ESG PUSH IN INDIAN CAPITAL MARKETS :

SOCIAL STOCK EXCHANGE (SSE) FRAMEWORK

Summary :

1. INTRODUCTION

The authority on capital markets, Securities & Exchange Board of India (SEBI), has announced a framework for the social stock exchange in 2022 to give social businesses another option to raise money.

The recommendations of a working group and technical group, assembled by the regulator, served as the foundation for the development of the Social Stock Exchange (SSE) framework.

A social stock exchange is a venue for social entrepreneurs involved in making a positive social impact to list shares and raise money. Such an exchange would be beneficial to businesses seeking funding as well as sociable investors looking for legitimate businesses operating in the social sectors. It would be a different component inside the existing Indian stock exchanges. Unlike traditional stock exchanges, SSE has a higher purpose that should be represented in their governance, structure, and operations.

2. WORKING OF SSE AROUND THE WORLD

A recent development in India is the Social Stock Exchange (SSE), which essentially allows social entrepreneurs to list themselves in order to raise funds in the form of loan or equity. The Hon'ble Finance Minister had recommended that we begin initiatives towards the same under the regulatory purview of SEBI as stated in the 'budget address' for FY 2019-2020. Conclusively, a Technical Group was established in May 2021 after the Working Group on Social Stock Exchange was established in September 2019. The SEBI published a notification on July 25, 2022, to alter the SEBI (Issue of Capital and Disclosure Requirements), 2018 and add Chapter X-A, which only discusses Social Stock Exchange.

Brazil was the first country to implement an SSE in 2003, however, it is no longer in use. The establishment of Social Stock Exchanges around the world is depicted in the following table:

S. No.	Name of SSE	Year of Establishment	Country
1.	Bolsa de Valores Socioambientais (BVSA)	2003	Brazil
2.	Social investment Exchange (SASIX)	2006	South Africa
3.	Bolsa de Valores Sociais (BVS)	2009	Portugal
4.	Impact Exchange (IX)	2013	Singapore
5.	Social Venture Connexion (SVX)	2013	Canada
6.	UK SSE	2013	United Kingdom
7.	Jamaica SSE	2019	Jamaica

Among these, only three are active including Canada, Jamaica and Singapore; while the other four are no longer in operation.

3. Key Takeaways from the International Scenario of SSEs

3.1 A Key Part Of Influencing SSE Structure Is Played By Domestic Regulations And Tax Laws

Some countries provide legal recognition to social enterprises to facilitate their listing and ensure that such organisations generate financial as well as socio-environmental returns. Others allow and receive, in addition to receiving donations, enabling them to float debt instruments. Some countries have specific mechanisms on stock exchanges that allow unlisted securities to be traded or provide exemptions from full disclosure and sale requirements.

3.2 For-Profit And Non-Profit Organisations Are Housed In Most SSEs

Developed countries with mature financial and capital markets have used SSEs to strengthen impact investing spaces for revenue-earning non-profits and for-profit entities, while developing countries have tried to be more inclusive of non-profits. The SSE structure may favour organisations not necessarily based on their quality or efficiency, but on their market language, or employing English-speaking talent from the private sector, instead of focusing on smaller local and/or grassroots organisations. All SSEs offer a variety of capacity-building services to social organisations, ranging from basic support to meet the eligibility criteria, monitoring and reporting assistance, to customized services such as business consulting.

3.3 SSEs Concentrate On A Few Prominent, Thematic Areas

While SSEs are generally cause-agnostic, they are likely to perpetuate funding imbalances towards thematic areas that are more visible and lend themselves to revenue streams. A review of 123 projects listed on six SSEs showed that environment projects were the most popular (25% of all projects), primarily because of the dominance of social businesses in sectors such as clean technology. These were followed by projects focused on livelihood, healthcare, and people with disabilities. Mental health, gender-based violence, care of the elderly, and policy-advocacy projects were less common. Most SSEs prioritize project financing over raising core funds to help set and scale organisational processes and systems.

3.4 Even Though SSEs Permit A Variety Of Donors And Investors, Institutional Investors Are More Prevalent

All currently operating SSEs accept institutional as well as retail investors, including those who make one-time and smaller gifts (foundations or high-net-worth individuals with regular and larger donations). The absence of acceptable products that strike a balance between risk and return, regulatory restrictions, and the high cost of servicing them, limit options for ordinary investors. In order to generate demand for their services and educate stakeholders on the conditions and subtleties of funding social organisations, the majority of SSEs also lay strong emphasis on educating investors and donors.

