONTIERS OF PHILANTHROPY: A GUIDE TO THE NEW TOOLS AND ACTORS RESHAPING GLOBAL PHILANTHROPY AND SOCIAL INVESTING* 539, 546-47 (Lester M. Salamon, ed. 2014) [hereinafter Edwards].

³⁰ Edwards, *supra* note 29, at 539.

³¹ *Id.* at 540.

story: impact investors, social businesses, and crucially, the beneficiaries.

2.2.1. *Impact Investors*

Impact investors are varied and have varying expectations of social and financial returns. A brief overview of the composition of the GIIN Investors Council illustrates this point. The Council comprises private foundations (e.g., Rockefeller Foundation, W.K. Kellogg Foundation, and Citi Foundation), institutional investors, financial services firms, wealth managers (e.g., Prudential, TIAA-CREF, Morgan Stanley, UBS, Big Society Capital, and J.P. Morgan), non-profit investment funds (e.g., National Community Investment Fund and Root Capital), and development finance institutions (e.g., the Inter-American Development Bank and the Overseas Private Investment Corporation).³² Individuals who buy shares in social businesses or who make equity or loan investments in such enterprises are another type of impact investor. This type of investor might also invest in socially driven Kickstarter projects, or make loans to micro-entrepreneurs in developing countries through websites like Kiva.

Investors also have different expectations of return and different motivations for engaging in social finance. While the common goal is to generate social impact alongside financial returns, some investors prioritize impact over financial gains, while others prioritize financial gains. Thus, some are described as “impact-first,” while others are described as “finance-first.”³³ Over time, and as the impact investing space has grown, these dichotomies have become less clear-cut and more nuanced: “[F]und investors have any number of reasons for their involvement in impact investing. Their engagement can be informed by deeply-held values and convictions; strategic institutional/mission priorities; rules and regulations; or, of course, risk and return objectives.”³⁴

³² EMERGING ASSET CLASS, *supra* note 20, at 16.

³³ MONITOR, *supra* note 19, at 31.

³⁴ INSIGHT AT PACIFIC COMMUNITY VENTURES ET AL., IMPACT INVESTING 2.0: THE WAY FORWARD (2013), available at http://www.pacificcommunityventures.org/impinv2/wp-content/uploads/2013/11/2013FullReport_sngpg.v8.pdf.

A central contention of this article is that, even though it is not always clear what drives investors, and even though there is an understandable eagerness to be inclusive in efforts to attract additional investment into the social finance space, it is nevertheless important to be selective about which investors should be invited under the impact umbrella. The less investors care about their investments achieving a positive social impact, the less likely they are to offer meaningful support to their investees in fulfilling their social mission. Furthermore, the less investors care about positive social outcomes, the more likely they are to pressure investees to prioritize profitability over impact. Both of these situations are problematic because they can harm beneficiaries.

In other words, investor motivations matter and investor selectivity is a powerful mechanism for attracting the “right” type of investor into the social finance space and for ensuring the health and safety of the market for social impact. How one might go about designing and operationalizing such a selection mechanism is a question that will be addressed in the discussion on SSEs below.

2.2.2. *Social Businesses*

The businesses that receive impact investments are referred to as “social businesses,” “social enterprises,”³⁵ or “inclusive businesses.”³⁶ For convenience, I mostly use the first term. Social businesses aim to achieve multiple bottom line returns by profitably, expanding access to needed goods and services for under-served

³⁵ For a definition of social entrepreneurs, see Alex Nicholls, *Social Enterprise and Social Entrepreneurs*, CIVIL SOCIETY 148 (2d ed, Polity, 2009); see generally REPORT OF THE UN COMMISSION ON THE PRIVATE SECTOR AND DEVELOPMENT TO THE SECRETARY GENERAL OF THE UNITED NATIONS, UNLEASHING ENTREPRENEURSHIP: MAKING BUSINESS WORK FOR THE POOR (2004), available at <http://web.undp.org/cpsd/documents/report/english/fullreport.pdf>.

³⁶ One article describes the difference as follows: “Social enterprises are for-profit entities with a mission to address social, environmental or otherwise development-related needs. An inclusive business, on the other hand, contributes to poverty reduction through the inclusion of low-income communities in its value chain.” Pete Troilo, *Are Social Stock Exchanges The Great Equalizer to Democratize Development Finance?*, DEVEXIMPACT (July 12, 2013), <https://www.devex.com/en/news/are-social-stock-exchanges-the-great-equalizer-to-democratize-development-finance> [hereinafter Troilo].

populations.³⁷ For these entities, creating positive social impact is a core component of the business model; that is, social impact is the business.³⁸ In principle, the better a social business is at solving problems and pursuing its mission, the more successful it will be, both financially and socially.³⁹

MFIs are the leading example of social businesses that serve the poor in developing countries. These institutions make small loans available to the poor, and are pioneers in the pursuit of double bottom line returns, having done so since (at least) the 1970s.⁴⁰ They cater to individuals who would otherwise not be able to access credit because they do not meet loan eligibility requirements.⁴¹ To clarify, for many conventional banks, it is difficult to lend to individuals who have neither credit history nor collateral to secure the loan in case of a default, which is the case for most micro-borrowers.⁴² It is also more expensive and burdensome to lend small amounts of money to a multitude of borrowers, rather than make larger loans to a smaller number of (more affluent) borrowers.⁴³ This challenge is compounded when borrowers are located in hard to reach areas, such as scattered rural villages.⁴⁴

In contrast to conventional lenders, MFIs are designed to cater precisely to this difficult-to-serve population, and in doing so they fill an important need.⁴⁵ By making financial services available to the under-served, MFIs fill a credit gap that discriminates against

³⁷ EMERGING ASSET CLASS, *supra* note 20, at 8.

³⁸ Cummings, *infra* note 60, at 581-582. See also, SOCIAL STOCK EXCHANGE FREQUENTLY ASKED QUESTIONS, <http://socialstockexchange.com/faqs/> (explaining that Corporate Social Responsibility describes activities through which companies give back to society (e.g., via charitable donations, volunteer staff, and commitments to reduce waste), but do not constitute the companies' core.).

³⁹ Eldar, *infra* note 78 at 17 (explaining that whereas donative organizations transfer subsidies by simply giving goods to beneficiaries (e.g. bed nets or water purifiers), social enterprises employ capital to produce goods and services for sale and *depend* on their patrons to remain commercially sustainable).

⁴⁰ BEYOND THE PIONEER, *supra* note 6, at 21-29.

⁴¹ Todd Arena, *Social Corporate Governance and the problem of Mission Drift in Socially-Oriented Microfinance Institutions*, 41 COLUM. J.L. & SOC. PROBS. 269, 270-73 n.108 (2008) [hereinafter Arena].

⁴² *Id.* at 278.

⁴³ *Id.*

⁴⁴ BEYOND THE PIONEER, *supra* note 6, at 7.

⁴⁵ Eldar, *infra* note 78 at 8-9 (describing the main benefit that MFIs confer on beneficiaries as the "opportunity to borrow" and social businesses as those that transact with beneficiaries who cannot transact with profit-maximizing firms).

the poor. Having access to credit makes it possible for micro-borrowers to invest in improving their own livelihoods, which they can do through the purchase of goods and services like food, school books, or medical visits; borrowers could also use the loan to buy a piece of equipment like a cell phone charger that they “rent” out to others for a fee, a sewing machine, or livestock to start a business and generate income.⁴⁶ Some MFIs also fill a social development gap by providing financial literacy training and other social programming designed to “empower” borrowers to make better use of the financial services the MFI provides.⁴⁷

MFIs are an important reference for understanding what it means to operate as a social business because they are designed to be both socially impactful and financially profitable, and many are quite profitable. This is because the loans that they extend must be repaid, and often at a high rate of interest. Globally, the median interest yield was 27% in 2011, with an even higher Annual Percentage Rate, and some MFIs charge over 100%.⁴⁸

Aravind Eye Care System is an Indian non-profit that also works in the health sector. It makes affordable blindness-prevention surgery available to poor patients. It performs about 350,000 eye operations per year, 60% of which are delivered at low or no cost.⁴⁹ Aravind encompasses a network of hospitals and clinics that charge market rates to patients who can afford to pay the full price in order to subsidize or completely waive fees for patients who cannot.⁵⁰

In the energy sector, Husk Power Systems transforms rice husks into electricity and sells “micro-power” to over 200,000 individuals in rural communities across India.⁵¹ Users are charged a variable fee

⁴⁶ See, e.g., Kiva Borrowers, available at <http://www.kiva.org/lend> (providing examples of the types of activities that micro-loans can finance).

⁴⁷ Arena, *supra* note 41, at 281, 49.

⁴⁸ RICHARD ROSENBERG ET AL., MICROCREDIT INTEREST RATES AND THEIR DETERMINANTS - 2004 TO 2011, (Reports by CGAP and its Partners, No. 7, 2013) [hereinafter CGAP]; see also, Neil MacFarquhar, *Banks Making Big Profits from Tiny Loans*, N.Y. TIMES, April 13, 2010, available at <http://www.nytimes.com/2010/04/14/world/14microfinance.html?pagewanted=all> [hereinafter *Big Profits*]; Elizabeth Rhyne, *Why Are Microfinance Rates So High?*, HUFFINGTON POST, May 28, 2011, available at http://www.huffingtonpost.com/elisabeth-rhyne/why-are-microfinance-inte_b_593359.html.

⁴⁹ TRACEY VICKERS & ELLEN ROSEN, DRIVING DOWN THE COST OF HIGH QUALITY CARE: LESSONS FROM THE ARAVIND EYECARE SYSTEM 19 (Health International, No. 11, 2011), available at <http://www.aravind.org/Downloads/draravindinterview.pdf>.

⁵⁰ *Id.*

⁵¹ *Husk Power Systems*, ACUMEN (Aug. 17, 2014),

depending on the type and size of appliance they need to power.⁵² Husk increases access to electricity in areas that are under-served by public utilities. This makes doing business easier and cheaper for enterprises that depend on a reliable supply of electricity to support their operations. Access to electricity also makes it possible for households to power necessary appliances, such as lamps that children can study under at night.⁵³ Husk also contributes to the local economy by training locals to operate the power plants and training women to make incense with the husk ash, which can then be sold to increase household income.⁵⁴ Finally, electricity is both cleaner and greener as a power source than kerosene, which is beneficial to the health of both individual users and the planet.⁵⁵

Some social businesses focus on creating and expanding employment opportunities for beneficiaries. For these entities, the social mission is job creation and workplace development. The beneficiary focus is on individuals who are at a disadvantage in the labor force due to some sort of vulnerability, such as a physical disability or a disadvantageous immigration status.⁵⁶

In the employment area, Hot Bread Kitchen (HBK) is a bakery in New York City (NYC) that recruits hard-to-employ immigrant women to make baked goods. The revenues from the sale of those goods are used to fund skill-building programs in order to help employees graduate to more senior positions in the food industry: “[HBK] combines two traditionally separate models: a social welfare model that guides its workforce development mission and a revenue generation model that guides its commercial activities.”⁵⁷ This business model is clearly inspired by worker cooperatives, where resources are pooled and redistributed among members.

<http://acumen.org/investment/husk-power-systems/>.

⁵² ASHDEN AWARDS, CASE STUDY SUMMARY: HUSK POWER SYSTEMS INDIA (2011), available at <http://www.ashden.org/files/Husk%20winner.pdf> (explaining that a basic connection supplies two 15WCFL lights and phone charging for US\$2.20 per month).

⁵³ *Id.*

⁵⁴ *Id.*

⁵⁵ *Id.*

⁵⁶ See Eldar, *infra* note 78, at 13 (referring to these social businesses as Work Integration Social Enterprises that hire disadvantaged employees who suffer from “systemic unemployment”).

⁵⁷ *Hybrid Ideal*, *supra* note 7, at 51.

Another example of an employment-focused social business is Goodwill Industries. Goodwill collects donated and used clothing, which it resells at Goodwill stores. The proceeds from the sales are used, in part, to fund job-training and placement programs for the communities serviced by any one of the 165 Goodwill agencies working across the U.S. and Canada.⁵⁸

2.2.3. Social Business 2.0: Make it Legal-ish

Certain social businesses commit to a double or triple bottom line business model through their legal structures. For example, in the U.S., companies can signal their commitment to advancing the interests of both shareholders and stakeholders—both the community that is directly served by the entity or its target beneficiaries and the environment—by incorporating as a “benefit corporation.” The first state to adopt a benefit corporation statute was Maryland, in 2010, and 30 States (including Delaware) have since followed suit.⁵⁹ Similarly, in the U.K., businesses can incorporate as Community Interest Corporations, or CICs, whose activities are “for the benefit of the community.”⁶⁰ CICs were first established as part of the Companies Act in 2004 and are overseen by a dedicated CIC Regulator.⁶¹

Benefit corporations are relatively new creatures on the corporate landscape. As a result, it is still rather early to assess their compliance with applicable rules. Nevertheless, initial studies have found that compliance with benefit corporation reporting

⁵⁸ See GOODWILL INDUSTRIES INTERNATIONAL, INC., THE GOOD BUSINESS MODEL AT GOODWILL, available at <http://www.goodwill.org/wp-content/uploads/2011/12/Goodwills-Successful-Social-Enterprise-Model.pdf> (discussing the employment-focused “social enterprise” business model of Goodwill Industries).

⁵⁹ Benefit Corp., *State by State Status of Legislation*, <http://benefitcorp.net/policymakers/state-by-state-status> (last visited Aug. 12, 2015).

⁶⁰ Matthew F. Doeringer, *Fostering Social Enterprise: A Historical and International Analysis*, 20 DUKE J. COMP. & INT'L L. 291, 313 (2010) [hereinafter Doeringer]; see also Dana Brakman Reiser, *Benefit Corporations—A Sustainable Form of Organization?*, 46 WAKE FOREST L. REV. 591, 593 (2011); Briana Cummings, *Benefit Corporations: How to Enforce a Mandate to Promote the Public Interest*, 112 COLUM. L. REV. 578, 586 (2012) [hereinafter Cummings].

⁶¹ Doeringer, *supra* note 60, at 312.

requirements is “abysmal,” at less than 10%.⁶² Perhaps because the Secretaries of State are under-resourced and still unfamiliar with the workings of benefit corporation law, there has been little or no enforcement on the government side.⁶³ Further, enforcement by stakeholders wanting to bring a claim against a benefit corporation is limited to the so-far untested device of Benefit Enforcement Proceedings. And, since automatic standing for such proceedings is given only to shareholders, directors, and owners of 5% or more of the equity in the benefit corporation’s parent company, stakeholders will likely remain “relatively helpless in enforcing their rights.”⁶⁴

As a dedicated agency that has been active for over ten years, the CIC Regulator has considerably more experience overseeing social businesses than its U.S. counterparts. In general, CIC rules are more detailed, stringent, developed, and better enforced than benefit corporation rules. We will return to them below in the discussion on improving SSE regulation—in particular, the limitations on dividends and on the transfer of CIC assets. CIC rules are also more advanced with respect to the tax treatment of CIC investments and experiments are underway to provide tax relief to CIC investors,⁶⁵ a prospect that remains distant for U.S. investors.

As concerns enforcement, the CIC Regulator has removed over three thousand CICs from its register over the course of eight years for various reasons, including failure to file accounts in a timely manner and failure to file statutory documents.⁶⁶ The CIC Regulator

⁶² Haskell Murray, *An Early Report on Benefit Reports*, 118 W. VA. L. REV. (forthcoming 2015) (manuscript at 2) (draft on file with author) (collecting benefic corporation compliance data and putting claims about heightened transparency into question).

⁶³ *Id.* (manuscript at 20) (referencing Model Benefit Corp. Legislation §§ 301(a), 305(c), which lists seven groups of stakeholders that directors must consider, including shareholders, employees, customers, community, and environment).

⁶⁴ *Id.*

⁶⁵ See Finance Act, 2014, c. 26, § 57, schs. 11 & 12 (Eng.), available at http://www.legislation.gov.uk/ukpga/2014/26/pdfs/ukpga_20140026_en.pdf (granting income tax relief to individuals who invest in social enterprises); see also CABINET OFFICE, HM REVENUE AND CUSTOMS, & HM TREASURY, GUIDANCE: SOCIAL INVESTMENT TAX RELIEF (2015), available at <https://www.gov.uk/government/publications/social-investment-tax-relief-factsheet/social-investment-tax-relief> (“Social investment tax relief (SITR) is the government’s tax relief for social investment which encourages individuals to support social enterprises and helps them access new sources of finance.”).

⁶⁶ THE OFFICE OF THE REGULATOR OF COMMUNITY INTEREST COMPANIES, CIC/14/972, ANNUAL REPORT 2013/2014, at 22-23, available at <https://www.gov>.

also provides a mechanism through which individual stakeholders (e.g. customers, community members, or employees) can file complaints against CICs.⁶⁷ It bears noting that such complaints doubled between 2013 and 2014.⁶⁸ The Regulator has the power to investigate and act on complaints that fall under its purview, for example by de-registering a CIC or mandating a wind down.

On the non-legal or voluntary end of the social regulation spectrum, businesses anywhere in the world can choose to undergo the "B Impact Assessment" created by a U.S. non-profit, B Lab, and obtain a certification as a B (for "benefit") Corporation.⁶⁹ This certification can be included on product packaging and company promotional materials. Some of the better-known B-certified businesses in the U.S. include Cabot Creamery Cooperative, Method Products, Ben and Jerry's Homemade Holdings, and Warby Parker.⁷⁰

Because certification schemes are voluntary, there is relatively little to say about legal enforcement. This should not be taken to mean that certifications have no regulatory power, however. In the case of B Corporation Certifications, companies must achieve a minimum score on the impact assessment; every two years, companies can renew their certification by undergoing the assessment again and verifying that their performance remains in line with B Lab's standards.⁷¹ If, at the two-year renewal period, a company's score falls below the required minimum, the certification will not be renewed and the company will be "de-certified."⁷² In B

uk/government/uploads/system/uploads/attachment_data/file/330648/CIC-14-972_-regulator-of-community-interest-companies-annual-report-2013-2014.pdf [hereinafter CIC ANNUAL REPORT 2013/2014].

⁶⁷ THE OFFICE OF THE REGULATOR OF COMMUNITY INTEREST COMPANIES, COMPLAINTS ABOUT COMMUNITY INTEREST COMPANIES (2009), available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/463751/09-1650-community-interest-companies-complaint-about-cics-leaflet.pdf.

⁶⁸ CIC ANNUAL REPORT 2013/2014, *supra* note 66, at 24.

⁶⁹ WHAT ARE B CORPS?, <http://www.bcorporation.net/what-are-b-corps> (last visited Feb. 28, 2015).

⁷⁰ B CORP COMMUNITY, <http://www.bcorporation.net/b-corp-community> (last visited Feb. 28, 2015).

⁷¹ B LAB PERFORMANCE REQUIREMENTS, <https://www.bcorporation.net/become-a-b-corp/how-to-become-a-b-corp/performance-requirements> (last visited Feb. 28, 2015).

