

Social investment objectives: can they be legally binding?

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People who fund philanthropic enterprises have a natural inclination to want to ensure that their money is used for the purposes for which they gave it. If a wealthy donor gives money to a charity to fund a hospital for sick children, he or she will not want to find out that the money has in fact been used to fund a home for the elderly, or worse still the salary of the charity's CEO. Even those giving smaller amounts to charity are often concerned to know how much of the charity's income is spent on administration and how much on its charitable objectives.

The traditional way of ensuring that money is used for a particular purpose in the UK is to give a charity 'restricted funds' – funds which are specifically earmarked for a purpose.

As a matter of charity law, the charity can only use the money for that purpose. Money is of course fungible, and there is no requirement to keep restricted funds in a segregated account. So, over time, restricted funds may be represented by investments or even creditors rather than cash. Sadly, the history of the UK charitable sector is littered with examples of charities which, under financial pressure, have used restricted funds to meet day-to-day expenditure, and of donors who have had little interest in checking that their donations are in fact used for the specified purpose.

In the new world of social investment the restricted funds mechanism is unlikely to be adequate. Money provided under social bonds and other new types of social finance may not go directly to a charity, but instead to a special purpose vehicle set up for the purpose of the project to be financed. That vehicle may not be subject to the constraints of UK charity law: it may not even be set up in a country with a clear body of charity law. More importantly, among philanthropists and their foundations, there is a shift in mindset from 'donor' to 'investor': investors want to get some or all of their money back, and instead of the normal financial investment return they expect to see a social return.

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As a result, rather than using the framework of charity law to enforce social investment objectives, investors are turning to the tools of contract law. This brings with it its own constraints. For example, one of



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the requirements of contract law in most jurisdictions is certainty: so social investment objectives included in a contract must be clear and, preferably, measurable. By way of example, an objective which says something like, ‘the funds raised by the issue of these social bonds must be used to improve living conditions in the poorer areas of Nairobi’, creates a number of uncertainties. Clearly the funds could not be spent on improvements to living conditions in Mumbai. But what exactly is meant by ‘living conditions’? What sort of improvements is envisaged? Which specific areas of Nairobi are contemplated?

It is up to those promoting social investment projects to consider these issues carefully so that the expectations of investors are not disappointed. Some suggestions about framing social investment objectives are:

- Careful attention should be paid to issues such as the geographical definition of the project, identification of the beneficiaries and delineation of the social benefits to be achieved.
- Building in a measurement methodology from the start of the fundraising process will assist in achieving certainty.
- Sponsors should also consider some form of regular reporting to investors, just as commercial companies report to their shareholders.
- It may also be appropriate to consider what will happen if the funds raised prove to be insufficient to achieve the objectives, or if there is money left over after the objectives have been achieved.

Following these rules, the sample objective might be redrafted as follows:

‘The funds raised by the issue of these social bonds must be used in providing a supply of clean water to the area of Nairobi shown on the attached map to persons earning less than 20% of the average weekly wage in Kenya as published by the Government of Kenya. For this purpose, the number of dwellings having the benefit of a water supply and the cleanliness of the water supplied shall be measured in accordance with the methodology set out in the Appendix. The issuer of the bonds shall provide semi-annual reports to the investors on the progress towards achieving this objective.’

Most investors in social bonds are not expecting to take legal action against the sponsors to enforce the objectives the sponsors themselves have set. But they are entitled to expect a robust legal framework which constrains how their money is used. Some have suggested that this may require amendments to charity law or even completely new legislation. However, contract law, which has served business so well over many hundreds of years, is flexible enough to do what is needed, provided careful thought is applied to project definition from the outset.

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