3.5 SSEs Have Robust Metrics For Measuring And Reporting, But They Do Not Always Capture Impact

All SSEs require impact measurement and reporting from social organisations pre- and post-listing, but reflect the challenges faced by the social sector in developing robust, contextualized outcome metrics and templates. Output indicators, such as coverage in terms of the number of people impacted, are the most commonly reported metrics. Some SSEs require mandatory third-party verification of reported impact. Most SSEs measure their own impact based on the number of projects and thematic areas they have supported along with the amount of funds raised.

Very few SSEs are able to capture wider changes to the social organisation ecosystem, including the enabling, standardizing policies and lower transaction costs they claim to catalyse.

3.6 Scale And Sustainability Challenges Are Faced By SSEs

Of the eight SSEs considered in the study, three are active (Canada, Jamaica, Singapore), one (India) is proposed and four (Brazil, Portugal, South Africa, UK) are no longer in operation. Social stock exchanges' ability to cover their costs, as well as the experimental nature of early SSEs, were highlighted as relevant factors in SSE sustainability. Seven SSEs got charity money to help them develop and launch their businesses, but this was frequently not enough to cover operational expenses because the SSEs did not charge enough for their services due to lack of scale and demand.

3.7 SSEs Could Contribute To The Development Of The Social Sector

Most SSEs have played a role in strengthening social sectors in their respective countries through the introduction of standardized impact reporting and benchmarks, prompting policy changes to empower the sector, encouraging transparency and building trust among various stakeholders such as the government, social organisations, businesses and the public. However, this role has been limited by the relatively small reach and duration of many SSEs.

4. SOCIAL STOCK EXCHANGE IN INDIA

The Hon'ble Finance Minister as part of the Budget Speech for FY 2019-20 had proposed to initiate steps towards creating a social stock exchange, under the regulatory ambit of Securities and Exchange Board of India, for listing social enterprise and voluntary organizations.

Subsequently, SEBI, in September 2019 constituted a working group (WG) to make recommendations w.r.t possible structures and mechanism within securities market domain. The working group consisted representatives of stakeholders active in the space of social welfare, social impact investing, representatives from Ministry of Finance, the stock exchanges and NGOs.

The working group had a series of consultations with various stakeholders including voluntary organizations, social enterprises and philanthropic organizations in order to assess the difficulties faced by them in raising funds/ donating funds.

Accordingly, SEBI in September 2020 constituted a Technical Group on SSE that was tasked to recommend on matters related to scope of work, eligibility criteria and regulation of social auditors. The Technical Group (TG) also considered the public comments received in respect of the WG report. The TG built upon the recommendations of the WG.

5. KEY RECOMMENDATIONS OF THE WG AND TG

The following areas of the SSE are centred on the working group's and technical group's main recommendations (referred to as expert groups):

The Social Stock Exchange might be established as a distinct division inside the current stock exchanges. If a social enterprise can show that its main objectives are having a positive social impact and reporting on that impact, it can be qualified for SSE on boarding.

The TG has also suggested a number of actions to establish the social aim of the business as the primary one, which are described in more detail in the following sections.

5.1 The TG has advised that NPOs may be required to be registered before raising funds through SSE and has put out a set of qualifying criteria for registration in order to instil a cultural shift and assist the transition towards a disclosure based regime.

5.2 The TG has suggested that after registration, NPOs be allowed to list directly on SSE by issuing Zero Coupon Zero Principal Bonds. Companies under Section 8 are permitted to raise money by issuing equity. Social venture funds, development impact bond structures, and donations made through mutual funds are a few other options open to NPOs.

5.3 The TG noted that various SEBI Regulations provide sufficient regulatory standards for listing instruments such as equities and debt issued by FPEs. FPEs may list their securities on the relevant existing board, such as the main board for debt securities, the SME or IGP for equity securities, or the main board for debt securities.

5.4 The expert groups proposed that the current legal framework for social venture funds be changed according to the following factors in order to make it easier for social companies to raise money through AIFs:

- 5.4.1 Social Impact Funds could replace Social Venture Funds (SVFs)
- 5.4.2 Permission may be granted for the establishment of a new type of SVF that is only available to SSE and is based on a grants-in, grants-out methodology.
- 5.4.3 Similar to angel funds under AIF, the minimum corpus requirements for SIFs may be lowered from Rs. 20 Crores to Rs. 5 Crores.
- 5.4.4 You can set the minimum subscription amount at Rs. 2 lakh (for individuals). For corporations, it will always be Rs. 1 crore.