⁷² Email Interview with Staff Member, Katie Holcomb, Director of Communications, B Lab (Oct. 3, 2015) (email on file with author) [hereinafter

Lab's experience, only 2-3% of B Corps have been de-certified, either due to performance or because they went out of business or just opted to leave "the community."⁷³

These figures indicate that, while there are no legal consequences attached to non-compliance, compliance with certification requirements is nevertheless high. This is not entirely surprising given that the types of entities that seek out—and pay for—a certification are typically also invested in keeping it. Still, the initial findings suggest that the prospect of reputational rather than legal liability has real regulatory power and that voluntary regimes can sometimes be more effective at regulating subscribers than official regulation.

The emergence of new corporate forms like CICs and benefit corporations is relevant for a few reasons. First, it shows the degree to which policy and lawmakers support the idea of deploying private capital and business acumen to improve social welfare. Second, these new forms highlight the importance of corporate law—both hard and soft—for the regulation of social businesses and, by extension, social finance. While this article is more focused on securities regulation, corporate law—particularly social enterprise law—is also critical for upgrading the social regulatory framework. This article draws heavily on the lessons (being) learned in the corporate arena to formulate recommendations for improving SSE regulatory performance.

Third, the CIC and benefit corporation models allow comparisons between official government approaches to regulation and other approaches, such as private certification schemes and SSEs. The juxtaposition of official and private—and voluntary—regulation is helpful for understanding how norms travel between the public and private spheres, changing both in the process. It also helps for understanding how new markets, such as the market for social impact, can become regulated through a combination of public and private rules. Indeed, social finance regulation is a natural subject for "new governance" scholars who "challenge the conventional wisdom that effective regulation should involve top-down and command-and-control rules, while rejecting a complete shift . . . toward pure market or self-regulation."⁷⁴ SSEs fit here

Interview with B Lab staff member].

⁷³ *Id.*

⁷⁴ Tamara C. Belifanti, *Shareholder Cultivation and New Governance*, DEL. J. CORP.

because they establish a private voluntary framework for regulating social businesses and investors that is very much in conversation with official regulation.

To summarize, impact investors and social businesses are not homogenous. They come in different shapes and sizes and provide a wide range of products and services. Crucially, they have different expectations of financial and social return. Though social businesses and investors share an intention to achieve both social impact and financial returns, mere intent is not enough to truly differentiate them from their conventional counterparts. Yet, if the market for social impact is to have integrity, the distinctions between social and conventional must be meaningful. Both official and voluntary regulatory regimes have an important role to play in making such distinctions real. While the promise of blending social and financial imperatives has a “beguiling charm,”⁷⁵ it is also volatile because maintaining equilibrium between the different involved interests is a delicate task. This is of particular concern when businesses are in a position to profit from the poor and generate financial returns through transactions with disadvantaged populations, as discussed below.

2.3. *The Beneficiaries*

Social finance beneficiaries are those whose lives should be improved by social businesses and impact investments. This group is comprised of a heterogeneous population of billions, residing all over the world—both in rich and poor countries.⁷⁶ In spite of the many differences in geographical location, culture, ethnicity, and race (to name a few), social finance beneficiaries share a few

L., 786, 801 (2014) [hereinafter Belifanti]; see also Kevin Kolben, *Transnational Labor Regulation and the Limits of Governance*, 12 THEORETICAL INQUIRIES IN LAW 403, 436-37 (2011) (arguing that the governance models applied to transnational labor regulation are not suitable for developing states and proposing alternatives).

⁷⁵ Cummings, *supra* note 60, at 627.

⁷⁶ See generally NEXT 4 BILLION, *supra* note 5. Even though most of the BoP literature focuses on emerging markets, similar “market opportunities” also exist at the lower end of the income spectrum in rich countries, for example, in the housing and financial sectors. See Adrian Wooldridge, *The Bottom Of The Pyramid: Businesses Are Learning To Serve The Growing Number Of Hard-Up Americans*, THE ECONOMIST, June 23, 2011, <http://www.economist.com/node/18863898> (“But even in one of the world’s richest countries the hard-up represent a huge and growing market.”).

important characteristics—including, most importantly, some form of vulnerability.⁷⁷

For our purposes, it helps to separate beneficiaries into two general categories. The first is comprised of individuals who purchase goods and services from a social business or who work for such a business. I refer to these individuals as Customer-Beneficiaries and Worker-Beneficiaries, respectively.⁷⁸ The second category is comprised of individuals who simply receive social goods and services (for free) through initiatives that make innovative use of the capital markets to finance social goods and services (e.g. vaccinations⁷⁹ and pre-release programs for prisoners⁸⁰). I refer to these individuals as Pure-Beneficiaries. This article is primarily concerned with the beneficiaries that fall under the first category, meaning those who transact with market-based providers to access social goods and services.

In developing countries, this demographic is targeted by the “BoP proposition,” which maintains that there are vast untapped resources at the bottom of the economic pyramid that can be profitably harnessed by selling goods and services to the poor.⁸¹ The

⁷⁷ Kirk Davidson, *Ethical Concerns at the Bottom of the Pyramid: Where CSR Meets BOP*, 2 J. INT'L BUS. ETHICS 22, 28-29 (2009).

⁷⁸ Other scholars use similar terms. See Ofer Eldar, *The Role of Social Enterprise and Hybrid Organizations* (John M. Olin Ctr. for Studies in Law, Econ., & Pub. Policy Working Paper Series, Research Paper No. 485, 2014) [hereinafter Eldar] (referring to individuals who purchase goods and services from a social enterprise or who provide input or labor to such a business as “patron-beneficiaries”).

⁷⁹ For example, the International Financing Facility for Immunizations issues government-backed bonds on capital markets to finance vaccination programs in developing countries. Bond proceeds are transferred to a public-private partnership, the GAVI Alliance, which then distributes funds to developing country governments to support national health programs. OVERVIEW, <http://www.iffim.org/about/overview/> (last visited August 17, 2015).

⁸⁰ For example, Social Finance, Inc. in the U.K. issued the first social impact bond in 2010, raising about \$8 million from 17 investors. Target beneficiaries comprise three thousand prisoners who are approaching release. Proceeds are used to fund recidivism reduction programs and investor returns are measured in proportion to the government savings brought about by lowered recidivism. SOCIAL FINANCE, INC., *A NEW TOOL FOR SCALING IMPACT: HOW SOCIAL IMPACT BONDS CAN MOBILIZE PRIVATE CAPITAL TO ADVANCE SOCIAL GOOD* (2012), at 9, available at <http://www.socialfinanceus.org/sites/socialfinanceus.org/files/small.SocialFinanceWPSingleFINAL.pdf>. N.Y.C. recently established a similar program with a city-guaranteed loan from Goldman Sachs. David W. Chen, *Goldman to Invest in City Jail Program, Profiting if Recidivism Falls Sharply*, N.Y. TIMES, Aug. 2, 2012, at A14.

⁸¹ “The poor” is technically defined as the 2.5 billion people who live on less than \$2 per day. Aneel Karnani, *Romanticizing the Poor*, STAN. SOC. INNOVATION REV.

idea is that, by meeting BoP demand, businesses can profit from developing a new consumer base and contribute to poverty alleviation.⁸² The “win-win” approach that drives the BoP proposition resonates deeply among social finance proponents who seek to mainstream the notion that businesses can do well by doing good.

There is also significant overlap between the BoP proposition and social finance in terms of how they are criticized. Specifically, Karnani cautions that “fighting poverty with business” treads on dangerous ethical ground because of problematic assumptions about poor people: “Proponents of these market solutions assume that poor people are fully capable and willing participants in free market economies” and that they are “well-informed and rational economic actors.”⁸³ In reality, he explains, “the poor lack education, information, and other economic, cultural, and social capital that would allow them to take advantage of—and shield themselves against—the vagaries of the free market.”⁸⁴ This critique highlights the vulnerability-enhancing effects of bringing the market to the BoP and vice versa. The combination of financial and non-financial poverty renders these new “consumers” relatively easy to exploit. This is aggravated by the fact that the market is unpredictable, especially when it comes to advancing non-financial objectives, like social welfare.

Beneficiaries are also vulnerable in the sense that they lack cushioning to absorb mistakes. They can’t “afford a reversal of fortune generated by a loss, economic or other” brought about by an abusive transaction: “The consequences of bad choices are bad for everyone, but even worse for the poor, who lack the resources—financial, psychological, social, and political—to compensate for their errors.”⁸⁵ It is, therefore, especially “important that inclusive

38, 38 (2009) [hereinafter Karnani].

⁸² See NEXT 4 BILLION, *supra* note 5, at 3 (“New empirical measures of [low-income consumers’] aggregate purchasing power . . . suggest significant opportunities for market-based approaches to better meet their needs”); C.K. PRAHALAD, FORTUNE AT THE BOTTOM OF THE PYRAMID: ERADICATING POVERTY THROUGH PROFITS (2004) (explaining how companies can profit from catering to the poor).

⁸³ Karnani, *supra* note 81, at 38-40.

⁸⁴ *Id.* at 40; BEYOND THE PIONEER, *supra* note 6, at 7.

⁸⁵ Ted London, *A Base-of-the-Pyramid Perspective on Poverty Alleviation* 32 (William Davidson Inst./Stephen M. Ross Sch. of Bus. at the Univ. of Mich., Working Paper No. 31, 2007).

industries should always be vigilant on the question of impact on the poor—while we have described the position of the poor as customers or producers in relation to these business models, they are also the intended beneficiaries from an impact perspective.”⁸⁶ The events in Andhra Pradesh show that poor vigilance can have tragic consequences.

As suggested above, one way to differentiate among beneficiaries is to make a distinction based on the nature of the beneficiary-social business relationship. Thus, the Customer-Beneficiary pays for social goods while the Worker-Beneficiary works for social goods. As an example of the former, consider the individual borrower of a microfinance loan. The typical micro-borrower is female and poor in both financial and non-financial terms. These characteristics tend to exclude her from access to conventional financial services and also subject her to various forms of social marginalization. She is a customer in the sense that she does not simply receive money from an MFI,⁸⁷ rather, she receives a loan that she must repay with interest—probably at a relatively high rate.⁸⁸ The social good here is access to finance, as well as, depending on the MFI, financial literacy training and other programs designed to empower borrowers to make good use of borrowed funds.⁸⁹ Micro-borrowers are one type of Customer-Beneficiary who buys a social good (e.g. credit) from a social business (e.g. an MFI).

Customer-Beneficiaries also include individuals who buy goods that are designed to affordably meet needs and improve lives. Examples of such goods include affordable housing; micro-power—electricity sold in small increments to power a single appliance; water filtration devices, which are especially in demand in poor rural areas; joint cell phone ownership schemes; “clean” cook stoves that carry health and environmental benefits; individualized packets of laundry detergent that contribute to improving health and sanitation; and other goods and services that are sold in micro-quantities or on a sliding scale like the Aravind eye surgeries. In

⁸⁶ BEYOND THE PIONEER, *supra* note 6, at 76.

⁸⁷ Eldar, *supra* note 78, at 17.

⁸⁸ CGAP, *supra* note 48; *Big Profits*, *supra* note 48.

⁸⁹ Arena, *supra* note 41, at 275-76 (describing “socially-oriented” MFIs as entities that “bundle non-financial services, typically educational or social services with financial services”).

each case, the Customer-Beneficiary must pay for the social good at issue in order to access benefits not made available through ordinary markets.

Moving to Worker-Beneficiaries, these individuals work to access the social good, which is quality employment. Consider the employees of HBK described earlier, “foreign born low income women” from non-English speaking countries.⁹⁰ These characteristics make it difficult to find employment at a conventional business. And, even if alternative employment were found, it is unlikely that it would pay a living wage or that it would afford these women the “benefits necessary to live a dignified life.”⁹¹ This explains why HBK’s founder describes the people in her target group as “the most vulnerable workers in the labor force.”⁹² In addition to a salary, HBK employees benefit from training in baking and language classes, and can also receive support for their own projects, all of which should facilitate graduating to higher paying jobs in the NYC food industry.⁹³ As indicated above, similar employment initiatives exist for people with disabilities or people coming out of prison. Worker-Beneficiaries therefore work to access social goods provided by a social business, namely, quality employment (at least a living wage with benefits, such as skill-building programs).

As this typology suggests, social finance beneficiaries are not passive in their interactions with social businesses. Rather, they are active, either as customers or as employees. While beneficiaries have power – limited as it may be – to choose the social business(es) with which they transact, it is important not to confuse choice with invulnerability. Social finance beneficiaries are identified as such precisely because they are excluded from the conventional marketplace as a result of financial or non-financial disadvantage – or a combination. This means that the social business-beneficiary dynamic is charged with vulnerability, and measures must be taken

⁹⁰ HOT BREAD KITCHEN: ABOUT US, <http://hotbreadkitchen.org/about-us/our-mission> (last visited Feb. 28, 2015).

⁹¹ Jessamyn W. Rodriguez, *72 Ways To Change the World*, EATER, <http://www.eater.com/a/72-ways-food-can-change-the-world/jessamyn-rodriguez> (last visited Feb. 28, 2015).

⁹² Jessamyn W. Rodriguez, *Now IS the Time*, HOT BREAD KITCHEN (Feb. 21, 2013), <http://hotbreadkitchen.org/now-is-the-time>.

⁹³ HOT BREAD KITCHEN: OUR MISSION, <http://hotbreadkitchen.org/about-us/our-mission> (last visited Feb. 28, 2015).

to ensure that beneficiaries are not rendered more vulnerable or exploited through their transactions. SSEs are important vehicles for designing and implementing such measures. In a future piece, I will also consider the possibilities for regulating social finance through an upgraded consumer protection framework designed to better protect the ultra-vulnerable, meaning those Pure-Beneficiaries transitioning from relying on government assistance (domestic and international) to meet basic needs to being consumers in an under-regulated market place of private providers.

Social businesses and their investors are heterogeneous, a feature that should be welcomed in so far as it leads to a more diverse—and better-funded—array of social problem-solving initiatives. But vigilance is required to ensure that commercial interests remain aligned with those of the already-vulnerable beneficiaries. These individuals occupy a precarious position within the market for social impact: They are both beneficiaries of life-improving initiatives and the source of profitability for those initiatives. While it may not be realistic to expect conventional businesses (and their investors) to make accommodations for their customers' or their employees' vulnerability, the ethical and moral imperative for social businesses to do so is very strong indeed. The risk of interest misalignment must be regulated to protect beneficiaries and, by extension, the integrity of social finance.

3. THE REGULATORY CHALLENGE: HYBRIDITY

This Part draws attention to the special hybridity feature of social finance in order to show how social finance can “go wrong,” breaking its social promise. It clarifies how the commercialization of social businesses can aggravate the risk of mission drift, which is inherent in entities that operate on double or triple bottom line business models.⁹⁴ It calls for regulating hybridity and explains why SSEs have a potentially important role to play in this regard.

⁹⁴ Tim Hindle, *Triple Bottom Line*, THE ECONOMIST (Nov. 17, 2009), <http://www.economist.com/node/14301663>.

3.1. Social-Financial Hybridity

Social finance is replete with hybridity. Some even refer to a “hybridization movement,” the essence of which is “a fundamental convergence and reconfiguration of the social and commercial sectors, from completely separate fields to a common space.”⁹⁵ As explained above, impact investors and social businesses are driven by two motives or “masters:”⁹⁶ financial sustainability/profitability and social impact. As distinct from philanthropy and public assistance, social finance is not ‘free’ in the sense that investors and social businesses expect returns consisting of some combination of financial and social gain. This duality makes impact investors and social businesses different from conventional commercial investors and corporations, respectively; it also distinguishes them from charitable foundations and non-profit organizations, respectively. Due to its hybridity, social finance does not fit neatly into existing regulatory regimes, like securities regulation or charities regulation. In this sense, it defies the regulatory expectations of lawyers who are used to being able to segregate different areas of economic activity into different regulatory schemes.

Social finance is characterized by a kind of “expectation-hybridity.” Investors expect investee social businesses to generate multiple bottom line returns. Similarly, social businesses expect that the financing they receive will be hybrid or “patient capital,”⁹⁷ meaning financing that does not chase short-term financial returns, but rather adjusts in support of the enterprise’s core social mission. In other words, social businesses expect investments to “align with their goal of creating both social and economic value.”⁹⁸ The expectations of beneficiaries are also hybrid. Social finance beneficiaries harbor the expectations of a conventional customer or employee, but also those of consumers of public or non-profit services:

⁹⁵ *Hybrid Ideal*, *supra* note 7, at 55.

⁹⁶ See John Tyler, *Negating the Legal Problem of Having “Two Masters”: A Framework for L3C Fiduciary Duties and Accountability*, 35 VT. L. REV. 117, 141 (2010) (describing the “dual purposes” of low-profit limited liability companies).

⁹⁷ ACUMEN FUND, *supra* note 10; Jacqueline Novogratz, *Making a Case for Patient Capital*, BLOOMBERG BUSINESSWEEK MAGAZINE (Oct. 10, 2011), <http://www.bloomberg.com/bw/magazine/making-a-case-for-patient-capital-10202011.html>.

⁹⁸ *Hybrid Ideal*, *supra* note 7, at 55.

Traditional businesses usually think of their consumers as customers, whereas traditional nonprofits think of their consumer base as beneficiaries. Hybrids, however, break this traditional customer-beneficiary dichotomy by providing products and services that, when consumed, produce social value. When consumption yields both revenue and social value, customers and beneficiaries may become indistinguishable.⁹⁹

Social finance is also marked by “value-hybridity.” The combination of social and financial objectives affects the definition of return on investment (“ROI”). Indeed, the very concept of value is hybrid in the social finance space. This is illustrated by Jed Emerson’s “blended value proposition,” which states that

[A]ll organizations, whether for-profit or not, create value that consists of economic, social and environmental value components – and that investors simultaneously generate all three forms of value when they provide capital to organizations. The outcome of all this activity is value creation and that value is itself non-divisible and, therefore, a blend of these three elements.¹⁰⁰

For subscribers to the blended value proposition, value is inherently hybrid, a mix of social, environmental, and financial outputs. From this perspective, corporate entities, whether for-profit or non-profit, do not produce only one or another type of value; instead, they produce all three simultaneously in greater or smaller proportion to one-another.

3.2. *Measuring Social Impact: A Complicated Proposition*

How does one measure impact or Social ROI? This question is central to the entire discourse around social finance and impact investing. To help answer it, this section provides an introduction to two tools that have been designed specifically to capture (and score) the social impact produced by social businesses: the Impact

⁹⁹ *Id.* at 53.

¹⁰⁰ Jed Emerson, *The Blended Value Proposition: Integrating Social and Financial Returns*, 45 CAL. MGMT. REV. 35, 44 (2003).

