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Combining Social Welfare and Capital Markets Through SSE

On February 22, the National Stock Exchange of India received the final approval from the markets regulator Securities and Exchange Board of India (SEBI) to set up a Social Stock Exchange (SSE). Finance Minister Nirmala Sitharaman, presenting the Union Budget back in 2019, had proposed to initiate steps for creating a stock exchange under the market regulator's ambit. She had argued that it was time "to take our capital markets closer to the masses and meet various social welfare objectives to inclusive growth and financial inclusion." The proposal was cleared in September 2021.

What is a Social Stock Exchange?

The SSE would function as a separate segment within the existing stock exchange and help social enterprises raise funds from the public through its mechanism. It would serve as a medium for enterprises to seek finance for their social initiatives , acquire visibility and provide increased transparency about fund mobilisation and utilisation. Retail investors can only invest in securities offered by for-profit social enterprises (SEs) under the Main Board. In all other cases, only institutional investors and non-institutional investors can invest in securities issued by SEs.

What about eligibility?

Any non-profit organisation (NPO) or for-profit social enterprise (FPSEs) that establishes the primacy of social intent would be recognised as a social enterprise (SE), which will make it eligible to be registered or listed on the SSE.

The seventeen plausible criteria as listed under Regulations 292E of SEBI's ICDR (Issue of Capital and Disclosure Requirements) Regulations, 2018 entail that enterprises must be serving to eradicate either hunger, poverty, malnutrition and inequality; promoting education, employability, equality, empowerment of women and LGBTQIA+ communities; working towards environmental sustainability; protection of national heritage and art or bridging the digital divide, among other things.

At least 67% of their activities must be directed towards attaining the stated objective. This is to be established by enumerating that, in the immediately preceding three-year period, either 67% of its average revenue came from the eligible activities, expenditure (in the same proportion) was incurred towards attaining the objective or the target population constitute 67% of the overall beneficiary base. Corporate foundations, political or religious organisations or activities, professional or trade associations, infrastructure and housing companies (except affordable housing) would not be identified as an SE. Additionally, NPOs would be deemed ineligible should it be dependent on corporates for more than 50% of its funding.

How do NPOs raise money?

NPOs can raise money either through issuance of Zero Coupon Zero Principal (ZCZP) Instruments from private placement or public issue, or donations from mutual funds. SEBI had earlier recognised that NPOs by their very nature have primacy of social impact and are non-revenue generating. Thus, there was a need to provide NPOs a direct access to securities market for raising funds. ZCZP bonds differ from conventional bonds in the sense that it entails zero coupon and no principal payment at maturity. The latter provisions a fixed interest (or repayment) on the funds raised through varied contractual agreement, whereas ZCZP would not provision any such return instead promising a social return.

What is a not-for-profit organisation in the context of the Social Stock Exchange?

A not for profit organisation is an entity which meets the criteria to be identified as a social enterprise and is any of the following entities:

- A charitable trust registered under the public trust statute of the relevant state;
- A charitable society registered under the Societies Registration Act, 1860 (21 of 1860);
- A company incorporated under section 8 of the Companies Act, 2013 (18 of 2013);
- Any other entity as may be specified by SEBI

Which entity can be identified as a for profit social enterprise in the context of Social Stock Exchange?

A for profit social enterprise is an entity which meets the criteria to be identified as a social enterprise and is any of the following entities:

- A company under the Companies Act, 2013, operating for profit and does not include a company incorporated under section 8 of the Companies Act, 2013 (18 of 2013);
- A body corporate operating for profit

Is this meant for Indian entities only or international NPOs can also get registered?

- Only Indian entities can register in the Social Stock Exchange.
- Foreign investors like FII's, FPI's or NRI investors, will not be allowed to invest in NPOs fund raising.

What are the tax benefits?

- Investors will get Section 80G benefits which allow all investments in securities/instruments of NPOs listed on SSE to be tax deductible, and corporates to deduct CSR expenditure from their taxable income, among other things.
- Investment by companies will be considered as part of their Corporate Social Responsibility (CSR) initiatives.

It is mandatory that the NPO is registered with the SSE for facilitating the issuance. The instrument must have a specific tenure and can only be issued for a specific project or activity that is to be completed within a specified duration as mentioned in the fund-raising document (to be submitted to the SSE). It must also demonstrate the requisite expertise through their performance in similar projects in the past, thus, acquiring investor confidence and tackle concerns about potential default.

The minimum issue size is presently prescribed as Rs 1 crore and minimum application size for subscription at Rs 2 lakhs for ZCZP issuance. The NPO may choose to register on the SSE and not raise funds through it but via other means. However, they would have to make necessary disclosures about the same.

Significance of SSEs

- SSE is a novel concept in India and it is meant to serve the private and non-profit sectors by channelling greater capital to them.It will also make investing in social ventures easier for morally conscious investors.
- This would be set up "under the regulatory ambit of SEBI for listing social enterprises and voluntary organisations working for the realisation of a social welfare".
- The establishment of the Social Stock Exchange is expected to create more opportunities for Social Auditors since the regulation makes it mandatory for social enterprises which are keen to list on the platform and raise money to undergo social audit.

What about on completion of projects?

Another structured finance product available for NPOs is the Development Impact Bonds. Upon the completion of a project and having delivered on pre-agreed social metrices at pre-agreed costs/rates, a grant is made to the NPO. The donor who makes the grant upon achieving the social metrics would be referred to as 'Outcome Funders'.

Since the payment above is on post facto basis, the NPOs would have to also raise money to finance their operations. This is done by a 'Risk Funder' who alongside enabling the financing of operations on a pre-payment basis, also bears the associated risk with non-delivery of social metrics. S/he typically earns a small return if the metrics are delivered.

How do FPOs raise money?

For-Profit Enterprises (FPEs) need not register with social stock exchanges before it raises funds through SSE. However, it must comply with all provisions of the ICDR Regulations when raising through the SSE. It can raise money through issue of equity shares (on main board, SME platform or innovators growth platform of the stock exchange) or issuing equity shares to an Alternative Investment Fund including Social Impact Fund or issue of debt instruments.

What disclosures need to be made?

SEBI's regulations state that a social enterprise should submit an annual impact report in a prescribed format. The report must be audited by a social audit firm and has to be submitted within 90 days from the end of the financial year. Listed NPOs, on a quarterly basis, are specifically required to furnish details about the money they have raised category-wise, how they have been utilised and the unutilised balance amount. The latter needs to be furbished until the proceeds are fully utilised or the purpose has been achieved.

Expected Question

Que. With reference to Social Stock Exchange (SSE), consider the following statements-

1. For-Profit Enterprises (FPEs) are not required to register with social stock exchanges before raising funds through SSEs.
2. Only Indian entities can register on the Social Stock Exchange.

Which of the statements given above is/are correct?

(a) Only 1

(b) Only 2

(c) Both 1 and 2

(d) Neither 1 nor 2

Answer : C

Mains Expected Question & Format

Que.: What is Social Stock Exchange? How does the Social Stock Exchange work and throw light on the importance and methods of raising funds through this exchange?

Answer Format :

- What is social stock exchange?
- How does it work and explain its importance.
- give a balanced conclusion.

Note: - The question of the main examination given for practice is designed keeping in mind the upcoming UPSC mains examination. Therefore, to get an answer to this question, you can take the help of this source as well as other sources related to this topic.