5.5 The SEBI (Alternative Investment Fund) Regulations, 2012 may be amended to delete the reference to "muted returns." The TG recommended that NPO or FPE that are designated as social enterprises be required to disclose their social impact on an annual basis, covering topics like strategic intent, planning, approach, impact scorecard, etc. FPEs must also abide by the segment's disclosure rules where they are listed, but NPOs may have their own set of annual statements including governance and financial matters.

5.6 Social audits, or audits of social effect, are necessary for entities on SSE. To start, only reputable businesses or institutions with the necessary knowledge may be permitted to conduct social audits. These organisations must hire social auditors who have completed a certified certification programme offered by NISM. It will be necessary for Social Auditors to be appointed by an SRO, which is anticipated to fall under ICAI as a distinct Sustainability Directorate.

5.7 In addition to raising awareness, a Rs. 100 crore capacity building fund (CBF) will be established to help NPOs and other stakeholders understand the SSE's procedures, tools, etc. CBF might be kept in NABARD as a management fund.

5.8 To give fundraising structures a boost, several relaxations in the deployment of CSR monies have been suggested. Furthermore, several tax incentives have been suggested in order to promote a culture of giving.

6. SEBI (ISSUE OF CAPITAL AND DISCLOSURE REQUIREMENTS) (AMENDMENT) REGULATIONS, 2022

The amendment inserts a new Chapter X-A, which deals specifically with Social Stock Exchange.

6.1 Regulation 292A under the chapter enlists some of the key definitions such as:

6.1.1 **For Profit Social Enterprise**- means a Social Enterprise which comprises of any of the following entities:

- 6.1.1.1 Charitable trust registered under the Indian Trusts Act, 1882 (2 of 1882);
- 6.1.1.2 Charitable trust registered under the public trust statute of the relevant state;
- 6.1.1.3 Charitable society registered under the Societies Registration Act, 1860 (21 of 1860);
- 6.1.1.4 Company incorporated under section 8 of the Companies Act, 2013 (18 of 2013);
- 6.1.1.5 Any other entity as may be specified by the Board;

6.1.2 **Not for Profit Organization**- means a company or a body corporate that does not earn profit, is a Social Enterprise for the purposes of these regulations and does not include a company incorporated under section 8 of the Companies Act, 2013.

6.1.3 **Social Auditor**- means an individual registered with a self-regulatory organization under the Institute of Chartered Accountants of India or such other agency, as may be specified by the Board, who has qualified a certification program conducted by National Institute of Securities Market and holds a valid certificate;

6.1.4 **Social Audit Firm**- means any entity which has employed Social Auditors and has a track record of minimum three years for conducting social impact assessment;

6.1.5 **Social Enterprise**- means either a Not for Profit Organization or a For Profit Social Enterprise that meets the eligibility criteria specified.

6.1.6 **Social Stock Exchange-** means a separate segment of a recognized stock exchange having nationwide trading terminals permitted to register Not for Profit Organizations and / or list the securities issued by Not for Profit Organizations in accordance with provisions of these regulations.

6.2 As per Regulation 292B, this chapter would be applicable to the following:

6.2.1 Not for Profit Organization seeking to only get registered with a SSE;

6.2.2 Not for Profit Organization seeking to get registered and raise funds through a SSE

6.2.3 For Profit Social Enterprise seeking to be identified as a Social Enterprise under the law

Further, the chapter also provides for constitution of a social stock exchange governing council. It is to be noted that the social stock exchange would be accessible only to the institutional and non-institutional investors.

6.3 Regulation 292E talks about the eligibility criteria for being identified as a Social Enterprise. It says that the not for profit organisation or for a profit, social enterprise needs to establish primacy of its social intent in order to be identified as a Social Enterprise. Further, it enlists some criteria to establish the same.

In addition to this, it also states that the said Social Enterprise shall target the less privileged segments of population or lower performance in development priorities of the Central or State government.