Reporting and Investment Standards (IRIS) and the Global Impact Investing Rating System (GIIRS).¹⁰¹

IRIS, a free public good, supplies a glossary of terms that equips users anywhere in the world with vocabulary for engaging in social finance activities. It provides standard definitions for terms like “full time employment,” which some businesses may claim to create (“[f]ull-time paid employees work year round and typically work 35-50 hours per week. If local definitions of full-time equivalency differ, use appropriate standard”); “low income area” which many social businesses claim to serve (“[a] geographic area (neighborhood, village, other region) where the median family income is less than 80% of the median family income of the surrounding vicinity”); or “affordable housing,” which some businesses claim to provide (“[h]ousing for which the associated financial costs are at a level that does not threaten other basic needs and represents a reasonable proportion of an individual’s overall income.”¹⁰² IRIS also provides a menu of performance metrics for different types of impact investments, such as investments in housing, agriculture, financial services, or water. For example, a housing developer might consider tracking the percentage of affordable housing units created, the number of individuals housed, or the number of new businesses created as a result of the development.¹⁰³

Businesses can select the metrics that are most relevant for their area of work, and then track their own social performance. The data could then be included in financial and social reports, or it could be used for operational purposes, to set new company policy. For instance, an MFI looking to upgrade its reporting might choose to disclose the Effective Interest Rate charged to borrowers, the number of borrowers per loan officer, or the number of loans disbursed during the reporting period.¹⁰⁴ Should these figures

¹⁰¹ IRIS: Introduction, <https://iris.thegiin.org/introduction> (last visited Feb. 28, 2015); see also Sarah Dadush, *Impact Investment Indicators: A Critical Assessment*, IN GOVERNANCE BY INDICATORS: GLOBAL POWER THROUGH QUANTIFICATION AND RANKINGS 392, 402-11 (Davis et al. eds., 2012) (evaluating the challenges of measuring social impact through tools such as the GIIRS and IRIS) [hereinafter Dadush].

¹⁰² IRIS: GLOSSARY, <https://iris.thegiin.org/glossary> (last visited Sept. 12, 2015).

¹⁰³ IRIS: GETTING STARTED WITH IRIS, <https://iris.thegiin.org/guide/getting-started-guide> (last visited Mar. 1, 2015).

¹⁰⁴ IRIS Metrics, Financial Services: Microfinance, GLOBAL IMPACT INVESTING

exceed an industry-recommended, statutory, or firm-imposed maximum, the MFI could make adjustments. The metrics could also be used by management to decide what firm-wide policies and standards to adopt, which in turn could inform firm thinking on the social mission.

Taking IRIS a step further, GIIRS serves a judgment function by aggregating IRIS-compliant data into an overall impact rating. The ratings are in the form of a star score—companies can receive one to five stars—and a percentage score, based on a maximum score achievable for a set of industry-specific questions.¹⁰⁵ GIIRS is independent of the entities it rates and the ratings are intended to reduce due diligence costs for investors. IRIS and GIIRS and other such tools¹⁰⁶ produce needed “market intelligence” by generating information about the impact investing market and about specific investment opportunities.¹⁰⁷

IRIS and GIIRS are important contributors to a process I refer to as “blueprinting.” I will explore the workings and limitations of blueprinting in depth in a future article, but some fundamentals are set out here to better frame the challenges facing SSEs. Blueprinting happens when a new market, such as the market for social finance, is created based on a template that is set by an already-existing market, such as the market for conventional finance. It explains the routine description of social finance as the social analog to

NETWORK, <https://iris.thegiin.org/metrics> (select “Financial services: Microfinance” checkbox under “Sectors of Focus”).

¹⁰⁵ GIIRS ASSESSMENT WEIGHTINGS AND STAR RATINGS, <http://giirs.nonprofitsoapbox.com/about-giirs/how-giirs-works/165> (last visited Sept. 12, 2015); see also Beth Richardson, *Sparking Impact Investing Through GIIRS*, STAN. SOC. INNOVATION REV. (Oct. 24, 2012) [hereinafter *Sparking Impact Investing*] (explaining that company ratings include (1) an overall rating; (2) an impact area rating in the fields of “Governance,” “Workers,” “Community,” and “Environment”; (3) detailed judgments on the company’s “Social or Environmental Business Model”; (4) key industry specific performance indicators; and (5) benchmarking based on the company’s geography, size and mission).

¹⁰⁶ Other social performance tools include: the Global Reporting Initiative (GRI) - Sustainability Reporting Framework; Sustainable Livelihoods (SL), Demonstrating Value (DV), and Social Return on Investment (SROI). See Global Impact Investing Rating System: Related Tools and Methods, <http://impactinvesting.marsdd.com/simt/global-impact-investing-rating-system-giirs/> (last visited Sept. 12, 2015) [hereinafter Global Impact Investing].

¹⁰⁷ Amit Bouri, *How Standards Emerge: The Role of Investor Leadership in Realizing the Potential of IRIS*, 6 INNOVATIONS 145, 146, available at http://www.thegiin.org/binary-data/RESOURCE/download_file/000/000/288-1.pdf.

conventional finance, which can be traced in the vocabulary of social finance, but also in the creation of new financial instruments and institutions for administering social finance.

Thus, conventional investments convert into impact investments in the social finance space,¹⁰⁸ and conventional bonds become “social impact bonds;”¹⁰⁹ rather than traditional for-profit corporations we now have benefit corporations and CICs; the financing for social businesses can now come from specially constituted social finance banks, such as Big Society Capital in the U.K.;¹¹⁰ and SSEs have emerged as the social counterparts of CSEs. Last but not least, the metrics developed for measuring financial performance in the conventional context, such as ROI, become Social Return on Investment (“SROI”), while IRIS is described as the social counterpart of the International Financial Reporting Standards (“IFRS”)¹¹¹ of the United States. Generally Accepted Accounting Principles, and GIIRS are described as the counterparts of S&P credit risk ratings or Morningstar investment rankings.¹¹² This systematic mimicry is deliberate and intended to attract investment through the strategic use of language, institutions, and metrics that are familiar to investors, like banks, debt instruments, and stars.¹¹³

Seen in this light, IRIS and GIIRS are designed to facilitate the conversion of conventional investors into impact investors. However, as I have explained elsewhere, these tools have serious deficiencies. Specifically, they fail actually to capture impact.¹¹⁴ Impact is defined as an improvement to a person’s life or a social outcome caused by an intervention above and beyond what is

¹⁰⁸ EMERGING ASSET CLASS, *supra* note 20.

¹⁰⁹ For a detailed explanation of Social Impact Bonds, see Deborah Burand, *Globalizing Social Finance: How Social Impact Bonds and Social Impact Performance Guarantees Can Scale Development*, 9 N.Y.U. J.L. & BUS. 447 (2013), available at http://www.nyujlb.org/wp-content/uploads/nyb_9-2_447-502_Burand.pdf.

¹¹⁰ BIG SOCIETY CAPITAL, <http://www.bigsocietycapital.com> (last visited Mar. 1, 2015).

¹¹¹ *Id.*

¹¹² Global Impact Investing, *supra* note 106.

¹¹³ Tom Stabile, *Architects of a ‘Social Investment Data Engine,’* FINANCIAL TIMES, Apr. 10, 2010; see also Margot Brandenburg & Sarah Gelfand, *Impact Reporting and Investment Standards – Comment Now!*, NEXT BILLION (Nov. 2, 2009), <http://nextbillion.net/blogpost.aspx?blogid=1585> (explaining the reporting standards for impact investing).

¹¹⁴ *Id.* at 423–24.

attributable to other factors.¹¹⁵ Thus, when it comes to assessing actual impact, the question is: What would have happened to a person who participated in a program (taking a micro-loan, for instance) if they had not done so? While this question may seem simple, drawing a causal relationship between an intervention and a social outcome is a fraught, expensive, and imprecise process; as a result, most measurement tools fall short of actually measuring impact.¹¹⁶ In balancing “the need for rigorous impact evaluation against the need for simple, cost effective ways” of measuring social impact, “[m]any impact investors . . . settle for measuring ‘activities’ or ‘outputs’ (such as the number of bednets sold) rather than running control groups to measure the ‘impact’.”¹¹⁷

IRIS and GIIRS measure proxies for impact, meaning outputs (e.g., the number of jobs created or clean cooking stoves sold or the lifespan of a water filtration device).¹¹⁸ Similarly, rather than evaluating the substantive feedback from the individuals who are supposed to benefit from the services of a social business, IRIS and GIIRS would only ask whether such feedback is sought and through which mechanisms (e.g., annual stakeholder meetings or anonymous surveys). The problem is that if information is limited to proxies, it becomes difficult to determine whether a social investment is in fact having a social impact. Conversely, it becomes difficult to determine whether a particular positive (or negative) social outcome can be attributed to a particular social investment.

As Morduch observes, rather than learning about the true impact of an intervention, readers of IRIS reports “get numbers on scale, outreach, costs, and revenues,” and proxies that are too

¹¹⁵ Syed Hashemi, *Beyond Good Intentions: Measuring the Social Performance of Microfinance Institutions*, CONSULTATIVE GROUP TO ASSIST THE POOR at 3 (May 2007), available at <https://www.cgap.org/sites/default/files/CGAP-Focus-Note-Beyond-Good-Intentions-Measuring-the-Social-Performance-of-Microfinance-Institutions-May-2007.pdf>.

¹¹⁶ Paul Brest & Kelly Born, *Unpacking the Impact in Impact Investing*, STAN. SOC. INNOVATION REV., Aug. 14, 2013 [hereinafter Brest], available at http://www.ssireview.org/articles/entry/unpacking_the_impact_in_impact_investing.

¹¹⁷ See EMERGING ASSET CLASS, *supra* note 20, at 72.

¹¹⁸ Jonathan Morduch, *Not So Fast: The Realities of Impact Investing*, AMERICAS Q., Fall 2013, at 4 available at https://wagner.nyu.edu/files/faculty/publications/Morduch_-_The_Realities_of_Impact_Investing_-_Americas_Quarterly_2011.pdf [hereinafter Morduch].

abstracted from the experience of beneficiaries to be useful.¹¹⁹ He cautions that “[i]f impact investing is to evolve as a mature development strategy, investors need to find ways to measure (and be accountable for) true net impacts.”¹²⁰ Yet, precisely because they are charged with telling an ROI story that is accessible to a wide range of investors, social performance metrics compromise on the task of telling a complete and accurate story about social impact. The proxy issue is compounded by the limited capacity of quantitative tools to measure the experience of beneficiaries in the form of greater “empowerment, tolerance, authenticity, solidarity, and caring.”¹²¹

It bears noting that the proxy problem is by no means isolated to the social finance space. Public assistance programs, international development programs, philanthropic and civil society initiatives frequently have difficulty with the question of how to properly assess the social outcomes of their work.¹²² Even in these settings, the pressure to quantify impact and to rely on (not-necessarily-reliable) metrics produces a range of perverse effects, including steering funds toward businesses and projects that “score” well, even if they don’t meaningfully improve lives. Such perversions are troubling in the social provisioning sphere, writ large; however, there is something particularly unsettling about an entire market being built on the fiction that one can treat social impact like a commodity that can be invested in, produced, exchanged, and whose “value” can be quantitatively captured.

Though the developers of IRIS and GIIRS recognize these limitations, their general response is that “the perfect is the enemy of the good” and that these tools are so vital to the growth of the impact investing market that the industry cannot afford to wait for perfection; instead, they should be put to use now and improved

¹¹⁹ *Id.*

¹²⁰ *Id.*

¹²¹ Edwards, *supra* note 29, at 542.

¹²² See generally Andrew Natsios, *The Clash of the Counter-bureaucracy and Development*, CTR. FOR GLOBAL DEV (2010), available at http://www.cgdev.org/sites/default/files/1424271_file_Natsios_Counterbureaucracy.pdf; see also Esther Duflo & Michael Kremer, *Use of Randomization in the Evaluation of Development Effectiveness* (2003), available at <http://economics.mit.edu/files/765>; KEVIN E. DAVIS, BENEDICT KINGSBURY & SALLY ENGLE MERRY, *Introduction: Global Governance by Indicators*, in GOVERNANCE BY INDICATORS: GLOBAL POWER THROUGH QUANTIFICATION AND RANKINGS (Davis et al. eds., 2012).

down the line with the benefit of experience.¹²³ While this response is understandable and, no doubt, well intentioned, for this author, it makes little sense to rate or assess the social impact of a business without taking the feedback from those whose lives are supposed to be positively impact-ed into account.

Admittedly, there is no easy (or cheap) solution for improving social impact metrics, especially given that the beneficiaries themselves are heterogeneous and may bring conflicting interests into play. However, as suggested in an earlier piece, one recommendation would be to supplement the quantitative proxy-based information with qualitative information that captures something closer to beneficiaries' lived experience of social finance.¹²⁴ Such information could be collected in the form of interviews with beneficiaries or through feedback mechanisms (e.g., using texting to survey beneficiaries or register complaints/compliments).¹²⁵ The information collected would, of course, need to be standardized for reporting purposes, but this process should stay true to the goal of (heavily) counting beneficiary experiences towards the assessment of social business' performance. Additionally, beneficiaries should, whenever possible, be directly involved and consulted in developing impact assessment metrics, so that it becomes clearer what positive impact looks like from their perspective, rather than that of a business or a removed third-party standard setter (e.g., B Lab, which developed GIIRS).¹²⁶ Such beneficiary-focused initiatives would paint a fuller, if not perfectly reflective, picture of the impact actually generated by impact investments.

This overview of social impact metrics shows that there are serious problems with converting tools that were built for conventional finance into tools for social finance. These limitations are evident with metrics, but they also extend beyond to include institutions like SSEs. Conventional finance is not built to accommodate social concerns to the degree demanded by social finance and its beneficiaries. Administrative institutions like SSEs

¹²³ Global Impact Investing Rating System, *Q1 2011 Progress Report: Impact Investing: Challenges and Opportunities to Scale* (2011), available at https://www.bcorporation.net/sites/all/themes/adaptivetheme/bcorp/pdfs/GIIRS_2011-Progress-Report.pdf.

¹²⁴ See Dadush, *supra* note 101, at 402-11.

¹²⁵ *Id.*

¹²⁶ *Id.*

must therefore take on the difficult task of making deep adjustments to the conventional blueprint to support a healthy market for impact.

Hybridity is multi-dimensional, pervasive, and intrinsic to social finance. It is at once the most compelling and the most dangerous feature of this new industry. Compelling because it embodies the promise of social finance, to change the way that companies do business, and make the world a better place. Dangerous because it is built upon a tense merger between two historically opposed imperatives that can clash in a way that critically compromises the anti-poverty and social development missions of impact investments.¹²⁷ Profit and social good are not natural bedfellows, and, at the risk of taking the metaphor too far, simply covering them with the same sheet does not guarantee that they will not kick each other in their sleep. As cautioned in a catalytic study on impact investing by JP Morgan, "it would be naïve to believe that these two imperatives are never in tension."¹²⁸

Some commentators go further and identify a tradeoff between the two: "Accomplishing either of these objectives makes the other more difficult to achieve, placing the dual goals in tension."¹²⁹ To illustrate the tradeoff argument, consider the example of microfinance. Recall that the interest rates charged on MFI loans are on average very high, with some in excess of 100 percent. As observed in a CGAP¹³⁰ Focus Note, "[e]ven people who favor a commercial approach to most microfinance have to scratch their heads when they see shareholders making annual returns of 100 percent on their investments, compounded for eight years running."¹³¹ Head scratching makes sense when one identifies the source of profits, namely, the poor. Simply put, when interest rates are higher than needed to cover expenses, MFI shareholders profit.

¹²⁷ Arena, *supra* note 41, at 276.

¹²⁸ EMERGING ASSET CLASS, *supra* note 20, at 67.

¹²⁹ Arena, *supra* note 41, at 274.

¹³⁰ See Richard Rosenberg, *CGAP Reflection on the Compartamos Initial Public Offering: A Case Study on Microfinance Interest Rates and Profit*, CGAP (June 2007), <https://www.cgap.org/sites/default/files/CGAP-Focus-Note-CGAP-Reflections-on-the-Compartamos-Initial-Public-Offering-A-Case-Study-on-Microfinance-Interest-Rates-and-Profits-Jun-2007.pdf> (explaining that the Consultative Group to Assist the Poor is a partnership of organizations that advances financial inclusion housed at the World Bank).

¹³¹ *Id.* at 4.

The ethical rub is that it is the micro-borrowers, or the Customer-Beneficiaries of microfinance, who pay the interest that is then converted into profit for MFI owners. The conversion of need into profit can be discomfoting, especially if revenues greatly exceed costs. Yet, it is entirely consistent with the workings of hybridity.

Social finance aims to advance the interests of both businesses and beneficiaries, but it is not difficult to imagine how the interests of businesses might be advanced at the expense of beneficiaries: “higher charges to borrowers correlate directly with higher profits captured by investors . . . there is a direct and obvious conflict between the welfare of clients and the welfare of investors.”¹³² While it may be acceptable to profit from customers in this way in a conventional commercial context, the acceptability gauge shifts in light of the promises made by social finance.

3.3. *Mission Drift and the Dangers of Commercialization*

Social-Financial hybridity is the source of mission drift, when profit seeking is prioritized over the social mission to the detriment of the latter. Mission drift can take various forms: “In pursuit of more profit, a business may be inclined to target relatively better-off customers, raise prices to take advantage of the lack of competition often encountered in underserved markets, or take cash out of the business rather than reinvest in innovation to enable even broader customer reach.”¹³³ Thus, mission drift can manifest in changes to the customer base of a social business, so that the customers who cost more to serve become sidelined, even when they formed the original target group, and even though they remain grossly underserved by conventional market providers. Alternatively, the programmatic focus of the business can shift to activities that generate greater financial revenue, rather than social benefit.¹³⁴ The

¹³² *Id.* at 10.

¹³³ EMERGING ASSET CLASS, *supra* note 20, at 67.

¹³⁴ See HOMI KHARAS & ANDREW ROGERSON, OVERSEAS DEV. INST., HORIZON 2025: CREATIVE DESTRUCTION IN THE AID INDUSTRY 20 (2012), available at <http://www.odi.org.uk/sites/odi.org.uk/files/odi-assets/publications-opinion-files/7723.pdf> (“the requirement to generate returns for private investors will skew investments towards more obviously cash-generating areas, at the expense of governments’ other developmental objectives.”).

costs of this type of mission drift are born primarily by Customer-Beneficiaries.

Mission drift can also result in revenue being deployed to increase executive compensation or investor dividends, rather than to expand access to the service or good being provided.¹³⁵ This type of mission drift affects both Customer-Beneficiaries and Worker-Beneficiaries, but can be particularly harmful to the latter. Worker-Beneficiaries employed by a social business that is drifting from its mission could, for example, see a contraction of the skills-building component of their employment, or be locked into a relatively low wage—ostensibly to subsidize capacity building programs—even when resources are available to increase salaries or benefits.

In its most acute form, mission drift can harm the very people who are supposed to benefit from social finance. This was seen in the microfinance crisis that seized the Indian state of Andhra Pradesh in 2010, sending ripples of alarm across the microfinance industry globally.¹³⁶ As explained, MFIs embody hybridity through the simultaneous pursuit of a strong social mission and a strong financial mission. Seeking to grow operations and reach more borrowers, some MFIs have embarked on a commercialization trajectory that fundamentally changes their financing structures. This means that they have seen their financing evolve from philanthropic grants to interest-bearing loans to equity investments.¹³⁷ For example, SKS, one of the largest MFIs in India, was originally founded on a mission to eradicate poverty as a non-

¹³⁵ Morduch, *supra* note 118.

¹³⁶ See CONSULTATIVE GRP. TO ASSIST THE POOR, ANDHRA PRADESH 2010: GLOBAL IMPLICATIONS OF THE CRISIS IN INDIAN MICROFINANCE 5 (2010) [hereinafter GLOBAL IMPLICATIONS], available at <https://www.cgap.org/sites/default/files/CGAP-Focus-Note-Andhra-Pradesh-2010-Global-Implications-of-the-Crisis-in-Indian-Microfinance-Nov-2010.pdf>; see also Elisabeth Rhyne, *Recalibrating Microfinance: A Six-Point Program*, CTR. FOR GLOBAL DEV. (Dec. 21, 2010), <http://www.cgdev.org/blog/recalibrating-microfinance-six-point-program> (describing the crisis in Andhra Pradesh as “the most serious challenge to the microfinance sector in its brief history” and explaining that “calls are arising to ‘recalibrate’ microfinance, or . . . to ‘get the house in order.’”).

¹³⁷ See generally RICHARD ROSENBERG, CONSULTATIVE GRP. TO ASSIST THE POOR, REFLECTIONS ON THE COMPARTAMOS INITIAL PUBLIC OFFERING: A CASE STUDY ON MICROFINANCE INTEREST RATES AND PROFITS (2007), available at <http://www.cgap.org/sites/default/files/CGAP-Focus-Note-CGAP-Reflections-on-the-Compartamos-Initial-Public-Offering-A-Case-Study-on-Microfinance-Interest-Rates-and-Profits-Jun-2007.pdf> (suggesting that Compartamos’ expansion was substantially funded by borrowers).

profit organization financed with grant money.¹³⁸ It later received loan financing from both public and private lenders, and eventually re-incorporated as a for-profit, which allowed it to bring in equity investment.¹³⁹ In 2010, SKS achieved the final milestone of commercialization by becoming a publicly listed company: It had a hugely successful Initial Public Offering (“IPO”) on the Bombay Stock Exchange in which its shares were over thirteen times oversubscribed.¹⁴⁰

At each step in the commercialization process, the pressure to prioritize profit over the social mission increases. This is particularly true if corporate control shifts to owners who are less committed to the social mission than the original owner-founders.¹⁴¹ In the case of SKS, commercialization led to a re-prioritizing of the MFI’s objectives, with growth becoming paramount. In the lead-up to the IPO, SKS management endeavored to increase profit in order to drive up the value of its soon-to-be-public shares. Lending was quickly and significantly expanded, in part by cutting corners on the due diligence processes for screening borrowers. Loosening the due diligence standards led to a practice of over-lending to individuals who could not afford to service their debt. Arena describes this as the “debt trap” form of mission drift, where “the drive to achieve large volumes of loans (ensuring high aggregate returns) leads the MFI to extend loans unethically or irresponsibly to clients who cannot actually afford them.”¹⁴²

Added to this, when borrowers (unsurprisingly) defaulted on loan payments, SKS’s loan officers, whose salaries and commissions were tied to the volume and performance of their loans,¹⁴³

¹³⁸ FAQ’s, SKS MICROFINANCE, <http://www.sksindia.com/faq.php> (last visited Aug. 17, 2014).

¹³⁹ Vikash Kumar & Daniel Rozas, *SKS Microfinance Journey to IPO: An Inside Story*, DANIEL ROZAS, MICRO OPUS (May 12, 2010), <http://www.danielrozas.com/2010/05/12/exclusive-sks-microfinance-journey-to-ipo-an-inside-story/>.

¹⁴⁰ *Id.*

¹⁴¹ Cummings, *supra* note 60, at 589; see also *Hybrid Ideal*, *supra* note 7, at 54.

¹⁴² Arena, *supra* note 41, at 276. See also, Chrystin Ondersma, *A Human Rights Approach to Consumer Credit*, TUL. L. REV. (forthcoming) (analyzing how lending practices that lead to over-indebtedness affect the protection of human rights).

¹⁴³ GLOBAL IMPLICATIONS, *supra* note 136, at 5 (describing “cascading incentives” resulting from over-emphasis on MFI growth from top to middle management to front line loan officers and driving “behavior that distorts basic good banking principles” including “unhealthy rises in loan amounts, cutting corners in the underwriting process, and resulting in an excessive supply of credit. Incentives at the field level are often based solely on disbursements and collection

reportedly employed coercive debt collection practices to shame defaulting borrowers into paying.¹⁴⁴ The combination of over-lending, inability to repay, and shaming practices—which was not unique to SKS—has been blamed for a tragic wave of borrower suicides in 2010.¹⁴⁵ The chairman of India's Microfinance Institutions Network reacted, saying that “multiple lending, over-indebtedness, coercive recovery practices and unseemly enrichment by promoters and senior executives [of micro-credit companies] has led to this situation.”¹⁴⁶

The events in Andhra Pradesh provide an alarming illustration of the effects that mission drift and commercialization can have on social businesses that transact with the poor.¹⁴⁷ In an ironic twist, it is precisely when social businesses become successful enough to commercialize that mission drift can creep in and create cracks in the social goods supply chain through which beneficiaries can slip. Indeed, episodes such as the one in Andhra Pradesh give flesh to the concern that entities that serve marginalized populations can lose

volumes, with insufficient incentives for sound underwriting and customer care.”).

¹⁴⁴ Justin Oliver, *Who's the Culprit? Accessing Finance in Andhra Pradesh*, CONSULTATIVE GRP. TO ASSIST THE POOR (Nov. 11, 2010), <http://www.cgap.org/blog/who%E2%80%99s-culprit-accessing-finance-andhra-pradesh>.

¹⁴⁵ *Id.*; see also Erika Kinetz, *AP IMPACT: Lender's Own Probe Links It To Suicides*, YAHOO FINANCE, Feb. 24, 2012, <http://finance.yahoo.com/news/ap-impact-lenders-own-probe-080122405.html> (explaining that the implicated MFIs denied any responsibility for the suicides before the Indian Supreme Court, refuting allegations that employees “verbally harassed over-indebted borrowers, forced them to pawn valuable items, incited other borrowers to humiliate them and orchestrated sit-ins outside their homes to publicly shame them Only in death would the debts be forgiven.”); Elizabeth Rhyne, *On Microfinance: Who's to Blame for the Crisis in Andhra Pradesh?*, HUFFINGTON POST, Nov. 2, 2010, http://www.huffingtonpost.com/elisabeth-rhyne/on-microfinance-whos-to-b_b_777911.html; Neha Thirani, *'Yunus Was Right,' SKS Microfinance Founder Says*, N.Y. TIMES, Feb. 27, 2012, http://india.blogs.nytimes.com/2012/02/27/yunus-was-right-sks-microfinance-founder-says/?_r=1; Associated Press, *Hundreds of Suicides in India Linked to Microfinance Organizations*, BUSINESS INSIDER, Feb. 24, 2012, <http://www.businessinsider.com/hundreds-of-suicides-in-india-linked-to-microfinance-organizations-2012-2>; Soutik Biswas, *India's Micro-Finance Suicide Epidemic*, BBC NEWS, Dec. 16, 2010, <http://www.bbc.co.uk/news/world-south-asia-11997571> [hereinafter *Suicide Epidemic*].

¹⁴⁶ *Suicide Epidemic*, *supra* note 145.

¹⁴⁷ Arena, *supra* note 41, at 273 (observing that in the face of commercial pressure, MFIs are forced to “pick a side: either abandon their social orientation and formalize into a regular financial institution or forgo financial self-sustainability and remain a subsidy-dependent NGO.”).

sight of their social mission when competing commercial interests come into play.¹⁴⁸

In early 2011, Nobel Peace Prize winner Muhammad Yunus, the celebrated microfinance pioneer, wrote an op-ed for the New York Times:

I never imagined that one day microcredit would give rise to its own breed of loan sharks. But it has. And as a result, many borrowers in India have been defaulting on their microloans, which could then result in lenders being driven out of business. India's crisis points to a clear need to get microcredit back on track.¹⁴⁹

Yunus blames the turn of microfinance away from the interests of the poor on commercialization: "Commercialization has been a terrible wrong turn for microfinance, and it indicates a worrying 'mission drift' in the motivation of those lending to the poor. Poverty should be eradicated, not seen as a money-making opportunity."¹⁵⁰

Yunus opposed the SKS IPO, voicing the concern that for-profit MFIs would inevitably engage in predatory lending practices, "one of the very things which microfinance ought to protect the poor against."¹⁵¹ This critique hits at the heart of the concern with adopting market-based solutions to solve social problems. Indeed, SKS's drastic departure from its social mission led "many observers to question whether social problems . . . can be solved through strategies that also produce revenue."¹⁵² Yunus's view is that "[y]ou will never see the situation of poor people if you look at it through the glasses of profit-making."¹⁵³ As explained above, the ramifications of mission drift are amplified when individuals living at the BoP are affected, precisely because their financial cushion is

¹⁴⁸ *Id.*

¹⁴⁹ Muhammad Yunus, *Sacrificing Microcredit for Megaprofits*, N.Y. TIMES, Jan. 14, 2011, <http://www.nytimes.com/2011/01/15/opinion/15yunus.html?ref=microfinance>.

¹⁵⁰ Jesse R. Gero, *Financing Social Enterprise, Realizing Political Equality: How the Consumer-Beneficiary Model of Social Enterprise Secures Beneficiary Participation and Why We Should Care*, 9 N.Y.U. J. L. & BUS. 617, 623 (2013).

¹⁵¹ *Id.* at 662.

¹⁵² *Hybrid Ideal*, *supra* note 7, at 52.

¹⁵³ *Big Profits*, *supra* note 48.

so thin: “the consequences of a business exploiting its customers can be particularly devastating, given how little they have.”¹⁵⁴

Given that microfinance is among the more established strands of social finance, it is not surprising that it is also among the first to materialize this particular type of market failure. As Jonathan Morduch warns, we must learn from India’s microfinance experience and mitigate the risks of social harm that come with commercialization:

The investors surely had good intentions and social commitments, but balance was lost. There’s often good reason to think that impact investments can bring a world of good, but it’s dangerous to ignore the flip side of the coin. There are times when investors can help turn something good into something risky for customers, as in India.¹⁵⁵

To summarize, mission drift is a product of the tensions involved with hybridity, tensions that are aggravated by commercialization. When mission drift occurs, the social gets squeezed out of social finance. Clearly, therefore, hybridity must be regulated. This is a complex project for both public and private regulators to undertake, but a necessary one given the vulnerability of social finance beneficiaries.¹⁵⁶ Hybridity constitutes a pressing regulatory challenge. It is morally pressing because it creates opportunities for exploitation and abuse under the guise of promoting market-based solutions to improve lives. It is also pressing time-wise because social finance is still in the market building stage. This means that whatever definitions, standards, rules, and enforcement mechanisms are developed today will fundamentally shape this fast-growing space for years to come. Such norms can quickly become entrenched and difficult to change. SSEs are well positioned to play a significant role in this norm-setting process. The next Parts consider how effective SSEs, as currently designed, are likely to be in performing this important regulatory function.

¹⁵⁴ EMERGING ASSET CLASS, *supra* note 20, at 68.

¹⁵⁵ Morduch, *supra* note 118, at 5.

¹⁵⁶ See Kevin E. Davis & Anna Gelpern, *Peer to Peer Financing for Development: Regulating the Intermediaries*, 43 N.Y.U. J. INT’L L. & POL. 1209, 1227 (2010) [hereinafter Davis & Gelpern] (identifying hybridity as a regulatory challenge).

4. SSEs AS REGULATORS¹⁵⁷

Today, social finance, and more specifically, the investors and businesses operating within this space, are generally under-regulated. In practical terms, this means that we lack regulatory tools for effectively differentiating social impact investors or social businesses from their respective conventional counterparts in a systematic or consistent way. Yet, unless these differences are drawn in a meaningful and workable fashion, there is little reason to expect that social finance will amount to much beyond an esthetic enhancement of the existing business and finance landscapes. In the worst case, social finance could actually make a negative contribution to social welfare. Significant rulemaking needs to take place for this regulatory vacuum to be filled.

As platforms for connecting impact investors, social businesses, and, less directly, beneficiaries, SSEs are well positioned to take on at least some of this work. Though still in their infancy, SSEs are useful to study for three main reasons: First, a central function of SSEs is to help social businesses commercialize their financing so that they can scale up operations and break their dependency on grant funding. As explained in the last Part, this launches SSEs into troubled waters, where the risk of mission drift is most acute. Tracking the development of SSE “law” with respect to mission drift can help to identify mechanisms for regulating hybridity and commercializing social solutions in a way that is safe and sustainable.

Second, SSEs ostensibly do the actual work of differentiating social from conventional finance by creating a separate marketplace for impact investments. SSEs can achieve this by developing specific listing criteria for social businesses wishing to transact on their platform; establishing requirements with which listed businesses must comply in order to stay listed, such as the production of financial and social reports; formulating and implementing rules and standards to govern social finance transactions, such as requiring a minimum investment duration, for example; putting in place investor-screens to ensure that the “right” kinds of investors access the platform; and, last but not least, setting up the

¹⁵⁷ This title is inspired by Paul Mahoney’s piece, *The Exchange As Regulator*, 83 VA. L. REV. 1453 (1997).

mechanisms for enforcing all of these rules, such as clear de-listing conditions and accessible grievance mechanisms. All of this rulemaking work can make a huge contribution to the crucial regulatory project of concretely differentiating the social finance space from its conventional counterpart.

Even if SSEs never become major players in international capital markets or never manage to transform impact investing into a mainstream type of investment, the rules and norms that they release into the world matter for understanding how to go about regulating social finance. Furthermore, by providing a venue for social businesses and investors to “meet,” SSEs not only create but also structure the relationships between these stakeholders, and, less directly but no less importantly, the beneficiaries. From a regulatory perspective, this means that SSEs could create important lines of accountability between the key social finance stakeholders – another big contribution to the regulatory project.

Third, SSEs are self-regulated to the extent that the rules they create and implement among their members – listed businesses and investors – are not being “fed” to them by an official government regulator. This is particularly true of the SSE-developed rules pertaining to social impact securities, since regulations already exist for conventional securities. We can therefore expect that SSE accountability will largely come from the social finance market itself, meaning the existing and potential users of the platforms. Because their survival depends on market appeal, SSEs can help us to better grasp the opportunities and limitations of self-regulation. More specifically, the study of SSEs allows us to see what can be done with the opportunity to design and curate rules for administering a new market, and how that opportunity might be constrained by that very market and the interests operating within it. This process should be of particular interest to lawyers who want to understand how rules can make (or not) a positive difference in the world.

4.1. Transnational Rulemaking Laboratories

Just as CSEs did for conventional finance, SSEs are well positioned to adopt and develop rules and standards for regulating social finance. Historically, securities regulation was an entirely

private affair managed by self-regulated stock exchanges. Stock exchanges were themselves conceived as private bodies or clubs.¹⁵⁸ For example, the London Stock Exchange traces its roots back to the bowels of a coffee shop called Jonathan's Coffee House in the 18th century.¹⁵⁹ Jonathan's was transformed into a private trading club that regulated membership, access to the physical premises, and the transactions in which members engaged.¹⁶⁰ Today, the securities field retains a strong self-regulating dimension, even though government is much more involved.¹⁶¹

In the U.S., for example, the Securities and Exchange Commission ("SEC"), the agency charged with enforcing federal securities law, delegates many regulatory responsibilities to self-regulating organizations ("SROs"). SROs are private institutions that establish, monitor compliance with, and enforce rules applicable to securities markets and the conduct of market participants.¹⁶² They include exchanges like the New York Stock Exchange ("NYSE") and NASDAQ. The Securities Act of 1934 requires that the SEC recognizes SROs and that SROs "regulate their members with both their own rules and federal securities laws."¹⁶³ In the U.S., as in many other jurisdictions, CSEs are responsible for developing and ensuring compliance with exchange-specific rules, as well as with public legislation.¹⁶⁴ Thus, exchanges have significant rulemaking power and discretion, particularly for new or specialized markets.

¹⁵⁸ *Id.*, at 1483.

¹⁵⁹ *Id.*

¹⁶⁰ *Id.*

¹⁶¹ See Edward Peter Stringham & Ivan Chen, *The Alternative of Private Regulation: The London Stock Exchange's Alternative Investment Market As A Model* 39 (George Mason Univ., Mercatus Ctr., Working Paper No. 12-30, 2012) (explaining that private exchanges were the sole rule-makers for securities regulation and that they were privately regulated in the U.K. until 1986); see also John Carson, *Self-Regulation in Securities Markets* (The World Bank, Policy Research Working Paper No. 5542, 2011), http://siteresources.worldbank.org/FINANCIALSECTOR/Resources/WPS5542_Self_Regulation_in_Securities_Markets.pdf [hereinafter Carson]; Adam C. Pritchard, *Self-Regulation and Securities Markets* 32-39 (Univ. of Mich. Ctr. For Law and Econ., Working Paper No. 02-008, 2003), <http://www.law.umich.edu/centersandprograms/olin/papers.htm> [hereinafter Pritchard].

¹⁶² Carson, *supra* note 161, at 5.

¹⁶³ *Id.* at 6.

¹⁶⁴ *Id.*

This background explains why SSEs can expect to enjoy independence as rule-makers for social finance, in particular when it comes to developing rules to regulate social-financial hybridity. Today, securities regulation is not granular enough to properly address the distinctive hybridity-related requirements of social finance. SSEs can therefore be described as operating like “rulemaking laboratories” that develop and test regulations for an under-governed space. They are poised to follow in CSEs’ regulatory footsteps and do the regulatory legwork of formulating, mainstreaming, and implementing rules and standards for social finance. Though SSE law will initially be limited in application to SSE members and invite only voluntary compliance, this could change as it did when CSE-developed rules became formalized as official, publicly enforceable, securities regulation.

SSEs can be described as “transnational” rulemaking laboratories because they develop norms that exceed the legal jurisdictions for which they were developed.¹⁶⁵ For example, the SVX model is currently being replicated outside of Canada, in the U.S. and in Mexico.¹⁶⁶ SSEs also keep track of each other’s progress and experience.¹⁶⁷ Thus, the lessons learned and practices developed by the U.K.’s SSX could influence those adopted by the Singapore-Mauritius IX, for example. Furthermore, as suggested just above, the dissemination of SSE law isn’t limited to SSEs or even to private actors. Indeed, the standards adopted by SVX, which is based in Canada’s Ontario Province, could influence government regulators at the provincial and the national level. In fact, SVX is

¹⁶⁵ See Greg Shaffer, *Transnational Legal Ordering and State Change*, in *TRANSNATIONAL LEGAL ORDERING AND STATE CHANGE*, (Ed. Gregory Shaffer, 2013) (explaining that “the concept of transnational law has been developed to address legal norms that do not clearly fall within traditional conceptions of national and international law but are not necessarily global in nature,” and highlighting the limitations of state-centric theories of public and private international law as compared with the concept of “transnational legal orders” for capturing the processes underlying the “construction, flow, and impact of transnational legal norms”); see also Benedict Kingsbury, Nico Kirsch and Richard Stewart, *The Emergence of Global Administrative Law*, 68 *LAW & CONTEMP. PROBS.* 15 (2005) (developing a framework for understanding the formation and administration of transnational orders that shape and are shaped by the conduct of state and non-state actors).

¹⁶⁶ Adam Spence, *SVX Scaling Social Innovation Across Borders*, (Nov. 18, 2014), <http://socialfinance.ca/2014/11/18/svx-scaling-social-innovation-across-borders/>.