It is important to note that the Social Enterprise shall have at least 67% of its activities, qualifying as eligible activities to the target population, to be established through one or more of the following:

6.3.1 At least 67% of the immediately preceding 3-year average of revenues comes from providing eligible activities to members of the target population;

6.3.2 At least 67% of the immediately preceding 3-year average of expenditure has been incurred for providing eligible activities to members of the target population;

6.3.3 Members of the target population to whom the eligible activities have been provided constitute at least 67% of the immediately preceding 3-year average of the total customer base and/or total number of beneficiaries.

The following are not eligible to be identified as a Social Enterprise:

6.3.4 Corporate foundations

6.3.5 Political or religious organizations or activities

6.3.6 Professional or Trade associations

6.3.7 All infrastructure and housing companies, except affordable housing only

6.4 Regulation 292F provides that a Not for Profit Organization shall mandatorily seek registration with a Social Stock Exchange before it raises funds through a Social Stock Exchange. However, it can also choose to only register itself with the social stock exchange and not raise any funds through it.

6.5 Regulation 292G provides the means for raising funds by the Social Enterprises. It provides that a **Not for Profit Organization** may raise funds on a Social Stock Exchange through:

6.5.1 Issuance of ZCZP Instruments to institutional/non-institutional investors

6.5.2 Donations through Mutual Fund schemes as specified by the Board;

6.5.3 Or any other means as specified by the Board

A **For Profit Social Enterprise** may raise funds through:

6.5.4 Issuance of equity shares on the main board, SME platform or innovators growth platform or equity shares issued to an Alternative Investment Fund including a Social Impact Fund;

6.5.5 Issuance of debt securities;

6.5.6 Any other means as specified by the Board from time to time

6.6 Regulation 292H provides the ineligibility criteria for raising funds by the Social Enterprises through a social stock exchange.

6.7 Regulation 292I says that a Zero Coupon Zero Principle Instruments, having specific tenure shall be issued only by a not for profit organisation on the social stock exchange. Further, this instrument shall be issued without any coupon and no principle amount shall be payable at its maturity. Further, these instruments can also be listed in the social stock exchange and can also be issued for a specific project or activity for a specific duration as provided in the fund raising document.

6.8 Regulation 292K provides procedure for public issuance of the zero coupon zero principle instruments by a not for profit organisation. The steps are as follows:

6.8.1 File a draft fund-raising document with the social stock exchange

6.8.2 File an application seeking in-principle approval for listing of its zero coupon zero principle instrument

6.8.3 Draft fund raising document shall be made available on the website of the social stock exchange and the not for profit organisation for at least 21 days to seek public comments

6.8.4 Social stock exchange shall then provide its observation on the draft fund raising document within 30 days of the filing of the same or receipt of clarification sought by the social stock exchange from the not for profit organisation.

6.8.5 Not for profit organisation shall incorporate the observations and file the final fund raising document prior to opening of the issue.

6.9 Regulation 292L provides for the issuance of zero coupon zero principle instruments by private issue. It says that the private issue can be made to Social Impact Funds registered under the applicable provisions of the Securities and Exchange Board of India (Alternative Investment Funds) Regulations 2012.

6.10 Regulation 292M provides for the contents of the fund raising documents and **Regulation 292N** provides for some other conditions relating to the issuance of the zero coupon zero principle instruments.

6.10.1 It shall be issued only in dematerialized form

6.10.2 Min. issue size = Rs. 1 Crore

6.10.3 Min. application size = Rs. 2 Lacs

6.10.4 Min. subscription required = 75% of the funds proposed to be raised through it

6.11 As per Regulation 292O, the public issuance of Zero Coupon Zero Principal Instruments by a registered Not for Profit Organization in accordance with these regulations shall be deemed to be in compliance with Rule 19 of the Securities Contracts (Regulation) Rules, 1957.

6.12 Regulation 292P provides for the termination of the listing of zero coupon zero principle instrument if any one of the following events occur:

6.12.1 The object for which the funds were raised has been achieved and a certificate to this effect is submitted to the Social Stock Exchange; or

6.12.2 The tenure to achieve the object for which the funds were raised as provided in the fundraising document has expired.

7. FRAMEWORK ON SOCIAL STOCK EXCHANGE (SSE)

7.1 Minimum requirements to be met by a Not-for-Profit Organization (NPO) for registration with SSE in terms of Regulation 292F of the ICDR Regulations

7.1.1 **Legal requirements-**

7.1.1.1 Entity registered as NPO
7.1.1.2 Ownership and control
7.1.1.3 Tax Exemption
7.1.1.4 Registration with Income Tax
7.1.1.5 Age of the NPO
7.1.1.6 Deduction under Income Tax
7.1.1.7 Social Enterprise eligibility

7.1.2 **Minimum fund flows-**

7.1.2.1 Annual spending for the last FY
7.1.2.2 Funding in the last FY

7.2 Minimal Disclosure at First Regulation 292K (1) of the ICDR Regulations requirement for NPOs raising money through the issuance of Zero Coupon Zero Principal Instruments.