¹⁶⁷ Interview with Adam Spence, SVX Founder, (July 24, 2015).

working to carve out an exception under Ontario securities law to allow non-accredited investors to transact on its platform.¹⁶⁸

SSE rulemaking could also inform the content of public law in other countries where regulators have been tasked with upgrading social enterprise or social disclosure laws, for example. It is not difficult to imagine a “transplant”¹⁶⁹ of the SSE legal ordering framework to a developing country whose social businesses are listed on the Singapore-Mauritius IX in East Asia and Africa, for example, as these countries may lack resources to develop new law. Indeed, an important distinction between private regulation and official regulation is that the former are not limited to a particular legal jurisdiction. This can be advantageous, especially when it comes to shaping and governing new markets.

While SSEs may have discretion to develop rules pertaining to the social dimension of social finance, they and the businesses they list must nevertheless comply with applicable securities regulation and corporate law. In other words, even though SSEs are private platforms with significant rulemaking powers, they are not themselves completely unregulated. SSE platforms must comply with applicable securities laws, in other words. Coming back to the SVX example, to date, non-accredited investors as defined under Ontario securities law are not allowed to transact on that platform; this restriction is imposed by law, not SVX. Similarly, in order to list, companies must show that they are in compliance with applicable securities laws and that they are in good corporate standing.

SSEs can be described as transnational rulemaking laboratories because the law they produce can travel within the social finance market and across borders to reach both public and private rule-makers. And, as in the earlier discussion concerning the formalization of new corporate forms and private certification schemes, it is important not to confuse the private and voluntary features of self-regulation and the absence of legal enforcement with

¹⁶⁸ Spence, *supra* note 166.

¹⁶⁹ See generally KATHARINA PISTOR & PHILIP WELLONS, *THE ROLE OF LAW AND LEGAL INSTITUTIONS IN ASIAN ECONOMIC DEVELOPMENT: 1960-1995*, 47 (1999); Katharina Pistor, Yoram Keinan, Jan Kleinheisterkamp & Mark D. West, *The Evolution of Corporate Law: A Cross-Country Comparison*, 23 U.P.A.J. INT'L ECON.L. 791, 794-95 (2002); JOHN BRAITHWAITE & PETER DRAHOS, Chapter 25: *Modelling, Globalization and the Politics of Empowerment*, in *GLOBAL BUSINESS REGULATION*, 578-602 (2000).

lack of regulatory power. The history of securities regulation demonstrates that government takes many of its regulatory cues from private rule-makers, particularly when dealing with new markets.¹⁷⁰ It also demonstrates that private actors have strong incentives to comply with rules that enable them to do business more efficiently, even when those rules are not officially enforceable. In other words, when the benefits of voluntary compliance exceed the costs—which can include market exclusion—private ordering regimes can be just as effective as official regulation.¹⁷¹

4.2. *Regulating Through Stock Exchanges: Why the Why Matters*

CSEs rely on three main devices to administer financial regulation: listing requirements, corporate governance and disclosure requirements, and enforcement or de-listing mechanisms.¹⁷² All of these devices apply to CSE issuers and are designed to protect the interests of investors by correcting information asymmetries in order to prevent fraud, better inform investor decision-making, and promote competition.¹⁷³ They are each replicated by SSEs, as described below. A central argument here is that, while some replication is necessary and desirable, SSEs must carefully tailor the devices they employ to effectively regulate against mission drift and protect beneficiary interests. If they are to meet the hybridity challenge, in other words, SSEs will need to adjust and devise new mechanisms that are especially designed to mitigate the risks of mission drift and to take into account the needs

¹⁷⁰ See generally WALTER MATLLI & TIM BUTHE, *THE NEW GLOBAL RULERS: THE PRIVATIZATION OF REGULATION IN THE WORLD ECONOMY* (2011) (providing a detailed account of the adoption of private rules for financial reporting by public bodies); see also Claire Kelley & Roberta Karmell, *The Hardening of Soft Law in Securities Regulation*, 34 *BROOK. J. INT'L L.* 883, 884-85 (2009) (explaining how U.S. securities laws are shaped by private standards and rules).

¹⁷¹ See Carson, *supra* note 161, at 9 (explaining that while exchange membership may be voluntary, as a practical matter, it is “essential to carry on securities business”); see also Davis & Gelpert, *supra* note 156, at 1255-57 and 1265-66 (describing the virtues and limitations of private ordering).

¹⁷² Hans Christiansen & Alissa Kolderstova, *The Role of Stock Exchanges in Corporate Governance*, *OECD JOURNAL: FINANCIAL MARKET TRENDS*, 4 (2008).

¹⁷³ See generally Stephen Choi, *Law, Finance, and Path Dependence: Developing Strong Securities Markets*, 80 *TEX. L. REV.* 1657, 1694-95 (2001-2002).

and vulnerabilities of Customer-Beneficiaries and Worker-Beneficiaries.

This means that it will not be sufficient for SSEs simply to “blueprint” the CSE regulatory model.¹⁷⁴ Instead, to create a truly social stock exchange, SSEs must take every opportunity to adjust the CSE blueprint and to inject it with beneficiary protections. It is on this basis that SSE success should be evaluated. Drawing new investors and capital into the social problem-solving space is of course an important mark of SSE success, as well. However, unless beneficiary interests feature centrally in the legal order that SSEs establish, these new regulators will have only partially succeeded in truly differentiating social from conventional finance.

Securities regulation in conventional markets is intended to protect the interests of investors above all and this requires trust. As Pritchard observes,

[s]ecurities markets cannot operate without trust. Investors can trust in exchanges to regulate because of their powerful incentive to maximize trading volume. The many choices that investors have today remind exchanges that investor protection is a crucial part of their business. Investors will leave markets that fail to protect investors to find markets that will.¹⁷⁵

The beneficiaries of CSE regulation and conventional securities regulation are the investors. While a well-functioning market is considered a “public good,” the actual public, meaning the investment-affected communities, are distant secondary beneficiaries of securities regulation as compared with investors.¹⁷⁶

¹⁷⁴ The International Securities Commissions Organization (IOSCO) explains that “[t]he broad objectives of self-regulation are the same as those identified for government regulation of financial markets . . . to preserve market integrity . . . to preserve financial integrity . . . and to protect investors.” IOSCO SRO CONSULTATIVE COMMITTEE, MODEL FOR EFFECTIVE SELF-REGULATION, at 2 (2000), available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD110.pdf>. Accordingly, the SEC’s stated mission is “to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation.” *The Investors Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation*, U.S. SECURITIES AND EXCHANGE COMMISSION (June 10, 2013), <http://www.sec.gov/about/whatwedo.shtml#VNpxVFXF9so>.

¹⁷⁵ Pritchard, *supra* note 161, at 39.

¹⁷⁶ IOSCO Technical Committee, Issues Paper on Exchange Demutualization, at 4, 10 (2000), available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD119.pdf>; see also IOSCO TECHNICAL COMMITTEE, CONSULTATION REPORT:

In the conventional context, investors are the consumers, not the subjects of regulation, which explains why very few rules govern investor conduct. The “why” of SSEs—to create platforms for improving lives and the health of the planet—is fundamentally different from the why of CSEs, and that difference should feature centrally in SSE design. An important measure of SSE regulatory success will therefore be how well their rules protect that social difference, or how well they protect the interests of beneficiaries, alongside those of investors.

5. THREE NEW KIDS ON THE REGULATORY BLOCK: SSX, SVX, AND IX

The three SSEs discussed in this sub-section are still very new, having emerged only in 2013. This review is therefore necessarily preliminary, as these platforms are likely to evolve substantially in the next few years. Some key features can nevertheless be identified and initial assessments are made concerning the likelihood of regulatory success. For each SSE, we report on the purpose or mission of the platform, its regulatory status, the devices employed to regulate social business issuers (listing requirements, reporting and corporate governance requirements, and enforcement mechanisms), and any devices employed to regulate investors.

At the outset, it bears noting that none of these platforms is yet trading in impact securities *per se*. Though it calls itself an SSE, the U.K.’s SSX is an information portal that provides investors with details about the social impact of businesses that are listed on conventional exchanges. SVX in Canada is a private placement platform that connects investors with social businesses and enables them to transact, but as yet there is no secondary market for trading in the resulting impact securities. Finally, the Impact Exchange (IX) of Mauritius (designed in Singapore) is most similar to a CSE in that it will eventually be possible for social businesses to sell shares on

REGULATORY ISSUES ARISING FROM EXCHANGE EVOLUTION, at 6 (2006), available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD212.pdf> (“The fair and efficient functioning of an exchange is of significant benefit to the public. The efficiency of the secondary market . . . facilitates efficient raising of capital for commercial enterprises, benefiting both the wider corporate sector and the economy as a whole.”).

the exchange, and for those shares to be traded on the secondary market, but this has yet to happen.

5.1. *The Social Stock Exchange (SSX), United Kingdom*

5.1.1. *The mission*

On June 6, 2013, U.K. Prime Minister David Cameron announced the launch of the SSX during the Social Impact Investment Forum, which was held just prior to the G8 summit:

We need a robust way of . . . connecting businesses that deliver social and environmental value with investors seeking both a social and a financial return. So I am absolutely delighted that today the London Stock Exchange is supporting the launch of the world's first Social Stock Exchange, an online portal that will become the first information platform on the planet to showcase publicly listed social impact businesses.¹⁷⁷

SSX seeks to increase the visibility of social businesses among the investment community and “to create an efficient, universally accessible buyers’ and sellers’ marketplace where impact investors and social impact businesses of all sizes can achieve greater impact either through capital allocation or capital raising.”¹⁷⁸ It further intends to “bridge the gap between the increasing desire of businesses to make a difference alongside making a profit, and those investors who share this vision and have the means to enable it to be fulfilled.”¹⁷⁹ SSX’s mission reveals a clear emphasis on capital raising and drawing investors into the social finance space.

¹⁷⁷ Cameron Speech *supra* note 1; see also FAQs, SOCIAL STOCK EXCHANGE, <http://www.socialstockexchange.com/faqs> (last visited Mar. 2, 2015); Troilo, *supra* note 36.

¹⁷⁸ *Our Mission*, SOCIAL STOCK EXCHANGE, <http://socialstockexchange.com/our-mission-history/>.

¹⁷⁹ *Id.*

When it comes to marketing itself to potential members, SSX mentions the following advantages:

Your company will be identified as a leading organisation delivering social or environmental impact through core business activities. Your company will be able to capitalise on the growing momentum around social impact investment. The core social and environmental aims of your business will become more transparent and visible, and ultimately more quantifiable and rewarded. You will benefit from a wide range of targeted marketing and communication programmes aimed at impact investors.¹⁸⁰

To fulfill its mission, SSX must address some of the problems that impair the growth of social finance, in particular the “lack of consistent data and regulation, the need for mission-oriented businesses to gain greater visibility, and a scarcity of mature enterprises to absorb available capital from interested impact investors, all of which lead to low investor confidence.”¹⁸¹ SSX can therefore be described as performing a two-pronged regulatory function: To create a rules-based, informationally rich and transparent platform that can draw investors into the social finance space and stimulate social business activity, and, as a necessary corollary, build up investor trust.

5.1.2. *Trading and official oversight*

SSX is not an actual trading platform. It is more accurately described as an information portal that investors can access to learn about impact investing opportunities: It “does not facilitate share trading but serves as a directory and research service for would-be social impact investors.”¹⁸² The companies listed on SSX must

¹⁸⁰ *Become a Member*, SOCIAL STOCK EXCHANGE, <http://socialstockexchange.com/become-a-member/> (last visited Mar. 2, 2015).

¹⁸¹ Evan Weaver, *Marrying cash and change: Social ‘stock markets’ spread worldwide*, THE CHRISTIAN SCI. MONITOR (Aug. 30, 2012), <http://www.csmonitor.com/World/Making-a-difference/Change-Agent/2012/0830/Marrying-cash-and-change-Social-stock-markets-spread-worldwide> [hereinafter Weaver].

¹⁸² Vanessa Kortekaas & Ruth Sullivan *U.K.’s, Social Stock Exchange Set to Include International Members*, FIN. TIMES (Aug. 30, 2013) [hereinafter Kortekaas &

already be publicly traded companies on a CSE and therefore trade in whatever securities are permitted under their CSE's rules. The SSX is therefore "not for start-ups - it's for more mature companies that need to raise significant amounts of money for growth and expansion."¹⁸³

Currently, the SSX lists 14 social impact businesses working in diverse areas: One company manufactures and licenses environmentally sustainable building materials; another is a developer of affordable housing that supports community health and social care services in the U.K.; another specializes in healthcare property and ensuring compliance with the recently enacted Health and Social Care Act; yet another, headquartered in the U.S. specializes in water purification technologies that are sold through partner distribution companies in the Asia Pacific region, Central and South America, and in the U.S. About 14 more companies are currently under review for admission by the members of the SSX Admissions Panel.

The SSX is open to companies headquartered outside the U.K., meaning that issuers can be incorporated in any jurisdiction, so long as they qualify to list on the SSE. As concerns official oversight, while SSX is supported by the London Stock Exchange, it is no part of the exchange. The SSX is a standalone non-profit entity that is not regulated by an official body. However, since businesses that list on the SSX must also be listed on a CSE, they will be subject to the rules of that CSE, including the CSE's home-state legislation. As discussed above, CSE rules pertain to conventional securities regulation, which is focused on financial performance. As concerns social performance, SSX has broad rulemaking powers, and businesses must comply with SSX rules if they wish to list and stay listed.

5.1.3. *Regulating social businesses*

5.1.3.1. *Listing and governance requirements*

Sullivan].

¹⁸³ Weaver, *supra* note 181; see generally *Future Plans*, SOCIAL STOCK EXCHANGE, <http://socialstockexchange.com/future-plans/> (last visited Mar. 2, 2015).

As mentioned above, in order to be listed on the SSX, companies must already be listed on an SSX-approved CSE.¹⁸⁴ Thus, only for-profit companies can list on the SSX. This is the first eligibility criterion. The second is that the company must have “social or environmental impact as a core aim” (emphasis added – the mission does not have to be the core aim).¹⁸⁵ To satisfy this requirement, companies must submit a Social Impact Report for review by the independent Admissions Panel composed of 11 finance and impact-investing experts. The Report must be drafted with the assistance of an approved, independent impact analyst.¹⁸⁶ If the application is accepted, the company must pay an annual listing fee of £10, 000, unless waived.¹⁸⁷

As concerns corporate governance, applicants must commit to “transparency and disclosure around such issues as remuneration, tax and ownership, as well as key activities such as arms sales, pornography, bonded labour, child labour, tobacco, abuse of human rights or discriminatory employment practices.”¹⁸⁸ Applicants must also disclose “any other reputational reason why your company should be admitted to the SSX.”¹⁸⁹ Presumably this includes disclosure of pending or prospective lawsuits. While the SSX application requires applicants to affirm that they adhere to the UK Corporate Governance Guidelines, the latter contain no specific requirements concerning social corporate governance. The focus is almost entirely financial. For example, the Guidelines recommend only that “[t]he board and its committees should have the appropriate balance of skills, experience, independence and knowledge of the company to enable them to discharge their respective duties and responsibilities effectively.”¹⁹⁰ These are

¹⁸⁴ SSX APPLICATION FORM, <http://socialstockexchange.com/membership/business-register-part-3/> [hereinafter SSX APPLICATION FORM].

¹⁸⁵ *Become a Member*, SOCIAL STOCK EXCHANGE, <http://socialstockexchange.com/become-member> (last visited Mar. 2, 2015) [hereinafter *Become a Member*].

¹⁸⁶ *Id.*

¹⁸⁷ Kortekaas & Sullivan, *supra* note 182; see also SSX APPLICATION FORM, *supra* note 184.

¹⁸⁸ SSX APPLICATION FORM, *supra* note 184.

¹⁸⁹ *Id.*

¹⁹⁰ Financial Reporting Council, *The U.K. Corporate Governance Code*, The Main Principles of the Code: Effectiveness, 5 (Sept. 2014), available at <https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Corporate-Governance-Code-2014.pdf>.

vague terms of reference for the board members of a business with a social mission.

Further, SSX does not provide additional specificity when it comes to defining directors' duties and responsibilities or skills. This means that the leadership of an SSX-listed business could lack the skills to advance or ensure compliance with the firm's social mission. In other words, aside from having a social (or an environmental) mission as a core aim, and "committing to" disclosing anti-social activities, the SSX governance requirements are not specific about how listed entities should fulfill their social promises. As an independent rule-maker, SSX could do more to elucidate what good social corporate governance looks like. For example, it could have required that applicants task a board member with monitoring compliance with the social mission and with identifying mechanisms to engage with beneficiaries.

5.1.3.2. *Disclosure and reporting requirements*

To stay listed, SSX issuers must provide annual social impact reports that are made available on the website free of charge.¹⁹¹ While the Admissions Panel is the body responsible for reviewing the initial report submitted with the application package, it is not clear if it is also responsible for reviewing the updated annual reports. It is also not clear whether review and/or verification of the updated reports are required for continued listing.

Unlike the financial disclosure rules implemented by CSEs, the SSX reporting rules do not require compliance with a particular set of standards or format, nor are listed entities required to report on a particular set of metrics. Rather than relying on metrics to capture impact, SSX reports mostly contain prose descriptions of social performance. As a result, SSX impact reports look different from business to business (e.g. they range from 9 to 28 pages). Some guidance is provided as to the required content of annual reports, but mostly in broad strokes. SSX reports must cover five themes: (1) The social or environmental purpose of the company and the impact it will deliver; (2) who benefits as a result of the company's social impact; (3) how a company's products, services, and operations

¹⁹¹ *Impact Report*, SOCIAL STOCK EXCHANGE, <http://www.socialstockexchange.com/membership/impact-report> (last visited Mar. 2, 2015).

deliver impact; (4) how a company involves and consults with all of its stakeholders; (5) what evidence a company has of its social impact and how that evidence is collected, measured, and reported.¹⁹²

The lack of metrics and comparable data points for evaluating social performance could prove problematic for investors if it increases the cost of investigating investment opportunities. Otherwise put, SSX vets social businesses and centralizes impact information, which should reduce investor transaction costs, but costs could climb because the information collected is not easily comparable. On the other hand, reporting on impact using prose rather than quantitative measures may be more protective of beneficiary interests.

As explained earlier, the emphasis on metrification is problematic in the social finance context because social returns are not as easy to quantify or track as financial returns. Investments that chase reportedly high SROI may not improve social welfare to the degree hoped for because of the difficulties involved with measuring actual impact, especially with proxies. Thus, from a beneficiary perspective, impact prose may be more protective than numeric reporting. In this regard, themes (2) and (4) are particularly important since they bring beneficiaries into the reporting fold and potentially create avenues for holding businesses accountable for their social promise. However, by providing only general guidance on reporting, SSX under-utilizes this source of regulatory power.

5.1.4. Enforcement mechanisms

It appears that there are two circumstances under which a company's membership to SSX could be suspended: If it fails to submit an updated annual report and if its business model changes:

As a member of the Social Stock Exchange, you will be required to update your Impact Report annually. If your business model changes, such that you are no longer operating as a social impact business, your Social Stock

¹⁹² *Id.*

Exchange membership will be suspended pending any appeal you may wish to make.¹⁹³

Very little detail is provided as to what constitutes a suspension-worthy change to the business's model. Further, unless a listed entity declares to SSX that it has changed, the only way a departure from the mission could be detected is through a review of the updated annual impact report, which is concerning, since the thoroughness of the annual review process is not clear, as mentioned above.

Other than a suspension based on a change to the business model and failure to report, the SSX does not appear to have mechanisms in place for ensuring compliance with its own rules. For example, neither investors nor beneficiaries can register complaints (or compliments) about a social business with the SSX. The combination of vague suspension criteria with limited recourse for holding businesses accountable, suggests that the enforcement mechanisms of the SSX are relatively weak. Here again, SSX seems to under-utilize its regulatory power. This may be because investment transactions take place on CSEs and not on SSX, but since CSEs do not deal with the social dimension of business conduct to the degree necessary to regulate against mission drift, SVX should use its powers in a more targeted fashion. It could, for example, develop a framework for identifying conduct that constitutes a "social breach" by listed entities and design enforcement devices accordingly.

5.1.5. *Regulating investors*

The SSX does not differentiate between finance-first and impact-first investors, meaning that all types of investors can access the platform. In other words, there is no stated preference for "patient" investors and no rules in place for regulating investor conduct. The communication addressed to investors is intended to give them a lay of the impact investing land in a way that makes this new market seem familiar and investable, and to build investor trust in the platform. This may be because the SSX is an information portal, and actual transactions take place on whatever CSE the business is listed

¹⁹³ *Become a Member*, *supra* note 185.

on, so that there is little SSX could do to regulate investors' conduct, even if it wanted to. But since CSEs do not regulate the social dimension of investor conduct, SSX would not be stepping on CSEs' regulatory toes by developing guidelines for investor conduct.

5.1.6. *Preliminary assessment*

Because SSX operates as an informational rather than a transactional platform, and because all SSX listed entities are publicly traded on CSEs, this exchange is well positioned to support the project of mainstreaming social finance. SSX can draw investors into the social finance space by presenting them with opportunities that are attractive because, at least in principle, impact investments comprise an asset class which require neither big financial nor big social "sacrifices."

However, SSX does not appear to make the most of its regulatory power when it comes to defining the content of social corporate governance as opposed to conventional corporate governance. Indeed, SSX requires only that listed entities comply with the standards set for conventional businesses by CSEs (and the U.K. Corporate Governance Code). This is problematic not only because it represents a missed opportunity to differentiate the social from the conventional space, but also because it could place or keep under-equipped directors at the helm of businesses that promise to produce positive social impact. Other than the impact reports, for which the standard of review is somewhat unclear, there seems to be only limited regulation of SSX listed entities. This finding is reinforced by the fact that the conditions for de-listing a company are defined only in vague terms.

There may also be issues related to transaction costs resulting from a dearth of comparable data points for evaluating investment opportunities. This matters for investors, but also for listed businesses, because the latter receive little guidance on how to report on their social performance beyond broad themes, which means that they may lack tools to assess or increase their comparative advantage. At the same time, the prose focus in the reports could, if properly developed and guided, more accurately capture beneficiary experiences, which in turn could paint a more complete picture of the impact actually created. Finally, this SSE

offers little by way of models for regulating investor conduct to be more patient rather than conventionally short-termist. Overall, and again this is only a preliminary assessment, SSX has a relatively weak framework for committing issuers and investors to the social missions or for holding them to account should they depart from it.

5.2. *The Social Venture Connection (SVX), Canada*

5.2.1. *The mission*

SVX was launched in September 2013 with support from, among others, TMX group (the operator of the Ontario Stock Exchange), the Government of Ontario, the law firm, Torys LLP, KPMG, the Royal Bank of Canada, and three charitable foundations, including the Rockefeller Foundation.¹⁹⁴ Its mission is to create a “market for good” in the form of “a local, impact-first platform connecting impact ventures, funds, and investors in order to catalyze new debt and equity investment capital for local ventures that have demonstrable social and/or environmental impact.”¹⁹⁵ By creating a venue for investors and businesses to meet, SVX seeks to “mobilize money toward impact ventures that are reducing poverty, creating opportunities and advancing environmental sustainability.”¹⁹⁶

SVX was developed by the MaRS Center for Impact Investing, which was formed in Toronto in late 2011 to “mobilize private capital for public good.”¹⁹⁷ As MaRS’s leading initiative, SVX creates a “space that allows investors to place their capital in enterprises that can make money and do good, and that allows high-impact organizations to find the capital they need to help them grow.”¹⁹⁸ The long-term aim of SVX is to standardize the local social finance

¹⁹⁴ *About, SVX*, <https://svx.ca/en/about> (last visited Mar. 2, 2015).

¹⁹⁵ ADAM SPENCE & TRISTINA SINOPOLI, *SVX: Invest for impact: Case Study*, 3 (Sept. 2013), available at http://s3.amazonaws.com/svx.production/cms/files/files/000/000/007/MaRS_SVX_Case_Study-original.pdf [hereinafter *SVX CASE STUDY*].

¹⁹⁶ *Id.* at 5.

¹⁹⁷ *About the Centre*, MARS CENTRE FOR IMPACT INVESTING, <http://impactinvesting.marsdd.com/the-centre/about-the-centre/> (last visited Mar. 2, 2015).

¹⁹⁸ *SVX CASE STUDY*, supra note 195, at 5.

space by creating “a fully regulated market with access for retail investors that could parallel or be integrated into mainstream markets.”¹⁹⁹

5.2.2. *Trading and official regulation*

Like the London SSX, SVX is not a true stock exchange. It is “a private investment platform built to connect impact ventures, funds and investors.”²⁰⁰ This means that, although SVX aims one day to be an exchange that is open to the public, as of now, only accredited investors (who meet certain net worth or income benchmarks) can transact on the platform. In other words, the securities issued on SVX are not public and there is no secondary market for them. So far, SVX has 34 Ontario-based listed issuers and its founders are exploring possibilities for bringing on additional issuers from other parts of Canada.²⁰¹ As mentioned earlier, SVX is also in the process of replicating its model in the U.S. (in California) and in Mexico.²⁰² SVX is the first online portal registered with a securities regulator in Canada and the first impact-investing portal registered in North America.²⁰³ It is registered as a restricted dealer with the Ontario Securities Commission (OSC) and “adheres to all relevant and applicable securities legislation as prescribed by the OSC,”²⁰⁴ although the FAQs section of the website clarifies that “[n]o regulatory authority has approved or expressed an opinion about the securities offered on the SVX.”²⁰⁵

Listed entities include a solar energy cooperative, a company that manufactures footwear in Ethiopia for sale worldwide, another that sells refurbished telecommunications equipment, a game

¹⁹⁹ *Id.* at 3.

²⁰⁰ SVX Invest for impact, *Issuer Manual 2*, available at http://s3.amazonaws.com/svx.staging/comfy/cms/files/files/000/000/173/SVX_Issuer_Manual-original.pdf [hereinafter SVX ISSUER MANUAL].

²⁰¹ Adam Spence, *SVX: From Launch to Getting Deals Done*, SOCIAL FINANCE (Mar. 18, 2014), <http://socialfinance.ca/2014/03/18/svx-from-launch-getting-deals-done/>.

²⁰² *SVX CASE STUDY*, *supra* note 195, at 10.

²⁰³ *Id.* at 6.

²⁰⁴ FAQ, SVX, <https://svx.ca/en/faqs> (last visited Mar. 2, 2015) [hereinafter FAQ].

²⁰⁵ *Id.* at SVX, Question 8.

developer whose games promote a progressive environmental agenda, a seller of equipment for organic farming operations, a green housing developer, and a fair trade jewelry business. As with SSX, businesses are assessed an annual fee to list based on their revenues: The fee ranges from \$500 for revenues under \$1 million to \$2,500 for revenues above \$10 million.²⁰⁶ SVX fees are lower than London's but the entities it targets are smaller.

5.2.3. *Regulating social businesses*

5.2.3.1. *Listing and governance requirements*

To list on SVX, entities must meet the Platform Access Requirements.²⁰⁷ SVX lists small and medium sized local for-profit social businesses with more than \$50,000 but less than \$25 million in revenues.²⁰⁸ It targets for profit businesses, non-profits, and cooperatives looking to raise anywhere from \$100,000 to \$10 million in investments.²⁰⁹ The ventures must have been incorporated in Ontario for at least two years and have audited financial statements available.²¹⁰ Issuers fall into one of two categories: Social impact issuers defined as “ventures that are creating opportunities and breaking the cycle of poverty in subsectors including affordable housing, employment services, food security, education, First Nations and new Canadians;” and environmental impact issuers, defined as “ventures that are building environmental sustainability in subsectors including renewable energy, sustainable agriculture, consumer products, water, waste reduction and transportation.”²¹¹

In order to be listed, for-profit businesses must obtain a satisfactory company rating through GIIRS, the privately administered rating system described in the previous Part.²¹² SVX,

²⁰⁶ *Id.* at Ventures and funds, Question 8.

²⁰⁷ SVX ISSUER MANUAL, *supra* note 200, at 17.

²⁰⁸ *Id.* at 17.

²⁰⁹ *Id.* at 18.

²¹⁰ *Id.* at 17.

²¹¹ SVX CASE STUDY, *supra* note 195, at 11.

²¹² GIIRS Ratings, B ANALYTICS, <http://b-analytics.net/giirs-ratings/> (last visited Mar. 2, 2015).

therefore, relies on a third party standard setter to carry out an important piece of the social business vetting process.²¹³ In so doing, SVX is helping to mainstream the use of GIIRS in the market for social impact. As discussed, while there are complications with using tools like GIIRS and IRIS to measure social impact, having access to data points, like star and percentage-based scores, makes it easier and cheaper for investors to compare different investment opportunities. Transaction costs may be reduced by only a small margin, however, as SVX cautions that it “cannot confirm the accuracy or completeness of this information” and strongly encourages investors to “conduct their own thorough due diligence” before making investment decisions.²¹⁴ Further, while metrics facilitate investor decision-making, those who are serious about impact may incur additional costs to verify impact claims and supplement quantitative with qualitative performance assessments.

As concerns corporate governance, the Access Requirements make brief mention of board composition: To be admitted, businesses must submit “[e]vidence of relevant expertise within management/officers and directors.”²¹⁵ This suggests that SVX may expect more of business heads than simply financial competence. However, this is at most a vague nod in the direction of social governance, and does not go far enough. Like SSX, SVX appears to be missing a regulatory opportunity to ensure that social businesses are run in a way that maximizes the pursuit of, and compliance with, the social mission.

5.2.3.2. Disclosure and reporting requirements

Entities wishing to list on SVX must agree to the SVX Issuer Agreement, which is contained in the SVX Issuer Manual, and includes a number of substantive requirements.²¹⁶ For example, issuers must file GIIRS-issued proof of rating and proof of updated ratings.²¹⁷ Once capital is raised, issuers must report on how it is spent and on “the impact achieved as a result of such use of

²¹³ SVX ISSUER MANUAL, *supra* note 200, at 15, 18.

²¹⁴ FAQ, *supra* note 204.

²¹⁵ SVX ISSUER MANUAL, *supra* note 200, at 17.

²¹⁶ *Id.* at 17-18, 32-34.

²¹⁷ *Id.* at 32.

capital.”²¹⁸ One problem with this framework is that it is not clear from the Issuer Agreement how often listed entities must provide updated ratings. Since GIIRS ratings have to be updated every two years to remain valid, it seems safe to assume that the same schedule would apply for SVX’s purposes. This should be clarified, however, as investors likely want assurance that they will not need to seek out updated information on their own. Issuers are required to make financial statements available annually and to prepare them using generally accepted accounting methods.²¹⁹ They must also comply with applicable securities legislation and must not post any information that is considered misleading.²²⁰

Thus, while traditional financial investor protections are in place with SVX, it is less clear how well investors—and other stakeholders, such as competing issuers and beneficiaries—are protected against misinformation concerning issuers’ social performance.

5.2.4. Enforcement mechanisms

Issuers are liable if they breach the Issuer Agreement. The Agreement requires prospective issuers to acknowledge “that a breach or threatened breach . . . will result in SVX suffering irreparable harm which cannot be calculated or [sic] fully or adequately compensated by recovery of damages alone.”²²¹ In the event of a breach, “SVX shall be entitled to interim and permanent injunctive relief, specific performance and other equitable remedies, in addition to any other relief to which SVX may become entitled.”²²² In addition, the SVX Issuer Agreement also gives SVX the “right, at any time, to halt, or suspend access to the SVX online platform or to remove from the Applicant, temporarily or permanently, from the SVX online platform, with or without notice and with or without giving any reason for such action.”²²³

²¹⁸ *Id.*

²¹⁹ *Id.*

²²⁰ *Id.*

²²¹ *Id.* at 33.

²²² *Id.*

²²³ *Id.*

With SVX, issuers who breach exchange rules can face a number of sanctions, including monetary damages, injunctive relief, and de-listing. This is sharper than the SSX enforcement mechanism, which is limited to de-listing under the vaguely defined circumstance of a change to the issuer's business model. Though SVX appears serious about enforcement, the Issuer Agreement still fails to explain when and why this power will be deployed. It lists many contractual obligations, but lacks specificity regarding what—beyond an (annually updated) GIIRS rating and a periodic impact report—is expected of issuers with regard to their social performance. It seems likely that if an issuer were to abandon its social mission or experience a big drop in its GIIRS rating, SVX would choose to terminate the agreement.²²⁴ However, this is not specified and the grounds for de-listing, or for finding a (social or other) breach should be clarified. Like SSX, SVX is under-utilizing its regulatory power by not defining with sufficient clarity the social commitments it expects of its issuers, and by not filling the gaps left open by conventional financial regulation with respect to identifying social, rather than financial breaches.

5.2.5. *Regulating investors*

SVX's manual for investors is very useful for understanding how SVX regulates investor conduct.²²⁵ Additionally, investors are required to enter into an Investor Agreement.²²⁶ These documents contain a number of substantive obligations. First, only accredited investors (as defined by the OSC), who are sophisticated enough to invest without a prospectus, can access SVX. Depending on the sophistication of the investor, they are subject to caps on how much they can invest on SVX in any given year. These restrictions go to investor protection.

²²⁴ Note that this mechanism looks a lot like the de-certification mechanism employed by B-Lab when a B corporation fails to achieve a minimum score on the Impact Assessment Survey. Interview with B Lab staff member, *supra* note 72.

²²⁵ See generally SVX, INVESTOR MANUAL, available at http://s3.amazonaws.com/svx.staging/comfy/cms/files/files/000/000/178/SVX_Investor_Manual-original.pdf [hereinafter INVESTOR MANUAL].

²²⁶ SVX INVESTOR AGREEMENT, available at <https://svx.ca/en/terms-of-use> (Oct. 3, 2015).

Second, SVX specifically targets accredited investors who care about impact. In answer to the question, “Who are the investors?” the SVX Investor Manual identifies “[i]mpact-first investors with a focus on achieving positive social and/or environmental outcomes with patient capital investments.”²²⁷ (emphasis added). Indeed, SVX acknowledges that social ventures require “a different type of capital to help them grow, scale and achieve systemic impact. They need impact capital: A type of investing with the goal of achieving a triple bottom line of social, environmental and economic return.”²²⁸

Thus, while there is no mention of mission drift in the SVX documents, SVX clearly wants investors and businesses to commit, and remain committed, to the social mission. Investors must be “patient” and know from the outset that social finance returns are not like financial returns from conventional investments that are easily measurable and usually generated in the short term. In fact, the SVX Investor Manual and the SVX Investor Agreement use hard language (in bold face) to manage investor expectations: “Investing in offerings posted on SVX has significant risk including severe illiquidity . . . and potential volatility of the investment. The main objective of these issuers is not to maximize returns to investors. You should invest in SVX issuers only if you are prepared not to receive any return on your investment and to lose your investment in its entirety.”²²⁹ (emphasis added).

Like the Issuer Agreement, the SVX Investor Agreement includes a liability provision. Clauses 10 and 11 give SVX the “right, at any time, to halt, suspend or terminate the access of the [sic] Investor to SVX online platform either temporarily or permanently, with or without notice, and with or without giving any reason for such action.”²³⁰ Like issuers, investors must also acknowledge that breaches can result in various remedies for SVX. We can presume that SVX would ban an investor who applied inappropriate pressure on a listed entity to prioritize profit over impact or pushed the investee away from its mission, but clarification is needed here. It is needed because if indeed investors can be banned as a result of committing a social breach, SVX would be introducing something

²²⁷ INVESTOR MANUAL, *supra* note 225, at 13.

²²⁸ *Id.* at 4.

²²⁹ *Id.* at 16.

²³⁰ *Id.* at 19.

entirely new into the regulatory mix, marking a real departure from the CSE model. Clarification is also needed because SVX, like SSX, does not appear to provide recourse either for investors, listed entities, or beneficiaries to bring complaints against each other.

SVX uses the Investor Agreement, the Investor Manual, and the accredited investor restriction to regulate investors. It also employs a deal cap mechanism: The maximum deal size for a social business—and by extension, its investors—is limited, depending on the submission of know-your-client and suitability requirements.²³¹ The deal cap is interesting because it automatically limits the financial returns that investors can obtain, which in turn directs investor expectations toward impact rather than profit. The cap should also help to regulate commercialization since it limits how much and how fast a social business can grow, which, in turn, should mitigate commercial pressures—whether coming from outside or within the issuer—to prioritize profit over impact. It would be good to clarify how many \$10 million deals a social business can enter into per year.

5.2.6. *Preliminary assessment*

With SVX, there are some questions as to both the regularity and the quality of the social reporting, in particular as concerns the SSE's reliance on GIIRS (a proxy-based system for assessing social impact). There is also a lack of clarity regarding the circumstances under which a social business might be de-listed, or an investor's access to the platform revoked. Nevertheless, SVX appears to be considerably more serious about regulating both issuers and investors than SSX.

Social finance and impact investing proponents are generally agnostic about whether investors are impact-first or profit-first. SVX is very clear that its platform is for investors who care deeply about advancing their investees' social missions. This may deter profit-first investors, but SVX evidently prefers to attract the "right" investors onto its platform, even if doing so limits capital flows.

²³¹ SVX ISSUER MANUAL, *supra* note 200, at 19.

Indeed, judging by how it (almost aggressively) manages investor expectations, it is apparent that SVX does not define success in reference to its trading volumes alone.²³² This is crucially important for differentiating CSEs from SSEs. Additionally, SVX's exclusive focus on small and medium sized enterprises, especially combined with the deal cap should go a long way toward keeping listed entities in mission-protecting hands that are less concerned with achieving large financial returns. The SVX framework would fare better if social reporting requirements were more systematized, the elements of social breach were better defined, the justifications for terminating platform access were clearly articulated, corporate governance requirements were more deeply considered, and if there was a mechanism in place for the stakeholders to bring and resolve complaints (or compliments).

5.3. *The Impact Exchange (IX), Mauritius*

5.3.1. *The mission*

The IX was established in 2013 and has yet to fully launch in the sense of listing individual social businesses whose securities can be bought and traded. When launch is complete, for-profits will be able to sell common equity, preference shares or bonds, while non-profit impact entities will be able to list bonds.²³³ So far, it appears that the last piece is closest to completion with the upcoming launch of two new types of social impact bonds.

²³² See Pritchard, *supra* note 161, at 38 (observing that “[e]xchanges live or die with trading volume”).