7.2.1 The structure of the preliminary and final fundraising documents must be mandated by SSE, which will post these requirements on its website under the direction of the SSE Governing Council (SGC).

7.2.2 SSE shall ensure that the documents contain the following minimum disclosures:

Vision	Management
Target Segment	Finance

Strategy	Compliance
Operations	Credibility
Governance	Social Impact and Risks

7.3 Annual disclosure by NPOs on SSE pursuant to Regulation 91C of the LODR Regulations that have either received funding through SSE or are enrolled with SSE.

The NPOs would annually provide the below information within 60 days after the end of the fiscal year.

7.3.1 **Disclosures on General aspects:**

i. Name of the organization
ii. Location of headquarters and operations
iii. Vision / Mission / Purpose
iv. Organizational goals
v. Outreach of the organization
vi. Scale of operations
vii. Details of top donors/investors of the organization - List of Top 5 donors/investors
viii. Details of top 5 programs in disclosure period - List of Top 5 interventions/programs

7.3.2 **Disclosures on Governance aspects:**

i. Ownership
ii. Governance Structure
iii. Details of the governing body
iv. Name of executives with key responsibilities
v. Number of meetings by governing body along with attendance and the process of performance review
vi. Organisation-level potential risks and their mitigation plan against it
vii. Reporting related party transactions
viii. Mechanisms for advice and concerns about ethics
ix. Remuneration Policies
x. Stakeholder grievance, grievance redressal, and no. of grievances received and resolved
xi. Compliance management process

xii. Organisation registration certificate and other licenses/certifications

7.3.3 **Disclosures on Financial aspects:**

i. Financial Statement - Balance Sheet, Income statement, and Cash Statement
ii. Auditors’ report along with auditor details

7.4 In accordance with Regulation 91E of the Listing Obligations and Disclosure Requirement (LODR) Regulations, all social enterprises that have registered or raised money utilising SSE are required to disclose their annual impact reports.

7.4.1 Within 90 days at the end of the fiscal year, all social enterprises must submit an Annual Impact Report (AIR) that has been properly audited to SSE.

7.4.2 The AIR must include both qualitative and quantitative information about the entity's social effect, as well as, if relevant, the impact of the project or solution for which money has been solicited on SSE.

7.4.3 An NPO's major operations and projects during the year, as well as the methodology used to determine significance, must be covered in the AIR if the NPO is only registered without listing any securities. The mentioned security will also qualify as a substantial activity, intervention, programme, or project if it covers an activity, intervention, programme, or project.

7.4.4 A Social Impact Fund that has SEs as the underlying beneficiaries of money and that has registered or collected funds via SSE is required to report an overall AIR for the fund that includes all grantee and investee organisations.

7.4.5 The Annual Impact Report shall cover at least the following points mentioned below: -

a. Strategic Intent and Planning
b. Approach
c. Impact Score Card

7.4.6 SSE has the option to indicate extra information that SE may be compelled to include in its AIR.

7.4.7 Social Auditors must audit the AIR, and the SEs must also disclose the Social Auditor's report together with the AIR.

7.5 Statement of the use of money in accordance with LODR Regulations 91F.

According to Regulation 91F of the LODR Regulations, Listed NPO must send a statement of fund utilisation to SSE within 45 days at the end of the quarter, as required by SEBI.

SEBI grants its in-principle approval to BSE for introducing Social Stock Exchange as a separate segment on BSE

The capital market regulator Securities and Exchange Board of India (SEBI) has given the Bombay Stock Exchange (BSE) in-principle clearance for the establishment of the Social Stock Exchange as a separate segment, according to a regulatory filing made on October 7, 2022. It may be noted that the SEBI announced the Social Stock Exchange (SSE) rules in July this year with the aim to give social companies a boost by offering them another way to obtain money.

The social stock exchange is a novel idea in India, and by channelling more capital to the private and non-profit sectors, it is intended to benefit those sectors. While BSE has initiated the process, many other exchanges are expected to follow the trend within the country.