²³³ *Impact Exchange Board Listing Guide*, IMPACT EXCHANGE, 6 (Feb. 2014), available at http://impactexchange.asiaix.com/wp-content/uploads/2014/03/Impact_Exchange_Listing_Guide_Feb2014_FINAL.pdf [hereinafter IX Impact Listing Guide].

Of the three SSEs reviewed here, IX is the only one that is an actual public exchange. It is billed as “the world’s first public trading platform dedicated to connecting Social Enterprises (SEs) with mission-aligned investment.”²³⁴ Thus, IX will be fully regulated and able to support the listing, trading, clearing and settlement of social business-issued securities. This means that the securities issued by social businesses on IX are liquid, and can be resold to another investor. That is not the case for private placement platforms, where investors cannot easily “exit,” as there is no secondary market for purchased securities. Like “any other global public trading platform,” IX provides advantages such as “transparency, efficiency and liquidity – while also ensuring that the social and/or environmental mission and impact of the issuers are both safeguarded and showcased.”²³⁵

IX’s mission is to serve as “the public gateway for those who wish to invest in sustainable change for the betterment of society and the environment.”²³⁶ Like any CSE, therefore, IX is focused on creating a fair efficient and transparent market with strong investor protections; unlike CSEs, the focus on bettering the world is also central, which requires developing strong mission and beneficiary protections.

5.3.2. *Trading and official oversight*

The IX is a joint initiative between the Stock Exchange of Mauritius Ltd (SEM) and Impact Investment exchange Asia (IIX Singapore), based in Singapore.²³⁷ The latter incubated IX “to allow larger Social Enterprises to access the public capital markets while offering socially-minded Impact Investors the opportunity to efficiently and effectively direct their capital into liquid investments that align with their values.”²³⁸ IX seeks to commercialize entities that “target underserved population groups . . . as . . . customers, employees and/or other relevant stakeholders;” these are entities

²³⁴ *Impact Exchange*, ASIA IIX, <http://impactexchange.asiaiiix.com> (last visited Mar. 2, 2015).

²³⁵ IX Impact Listing Guide, *supra* note 233, at 4.

²³⁶ *Id.*

²³⁷ *Mission*, ASIA IIX, <http://www.asiaiiix.com/mission/> (last visited Mar. 2, 2015).

²³⁸ *Id.*

that operate in Africa or the Asia Pacific region, though their headquarters could be anywhere.²³⁹

The IX is operated by the SEM and is regulated by the Financial Services Commission of Mauritius. The SEM, established in 1989, is the only exchange in Africa and operates 3 boards: the Official Market, the Development and Enterprise Market, and IX.²⁴⁰ As with SVX and SSX, entities that list on the IX are subject to conventional securities regulation.²⁴¹ However, this only matters for the financial dimension of impact investments and does not extend to their social dimension. In other words, as with the other SSEs, IX is responsible for the social regulation of impact investments. Annual revenues will determine the listing fees.

As mentioned, trading was due to begin at the end of 2014, but as of this Writing, that has not happened. When the Author inquired about the launch, she was informed that the current priority is to create two types of social impact bonds that will be issued on the IX: the Humanity Bond and the Women's Livelihood Bond ("WLB").²⁴² The former will be issued by social service organizations – primarily non-profit, which do not include social businesses of the type at issue in this article – to raise funds for programs that save lives and “enable service organizations to overcome the challenge of unstable, inconsistent cash flows while offering an attractive investment proposition to new investors: One which can create a social/environmental impact while simultaneously generating a modest financial return.”²⁴³ The WLB involves issuing a \$20 million debt product, “targeting women as the core beneficiaries.”²⁴⁴ A collective of social enterprises and MFIs will issue a WLB to “scale their high-impact, revenue-generating programs to empower women.”²⁴⁵ With the WLB, businesses would pool together as

²³⁹ FAQ, IMPACT EXCHANGE, <http://impactexchange.asiaix.com/faq/> (last visited Mar. 2, 2015) [hereinafter IX FAQ].

²⁴⁰ IX Impact Listing Guide, *supra* note 233, at 5.

²⁴¹ *Id.* at 6.

²⁴² *Humanity Bond*, ASIA IIX, <http://www.asiaix.com/humanity-bond/> (last visited Mar. 1, 2015).

²⁴³ Jenna Liang, *The Humanity Bond: A Life Saving Game Changer For All*, IMPACT QUARTERLY (Oct. 13, 2014), <http://impactquarterly.asiaix.com/the-humanity-bond-a-life-saving-game-changer-for-all/>.

²⁴⁴ *The WLB Structure*, ASIA IIX, <http://www.asiaix.com/womens-livelihood-bond/> (last visited Mar. 1, 2015).

²⁴⁵ *About WLB*, ASIA IIX, <http://www.asiaix.com/womens-livelihood-bond/> (last visited Mar. 1, 2015).

borrowers and enter into a contract with investors to repay the loan at maturity, with interest paid at fixed intervals over the bond duration.²⁴⁶ A white paper on these new financial instruments is forthcoming, but as of this Writing, there is not enough information available on these instruments to assess how effective the IX will be in administering them.

5.3.3. *Regulating social businesses*

5.3.3.1. *Listing and governance requirements*

Perhaps the most interesting feature of IX is that it introduces a new figure into the listing and compliance process: Potential issuers must appoint an Authorized Impact Representative (“AIR”) to support them in the listing process and to ensure compliance with listing requirements.²⁴⁷ All AIRs must be accredited and registered with the SEM.

The listing requirements break down into social and financial categories. In their application package, prospective issuers must: (1) clearly specify that positive social or environmental impact is the primary reason for their existence; (2) clearly articulate the purpose and intent of the company in the form of a theory of change—the basis for demonstrating social performance; (3) commit to ongoing monitoring and evaluation of impact performance, using clearly defined impact indicators for performance assessment and reporting; (4) have a minimum of one year of impact reports prepared in accordance with IX reporting principles; (5) obtain certification of impact reports by an independent standards or rating body 12 months prior to listing.²⁴⁸ On the financial side, a prospective issuer must, among other things: (1) demonstrate that it uses a market-based approach to achieve its purpose and provide financial returns sufficient to meet investors expectations; (2) publish financial statements meeting internationally accepted

²⁴⁶ *Id.*

²⁴⁷ IX Impact Listing Guide, *supra* note 233, at 14.

²⁴⁸ *Id.* at 10.

standards for at least one year prior to listing; (3) have minimum market capitalization of \$700, 000.²⁴⁹

On corporate governance, prospective issuers must address a question: “Are the key management positions filled and are there strategies in place to retain key employees and key customers?”²⁵⁰ This appears to be the only place that references to the leadership skills base is referenced. It also appears to be the only place that beneficiary interests are brought into the regulatory fold. IX imposes no requirements on issuers to include beneficiaries or beneficiary representatives in their governance, nor are issuers required to have mechanisms for registering beneficiary feedback. Like SSX and SVX, IX is under-utilizing its regulatory power by not implementing standards, rules, or measures that concretely differentiate the social from the conventional financial space.

5.3.3.2. *Disclosure and reporting requirements*

As mentioned above, issuers must comply with the securities laws and reporting regulations of Mauritius, the SEM, and with the IX Rules. The latter govern listings, set out the requirements for issuers to remain listed, such as reporting and “certain aspects of issuer conduct,” and the minimum standards of behavior to ensure that market is “fair, orderly and transparent.”²⁵¹ IX issuers cannot sell their securities on another exchange, which means that IX has exclusive regulatory control over its issuers.

Issuers must provide independently verified social and financial reports multiple times per year.²⁵² While financial reporting is standardized (using IFRS), the IX Rules do not specify what standards are to be used for social reporting. This creates two problems. First, it is unclear whether IX impact reports will incorporate beneficiary experiences and feedback. To the extent that reports are metrics-heavy, they will capture only proxies for impact and thus fall short of conveying a full picture of beneficiaries’ experiences (positive or negative). Second, as with SSX, inconsistent reporting standards increase the costs of investor due diligence.

²⁴⁹ *Id.*

²⁵⁰ *Id.* at 11.

²⁵¹ *Id.* at 9.

²⁵² *Id.*

This problem is compounded if issuers select standards that are easier to satisfy and make them look better to investors.

AIRs help address this, insofar as they supervise listed entities' selection of standards and verify impact reports.²⁵³ Unlike SVX and SSX, IX has accredited individuals on staff to verify the content of the impact reports, which reduces the likelihood of misrepresentations to investors. Indeed, AIR assistance "is intended to . . . bolster investor confidence – through independent verification of the social and environmental impact of the issuer."²⁵⁴ AIRs, therefore, have an important role to play. Additionally, the integrity of IX depends on how thoroughly they do their job, which is assessed by how demanding they are about selecting quality metrics and standards, and how deeply they look into the experiences of beneficiaries when verifying reports.

5.3.4. Enforcement mechanisms

There is no information concerning the consequences of breaching IX Rules. Presumably, if an entity breaches, it can be delisted. If it breaches the SEM (conventional securities) rules, the entity can be served with a formal written letter of disapproval and requested to explain its actions and rectify the situation. The SEM can also publish any censure, refer the company to the Financial Services Commission for further disciplining, and suspend or remove its listing.²⁵⁵ While these are strong mechanisms, it is unclear to what extent the SEM mechanisms will extend to incorporate breaches (social and financial) of the IX Rules and this should be clarified.

As with SSX and SVX, IX provides no mechanisms for investors, social businesses, or beneficiaries to bring complaints against each other.

²⁵³ IX FAQ, *supra* note 239.

²⁵⁴ IX Impact Listing Guide, *supra* note 233, at 14.

²⁵⁵ *Regulatory Functions of the SEM*, STOCK EXCHANGE OF MAURITIUS, <http://www.stockexchangeofmauritius.com/regulatory-functions-of-the-SEM> (last visited March 2, 2015).

5.3.5. *Regulating the investors*

The IX does not distinguish between impact-first and profit-first investors; rather, it “is designed to accommodate all investors, including retail investors.”²⁵⁶ In contrast to SVX, which requires investors to enter an Investor Agreement, IX does not have a mechanism for committing investors to their investees’ social mission. Further, there are no investor screens or rules for regulating the conduct of investors on the IX platform. The language in the FAQs may help to manage investor expectations of return: “As with any investment, the financial return that the investor achieves will depend on a variety of factors including the financial performance of the enterprise and the availability of a ready buyer if the investor wishes to sell the investment.”²⁵⁷ In comparison, the SVX language is much stronger and likely more effective in terms of deterring the “wrong” kind of investor.

The IX Listings Guide includes useful language concerning “mission protection:” “Because monitoring of each issuer’s impact is built into the Listing Rules . . . , issuers are ensured that access to capital can be achieved without losing purpose, mission and integrity. At the same time, investors are ensured that their co-investors are like minded in their support of the issuer’s mission.”²⁵⁸ (emphasis added). As suggested by this quote, with IX, the main mechanism for regulating investors is self-selection; those interested in supporting the mission will come and others will not. Self-selection can fall short of protecting the promise of social finance, especially for IX, which is an actual trading platform. This is because investors can exit their investments and sell their impact securities to others. If the initial investors are not committed to the social mission, there is reason to be concerned that they will sell to buyers who are even less committed, or who care more about the securities’ financial value rather than their social value. The risk of making social impact “liquid” through trading is that the commitment to the issuers’ social mission could become diluted, which, in turn, can create pressure to prioritize profitability over impact, to the detriment of beneficiaries.

²⁵⁶ IX FAQ, *supra* note 239.

²⁵⁷ *Id.*

²⁵⁸ IX Impact Listing Guide, *supra* note 233, at 7.

5.3.6. Preliminary assessment

As an initial assessment of IX, there is a benefit to introducing AIRs into the regulatory sphere, as they help keep social businesses in check and guide them toward good reporting and business management practices. However, this benefit may be undermined for three reasons. First, as discussed, existing metrics and standards for tracking social performance, such as IRIS and GIIRS, are deficient because they tell only an abbreviated story about impact. This problem is compounded if issuers report on “easy” metrics that make them look better than deserved. Second, IX does not specify what reporting standards to use, which increases transaction costs for investors by complicating the comparison of investment opportunities. Third, even if the AIR succeeds in keeping social businesses social, its efforts may be jeopardized by the under-regulation of IX investors.

Indeed, the only device employed by IX to attract the “right” kind of investor is self-selection, which is a relatively poor mechanism, particularly considering the dangers that commercialization creates for mission protection. This is especially problematic, since IX is (or will be) a real exchange with a secondary market for impact securities, which will make it easier for investors to exit their investments—as compared with private placement platforms. In the conventional finance context, liquidity is a major draw for investors. However, in the social finance context, liquidity could diminish the integrity of investors’ commitment to the mission. As rule makers for social finance, in order to protect the beneficiaries, SSEs must use their regulatory power to ensure that investor commitment to the mission is not diluted, but sustained. It is unclear whether IX will be effective in serving this regulatory function.

6. SSE REGULATION: PROGNOSSES AND PRESCRIPTIONS

As demonstrated in the previous Part, the regulatory devices employed by SSEs—listings requirements, reporting and governance requirements, and enforcement mechanisms—largely

track those of CSEs, with more or less effective social adjustments. In this Part, I review each device and recommend ways to make it more responsive to the regulatory needs of social finance and its beneficiaries. At the outset, it helps to break SSE regulatory functions into two protective spheres, one for beneficiaries and one for investors. On the one hand, SSEs are tasked with protecting the social mission of listed issuers, which is directly tied to protecting the interests of the beneficiaries who are serviced by the issuer. On the other, SSEs are tasked with protecting investors who will only invest if they trust the market and the information they receive about issuers' social and financial performance. Both spheres are considered below.

6.1. The Mission

In its own way, each SSE commits to achieving social welfare gains by establishing a regulated market for transacting in impact securities. This points to a fundamental difference between SSEs and CSEs where social welfare is at best derivative byproduct of investor gains. This difference must be captured in the mission statement. SSE mission statements offer important signals to potential users—investors and issuers—who are deciding whether or not to access a particular platform. Equally important, the formulation of the mission dictates the design of whatever framework is established to achieve it. To make positive societal contributions, therefore, SSEs must place social objectives at the heart of their mission statement and adopt an operational design that best advances that mission.

Canada's SVX may do the best job here because it speaks of success not in terms of attracting investors or trading volumes but in terms of bettering the world. Indeed, when it comes to defining success, a by-product of formulating the mission, it is imperative that SSEs not identify trading volumes as the main criteria. The number of listed entities and the amount of capital flowing into the market for social impact are only proxies for SSE success. True success must be assessed against the goal of improving social welfare. While the tendency in the CSE context is to equate social welfare with increased capital flows, these variables ought to be kept separate in the SSE context. Should SSEs conflate financial and

social gains, these vehicles for commercializing social businesses could become complicit in creating a perfect mission drift storm.

Baradaran makes a similar point in the context of banking regulation.²⁵⁹ She explains that while regulation initially directed banks to serve the public interest, it gradually shifted to enable banks to pursue profitability for its own sake.²⁶⁰ She recounts how over time, “public benefit” became synonymous with profitability so that today, “[t]o show a public benefit, a bank need only prove that the proposed activity increases efficiency and competition, which do favor the public tangentially, but are not direct benefits.”²⁶¹ To reverse this trend, Baradaran advocates a return to the “public benefit test” and recommends that regulators “develop a new regulatory paradigm built on a reinvigorated social contract that will ensure banks meet the needs of the public in years to come.”²⁶²

SSEs are poised to invigorate the promise of social finance through the development and administration of new, market-specific, rules. To play this role effectively, however, SSEs must clearly formulate their own mission around a commitment to improve social welfare. This requires adopting a definition of success that goes far beyond the CSE measure of trading volumes. It also requires being explicit about the protection of beneficiary interests, particularly against mission drift, and about creating a safe space for social businesses to commercialize their financing so that incentives to drift are minimized. The following three core values should be enshrined in every SSE mission statement: A commitment to achieving social (and environmental) gains, the protection of investment-affected individuals and communities, and the creation of a safe and well regulated market for social impact.

²⁵⁹ Mehrsa Baradaran, *Banking and the Social Contract*, 89 NOTRE DAME L. REV. 1293, 1310 (2014).

²⁶⁰ *Id.* at 1341.

²⁶¹ *Id.* at 1341.

²⁶² *Id.* at 1342.

6.2. *Regulating Social Businesses*

6.2.1. *Listing and governance requirements*

While a number of countries are beginning to require some form of sustainability (environmental and social) reporting by publicly listed entities, the listing and corporate governance requirements of CSEs remain primarily focused on verifying the financial integrity of issuers.²⁶³ For SSEs, however, it is imperative to collect and monitor information pertaining to issuers' social integrity, and a few recommendations can be made in this regard. The first is for SSEs to stimulate inclusive governance by instituting requirements that shape issuers' leadership. The second recommendation, which is perhaps harder, is for SSEs to require that issuers have a system for collecting feedback from Worker and Customer Beneficiaries. And the third is to bolster the listing and governance requirements that serve to limit the mission-diluting effects of commercialization.

With respect to inclusive governance, none of the SSEs impose adequate requirements. Governance issues feature only peripherally in the listing process, through questions (not requirements) about the composition of the executive board. SSEs should be more demanding in this regard. Leadership constitutes an important source of mission protection and SSEs should use their regulatory power to require that executives possess beneficiary-oriented skills and credentials to help the venture meet the expectations of investors and beneficiaries. It is not enough to refer to existing codes of corporate governance, as SSX does, because these codes are tailored for conventional corporations that are far more concerned with financial than social performance.

In his overview of social governance, Arena refers favorably to the Grameen model, which is essentially a microcredit cooperative where the borrowers are also the shareholders of the MFI.²⁶⁴ Though

²⁶³ See generally *Global CSR Disclosure, the Harvard Initiative for Responsible Investment*, available at <http://hausercenter.org/iri/about/global-csr-disclosure-requirements>; see generally Galit A. Sarfaty, *Human Rights Meets Securities Regulation*, 54 VA. J. INT'L L. 97 (2013).

²⁶⁴ Arena, *supra* note 41, at 290; see Henry Hansmann, *THE OWNERSHIP OF ENTERPRISE* (2000) (describing and explaining different models of corporate ownership, including investor-owned, producer-owned, and customer owned enterprises).

imperfect, this model has the distinct advantage that it directly involves those who are impacted by a social business in corporate governance. Where having beneficiary shareholders is not viable, another option is to appoint a social director whose "role is to ensure that the organization remains responsive to the social transformation of clients and adheres to stated social goals."²⁶⁵ While the IX's AIRs could come close to fulfilling this mission-protecting function, it would be preferable to have someone on the inside who is part of the issuer's executive team. AIRs should support, not substitute, the social director. Requiring issuers to appoint a social director or some equivalent as a listing requirement is easily within the regulatory reach of SSEs, and would enhance their ability to protect the interests of beneficiaries, if only indirectly.

Furthermore, by developing the terms of reference for a social director, including credentials and day-to-day obligations, SSEs would help issuers to operationalize a broad conception of fiduciary duty that extends beyond shareholders to stakeholders. In fact, SSE listing rules should require issuers to expressly commit to expanded fiduciary duties, and SSEs should help their issuers to understand what complying with those duties means in practice. The IX model nicely illustrates how listing requirements create learning opportunities for issuers and how SSEs can offer guidance to help issuers operationalize that learning: Yes, impose stringent mission-protecting obligations on issuers, but also give them guidance and support in complying with those requirements.

The second recommendation concerns the solicitation of beneficiary feedback. In this regard the U.K.'s SSX offers an initial solution by requiring prospective issuers to identify their target beneficiaries and to show how they involve and consult with that group. Neither IX nor SVX ask issuers to demonstrate how they involve beneficiaries. At a minimum, SSEs should require issuers to identify their beneficiaries and to have mechanisms in place for soliciting feedback. If beneficiary input is not sought regularly, this should count against admitting the issuer to the SSE. Ideally, SSEs would also set thresholds for admission based on the quality of beneficiary feedback; however, given the challenges involved with comparing this type of qualitative, non-objective, information, that may not be realistic. SSEs should carry out some high level due diligence on applicants; if such diligence reveals that a would-be

²⁶⁵ *Id.* at 306-07.

issuer received negative beneficiary feedback, that should weigh against admitting them to the platform.

The third recommendation deals with using SSE regulatory power to limit the mission-diluting effects of commercialization. In this regard, SVX introduces an easy-to-replicate listing requirement that doubles as a mission-protecting mechanism. The focus on small and medium sized enterprises, especially when combined with the deal cap should significantly mitigate commercial pressures to prioritize growth over impact. By regulating the pace of commercialization, SVX facilitates issuer compliance with—rather than drift from—their mission. Such rules protect issuers, beneficiaries, and investors who may be reluctant to invest without assurance that their co-investors are comparably committed to the social mission. Other SSEs should consider instituting similar issuer size and deal cap requirements.

Across the board, SSEs could make better use of their regulatory power when it comes to dealing with changes to issuers' investor base, use of assets, and ownership. As explained, such changes can contribute to mission drift, particularly if newcomers have differing commitments to the issuer's social mission.²⁶⁶ Conventional corporate law includes various devices for defending against challenges to corporate control. For example, in the U.S., for-profit corporations can create classified shares of stock with different voting rights, institute staggered boards, and implement (or threaten to) a shareholder rights plan commonly referred to as a "poison pill." By and large, these mechanisms have been quite effective, particularly when used in combination.²⁶⁷ As explained below in the discussion on investor regulation, similar devices could be employed in the social business context to mitigate the risk of mission dilution resulting from commercialization.

²⁶⁶ See Cummings *supra* note 60, at 589 (cautioning that hybrids must "prevent neglect of the social bottom line if the company assumes new leadership . . . if controlling shares are acquired by someone who wants to prioritize profit-making, or in response to market pressures."); see also, Belifanti, *supra* note 74, at 827 (explaining "going public represents a transition from being surrounded by a core base of founders, initial investors, and employees who are hopefully supportive of the firm's mission and value proposition, to being surrounded by a new group of shareholders who may or may not support the firm's value proposition").

²⁶⁷ See, e.g., Lucian Arye Bebchuk et al., *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy*, 54 STAN. L. REV. 887, 893 (2002) (explaining the antitakeover power of staggered boards).

As concerns regulating the use of social business assets and ownership, it is helpful to consider the U.K. model for regulating CICs. The CIC Regulator imposes an asset lock to ensure that “the assets of the CIC (including any profits or other surpluses generated by its activities) are used for the benefit of the community.”²⁶⁸ The asset lock works in two main ways: First, it places an aggregate cap on dividends to keep CIC earnings within the company and encourages the reinvestment of earnings toward benefit—rather than investor “extraction.”²⁶⁹ Second, the lock restricts transfer of CIC assets, principally to other CICs or asset-locked entities.²⁷⁰ Following this model, SSEs could require that their issuers adopt asset lock and change of control restrictions to ensure that ownership remains in mission-safe and benefit-enhancing hands. To the extent that there is concern about chilling the market for impact through over-regulation, SSEs could also consider instituting patient investor incentives, as described below.

If SSEs were to enhance listing and governance requirements to incorporate these suggestions, it would go a long way toward ensuring compliance with issuers’ missions and with the SSEs’ own missions. It would also significantly increase SSEs’ ability to regulate in the interests of the poor, while protecting those of investors, so that both spheres of regulation are adequately shielded from the effects of broken promises.

6.2.2. Disclosure and reporting requirements

To establish a fair, healthy, and trustworthy market for impact securities, SSEs—like CSEs before them—must devise mechanisms for filling information gaps to correct asymmetries between insiders and outsiders, and promote the standardization of social finance. Conventional financial disclosure and reporting requirements are designed to protect investors and blueprinting against the CSE model works well for that purpose. With respect to social reporting,

²⁶⁸ OFFICE OF THE REGULATOR OF COMMUNITY INTEREST COMPANIES, INFORMATION AND GUIDANCE NOTES, CHAPTER 6: THE ASSET LOCK 3, *available at* https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/416360/14-1089-community-interest-companies-chapter-6-the-asset-lock.pdf.

²⁶⁹ *Id.* at 6-7 (explaining that, to ensure that they do not pay out too much of their profits in dividends, CICs are subject to an aggregate dividend cap of 35%).

²⁷⁰ *Id.* at 3.

however, the CSE blueprint is inadequate since it supports only a narrow welfare-enhancing mission. If SSEs are to succeed in achieving ambitious social gains, they must adjust the conventional disclosure and reporting blueprint to protect investors and the beneficiaries of those investments. This is by no means an easy task and SSEs face at least two challenges in carrying it out.

First, as already discussed, the metrics and standards available for social reporting do not in fact capture impact, which means that investor decisions could be based on incomplete information and that initiatives which are impactful-in-fact but score poorly on quantitative assessments may go under-funded, to the detriment of beneficiaries. Second, for those SSEs that do not specify a particular set of reporting standards, there is a risk that issuers will opportunistically select those that are easiest to satisfy, in order to appear more attractive to investors. For investors serious about impact, these challenges increase the transaction costs of engaging in social finance.

Further, because the metrics and standards for tracking social impact are imperfect, and because there is no universal standard for reporting on social performance, investors lack the tools for identifying “social misrepresentations.” Indeed, it is easier to show that an issuer has misrepresented its financial performance – which is primarily about numbers – than its social performance – which is more subjective and considerably harder to measure. Because of this fundamental difference, SSEs will no doubt struggle to protect investors from instances of red washing where issuers misrepresent their social performance.

One initial solution could be to require issuers to report both on metrics and on the substantive feedback they solicit from beneficiaries. Again, this is not an easy proposition to convert into a workable requirement, but unless a concerted effort is made to collect and convey beneficiary experiences, a major piece of the SSE informational regulation mechanism will be missing. Without that piece, both the investor and the beneficiary spheres of protection are weakened.

6.3. Enforcement mechanisms

To effectively protect both investors and beneficiaries, SSEs should upgrade the CSE blueprint to regulate not only issuer conduct, but also investor conduct. SVX does the best job in this regard since it requires issuers and investors to enter into contractual agreements with relatively robust remedies provisions. It also does the best job of laying out what sanctions are available, including de-listing, revoking platform access, and monetary damages. The SSX and IX documents say virtually nothing about the consequences of non-compliance with SSE rules.

While SVX is ahead as far as outlining the sanctions for misconduct on the platform, none of the SSEs adequately specify what kinds of misconduct actually justify enforcement. This should be rectified. Enforcement is an important part of the regulatory toolkit, and it must have (at least a few) teeth to deter misconduct. Unless social obligations are clearly spelled out, it will be hard to know when they have been breached.

For an issuer, a social breach could be something simple, like a diminished GIIRS rating. Ideally, however, the definition of social breach would be versatile enough to incorporate various forms of mission drift, particularly if beneficiaries are at risk of being harmed or exploited. For investors, a social breach would occur if they pressured an issuer to depart from its mission in order to increase profitability. For example, an investor could push an investee to focus on more affluent populations so as to reduce the transaction costs of servicing the poor, which would leave the initial target population under-served, yet again. Such pressure-dynamics are hard to detect, which is why a three-way accountability mechanism such as the one described below would be useful.

6.4. Regulating Investors

The regulation of issuers and investors constitutes another challenging but necessary departure from the CSE blueprint. In the CSE setting, investors are the principal beneficiaries of the regulatory framework. In contrast, with social finance, those who benefit from regulation include the investors, the issuers, and Consumer and Worker-Beneficiaries. Such a multiplication of regulatory beneficiaries requires a multiplication of the subjects of regulation, which must include investors.

Regulating investors is particularly important for an SSE like IX that promises liquidity and the freedom to exit investments. Liquidity or ease of exit can be problematic for a couple of reasons. First, it encourages short-termism, whereby long-term opportunities are sacrificed to meet short-term expectations of return.²⁷¹ Short-termism can be dangerous in any context,²⁷² but particularly in impact investing where social gains can take longer to materialize than financial returns—or losses. Indeed, as the SVX documents indicate, financial returns may be disappointing for indefinite periods of time. Should investors fail to grasp the special-ness of this space and exit too quickly, they could drive down the value of securities and jeopardize the missions of the issuers and of the SSE. Second, investors who trade in liquid impact securities could vary in their social commitment and some may pressure issuers to prioritize profitability over impact, to the detriment of beneficiaries. For these reasons, it is important that SSE investors be truly patient and harbor different expectations of short-term returns than their CSE counterparts.

One way for SSEs to regulate investors is through the administration of an investor screen designed to ensure that investors seeking platform access are true impact investors. The SVX Investor Agreement requires that investors acknowledge the possibility that their investments will yield no financial return. Especially when combined with the deal cap, the Investor Agreement serves to manage investor expectations and deter profit-first investors from accessing the platform. We can think of the SVX mechanism as a self-selection screen that investors can use to decide if the platform suits their needs. While self-selection is a powerful screening device, it would be preferable to have a screen that is administered by the SSE to ensure that access to the market for social impact is granted only to patient investors. Where self-selection is

²⁷¹ See LYNN STOUT, *THE SHAREHOLDER VALUE MYTH: HOW PUTTING SHAREHOLDERS FIRST HARMS INVESTORS, CORPORATIONS, AND THE PUBLIC* 3-4 (2012) (challenging shareholder primacy as an ideology—not a law—that requires directors of public corporations to maximize shareholder wealth rather than prioritize long term goals like “growing the firm, creating quality products, protecting employees, and serving the public interest”).

²⁷² In the conventional finance context, proposals for a transactions tax or a Tobin Tax are directed at this issue, see Q&A: What Is the Tobin Tax on Financial Trading, available at <http://www.bbc.com/news/business-15552412>.

the only tool for regulating investors, as is the case with IX, the beneficiary sphere of SSE regulation may be under-protected.

Self-selection should therefore be supplemented with other devices, such as an investor agreement similar to the one employed by SVX, or a "Patient Investor Code of Conduct" to which investors would subscribe before being granted admission to the platform. The Code, a type of soft law, would explain what it means to be a patient investor, includes a list of dos and don'ts to guide behavior, as well as substantive commitments. For example, signatories could commit to holding investments for a minimum period of time, e.g. three years, and selling impact securities only to other screened investors or Code signatories. They could further commit to prioritizing impact expansion over profit extraction, which would allow/encourage investees to reinvest profits into their programs and lower investor expectations of receiving high dividends or interest on debt instruments.

Such (soft) commitments would combine to create an asset-lock mechanism similar to the U.K.'s, but this time focused on investors rather than issuer businesses. The Code, fleshed out with principles and commitments, would further serve to identify the type of investor conduct that constitutes a social breach, which would bolster SSE enforcement mechanisms, as recommended above. Rather than each SSE having its own code, it might be preferable for an industry player like the GIIN to develop a single Patient Investor Code of Conduct and to require that investors subscribe to it as a condition for GIIN membership. SSEs could then simply add GIIN membership to their individual investor screens.

In preparing the Code, drafters could consult the U.K. Stewardship Code, which applies to signatory institutional investors in publicly traded companies on a "comply or explain" basis.²⁷³ That document contains seven principles designed to "protect and enhance the value that accrues to the ultimate beneficiary."²⁷⁴ Signatory investors (1) publicly disclose their policy on how they will discharge their stewardship responsibilities; (2) have a robust policy on managing conflicts of interest in relation to stewardship which should be publicly disclosed; (3) monitor their

²⁷³ See FIN. REPORTING COUNCIL, THE U.K. STEWARDSHIP CODE 6-10 (2012), <http://www.frc.org.uk/getattachment/e2db042e-120b-4e4e-bdc7-d540923533a6/UK-Stewardship-Code-September-2012.aspx> (detailing the guiding principles overseeing investor stewardship).

²⁷⁴ *Id.*

investee companies; (4) establish clear guidelines on when and how they will escalate their stewardship activities; (5) be willing to act collectively with other investors when appropriate; (6) have a clear policy and disclosure of voting activity; and (7) report periodically on their stewardship and voting activities.²⁷⁵ For SSEs, Principles (2), (3), and (4) are the most relevant because they invite investors to actively participate in the pursuit of their investee's mission, while committing them to refrain from engaging in self-serving conduct.

An important adjustment to the Stewardship Code for social finance purposes would involve expanding the definition of "ultimate beneficiary" to include not only the investor's clients (those on whose behalf investors allocate capital) but also Worker and Customer-Beneficiaries. With this fundamental adjustment, much of what is contained in the U.K. Stewardship Code could be usefully incorporated into a Patient Investor Code of Conduct. Since investors in the social finance space are heterogeneous in terms of their size, mission, and complexity, the "comply or explain" principle should apply in the SSE context as well, so as to allow investors (justified) latitude in observing some principles more than others.

Having a code would serve not only to regulate investor conduct but also, as Belifanti puts it, to "cultivate" investors to provide the type of capital that issuers and co-investors want to see circulating within the market for social impact. Belifanti explains that the aim of "[c]ultivation is to identify, attract, and cultivate a core of committed . . . stewards who understand the firm's purpose and value proposition"²⁷⁶ The underlying notion is that where investors collaborate with investees to advance the mission, the opportunities for disruptive conflicts of interest and managerial maneuverings are lessened.

She proposes several tools for incentivizing cultivation: Businesses could issue what she calls "MY Shares or Mission-Yield shares," that give greater voting rights to stewards; they could also issue time-weighted dividends that increase in proportion to the length of a steward's investment; or "mission-weighted" dividends that depend not on the duration but the quality of the investment;

²⁷⁵ *Id.*

²⁷⁶ Belifanti, *supra* note 74 at 792, 812 (identifying two main characteristics of stewards: (1) their "investment behavior meshes with the firm's vision and operational strategy;" and (2) the steward "understands and is supportive of the firm's mission and management's long-term strategy . . .").

issuers could also set up a stewards “rewards” program and points could be applied toward the purchase of additional shares or firm products and services.²⁷⁷ Such investor benefits could incentivize good stewardship and offset some of the costs of being regulated. For those investors who behave in opposition to their investee’s mission, Belifanti suggests “de-cultivation” tools, such as share buybacks and going private.²⁷⁸ While these (de)cultivation tools would be put to use by issuers, not SSEs, the latter could encourage listed entities to adopt them as part of their corporate governance.

6.5. *Grievance Mechanisms*

A key ingredient for CSE success is investor trust. This is equally important in the SSE context, though with yet another social adjustment: The SSE marketplace must be trusted not only by investors, but also by the issuers, who should be “matched” with investors whose values and priorities align with their own. SSEs have a big part to play in creating healthy matches and making sure that everyone is on the same hybridity plane. Should matches that start out right become wrong, issuers and investors should have access to recourse.

In the CSE context, investors are able to register complaints about inappropriate issuer conduct. They should be able to do this in the SSE context as well. Additionally, SSE issuers should be able to register complaints concerning inappropriate investor conduct — perhaps consulting the above mentioned Patient Investor Code of Conduct. Having the opportunity to air complaints about the investor/ee relationship through an SSE administered grievance mechanism could be hugely beneficial for keeping interests aligned within this delicate hybrid space and for trust building generally.²⁷⁹ Ideally, beneficiaries would also be able to register complaints about social businesses. The multiplicity of regulatory beneficiaries fundamentally distinguishes conventional from social finance

²⁷⁷ *Id.* at 845.

²⁷⁸ *Id.* at 842-44.

²⁷⁹ See Kishanthi Parella, *Procedural Fairness by the Corporation*, 56 VA. J. INT’L L. (forthcoming 2016) (on file with author), Abstract available at <http://ssrn.com/abstract=2557030> (explaining that firm-level grievance mechanisms are important for building trust between workers, community stakeholders, and employers).

regulation, and grievance mechanisms could be important for accommodating this difference. In setting up such a mechanism, SSEs could consider the model of the World Bank's Inspection Panel, which allows individuals (in groups of two or more) who have been negatively affected by Bank projects to bring their claims to an independent panel for review.²⁸⁰ Though it may be too challenging this early in SSEs' lives to establish a grievance mechanism for beneficiaries, it is something to aspire to down the line. For now, the recommended adjustments to the listing and governance requirements should help create some degree of three-way accountability.

The adjustments to the CSE blueprint recommended in this Part may be viewed as onerous to conventional investors. However, this is likely not the case for those impact investors who are serious about safeguarding investee missions and achieving social welfare gains. In fact, the latter's trust in the SSE marketplace could be deepened if they share express social commitments with other investors on the platform, and if mechanisms are put in place to stimulate compliance with those commitments. In other words, while some may be concerned about the chilling effects of regulating the market for impact as recommended here, better regulation would ultimately advance the interests of anyone who is sincerely committed to realizing the potential of social finance.

7. CONCLUSION

Proponents of social finance see it as a vehicle for transforming the role of business in society and harnessing market forces to better meet social challenges. Critics see it as symptomatic of a problematic over-reliance on markets to tackle every type of problem, even social problems that may be better addressed without expectations of return. The concern is that by injecting the social provisioning system with an ROI mentality, we risk deepening, rather than reducing, the vulnerability of the world's poor. My own position is that the market for social impact is not yet mature enough

²⁸⁰ See generally *How To File a Request for Inspection to the World Bank Inspection Panel*, available at http://ewebapps.worldbank.org/apps/ip/Documents/Guidelines_How%20to%20File_for_web.pdf; *Meet the Panel*, available at <http://ewebapps.worldbank.org/apps/ip/Pages/MeetthePanel.aspx>.

to justify adopting one view or the other categorically. However, in order to ensure that the critical view does not become prophecy, regulatory frameworks must be upgraded to better govern the growth of social finance.

As transnational rulemaking laboratories for social finance, SSEs are ideal vehicles for testing regulatory solutions that meet the specific requirements of social finance. SSEs are not the only (or even the best) regulators of social finance, but they do provide a unique opportunity to imagine new ways of regulating in the interest of the poor. It would be a shame not to make the most of this opportunity, especially while the market for social impact is still being formed.

This article has argued that to serve as effective regulators, SSEs must add a beneficiary-protection mandate to the conventional investor-protection mandate. They must strive to inject beneficiary protections into every dimension of their work including the mission statement, listing and corporate governance requirements, reporting requirements, and enforcement mechanisms. Social regulations should be imposed not only on the listed businesses, but also on the investors who transact on these platforms, in order to minimize incentives to drift from the social mission. Such regulatory innovations would contribute greatly to realizing the potential of social finance, ensuring that its promises are fulfilled, not undermined.