



Sustainability | Leadership | Innovation

ACCOUNTING FOR SUSTAINABILITY



2014 WINNER CASE STUDY

LESSONS IN DRIVING BUSINESS SUSTAINABILITY

A BETTER BOND

A new social bond fund offers investors the chance to back socially worthwhile projects while earning a good return.

THE BUSINESS

Threadneedle Investments is a global asset manager which invests in equities, fixed income, commodities, property and socially responsible investments.

THE IDEA

Threadneedle has launched a **UK Social Bond Fund** which gives investors the opportunity to put their money into organisations that deliver socially desirable outcomes as well as financial returns. For example, its investments focus on organisations that aid deprived communities or favour regional development outside the Greater South East. The Fund has invested in bonds issued by organisations such as Derbyshire Health Care, East Midlands Housing Association, and Walsall Housing Group. The Fund was launched in January 2014 in partnership with Big Issue Invest, the social investment arm of The Big Issue. The Fund invests in the fixed-income securities of organisations that support socially beneficial activities and economic development. 'We're using the market to provide social outcomes,' explains Simon Bond, Fund Manager. 'We're using the market positively and taking social investment into the mainstream.'

THE INNOVATION

The **UK Social Bond Fund** is a significant innovation in socially responsible investments, sometimes called 'impact investing'. Until now, impact investing has been associated with illiquid, higher risk, often equity-based private investment into ventures that have a specific outcome. The innovation challenge for asset managers has been to develop a credible, mainstream, daily priced investment product, which can appeal to a broad investor base ranging from pension funds through to ISA investors, which in addition contributes to social outcomes. The Fund aims to achieve respectable risk-adjusted returns in line with traditional UK corporate bond portfolios. In doing this, it has increased the range of individuals and organisations that are willing to commit funds to social investing.

“ The key to the Fund’s success is that the financial characteristics are the same as any other UK corporate bond fund. But there is the added benefit of the social outcomes. ”

The Fund is a diversified portfolio that targets positive benefits and outcomes across eight fields of social development:

- employment and training
- education, learning and skills
- community services
- health and social care
- financial inclusion
- transport, communications and infrastructure
- utilities and the environment
- housing and property

For example, the Fund has already invested £11.3m in the construction or refurbishment of social housing.

Big Issue Invest, working with Threadneedle’s socially responsible investment (SRI) team, developed a social assessment methodology that screens all investable bonds to determine which will deliver positive outcomes across the eight social development fields. The methodology provides the framework against which Threadneedle assesses the social attributes and intensity of an investment. It considers



Threadneedle has partnered with Big Issue Invest to launch the Threadneedle UK Social Bond Fund

these factors alongside a bond's yield and liquidity characteristics in order to build a balanced, diversified portfolio. Threadneedle believes this approach differentiates the **UK Social Bond Fund** from other products in the market that focus either on one specific sector (such as social housing), or which target a set of beliefs and values (such as ethical bond funds).

The **UK Social Bond Fund** has been launched at a time when funding is tight. But Threadneedle believes the provision of capital to support investments with social outcomes is increasingly important. It has identified a considerable demand from investors for social investment strategies.

Threadneedle set up the **UK Social Bond Fund** after commissioning market research from the Defined Contribution Investment Forum. The new Fund seeks to overcome one of the key dilemmas in UK social investing – the fact that many social investments are illiquid. This has too often made them unattractive from an investor perspective.

Threadneedle's strategy seeks to overcome illiquidity while, at the same time, creating a bond that is attractive to investors from the perspective of both financial and social outcomes. Threadneedle believes this approach can encourage the market for bond issuance among social organisations to develop and grow. At the same time, it can meet the needs of investors by providing a high quality fixed income component within their portfolio.

FINANCE FUNCTION LEADERSHIP

Whenever Threadneedle sets up a new fund, the finance function has an important role to play. The Finance team focuses on issues such as risk analysis and ensures there is financial rigour built into the fund's management and operations. It was the same for the **UK Social Bond Fund**.

But there was an extra significant dimension. Because Threadneedle is running the Fund at cost, the finance function had to work on a management accounting process to ensure that the Fund had the resources it needed yet covered its administrative costs from fees received, given that a portion of the fees is remitted to Big Issue Invest. 'The finance function's role was to ensure that the way the Fund was set up and structured was appropriate,' says Iain Richards, Head of Governance and Responsible Investment at Threadneedle.

The finance function is also playing a role in monitoring when the fund comes into profit – expected soon, at the time of writing – as part of the profits will be allocated to charitable purposes through the Threadneedle Foundation. 'It's critical for the finance function to figure out where that break-even point is,' says Richards.

‘ A key selling point of the Fund is that it does not sacrifice return for social outcomes – the two work in harmony. ’



Simon Bond, Fund Manager at Threadneedle Investments

POSITIVE LONG-TERM IMPACT

As a long-term investment tool for targeting social outcomes, Threadneedle believes that bonds have many strengths over equities. First, a wide range of bodies, including local authorities, mutuals, charities, not-for-profit organisations and development agencies, do not issue public equity. But they can and do issue bonds to finance projects which fund their objectives.

Secondly, unlike equities, bonds can be secured on identifiable assets, such as property or cash flow, from specific operations. They can even target particular parts of a business and dictate specific uses of funds. So investors can target funding at a particular social outcome.

Thirdly, diversified bond portfolios have an added advantage over more specialist investments such as loans or private equity vehicles. That is because they can provide daily liquidity through a more tradeable secondary market.

LESSONS FROM THE CASE STUDY

One lesson from the project is that it is always tough being first into a market. But Bond says he hopes the new Fund has started a trend which eventually shifts the traditional investment supply and demand curve so that it takes account of positive social outcomes. 'If that happens, the economy will be allocating its resources more efficiently,' he says.

Another lesson is not to ignore the basic laws of economics when seeking social outcomes. 'A key selling point of the Fund is that it does not sacrifice return for social outcomes – the two work in harmony,' says Cathrine De Coninck-Lopez, Sustainable and Responsible Investment Officer at Threadneedle.

Finally, a pioneering project needs sponsorship right from the top and the **UK Social Bond Fund** had the enthusiastic backing of Threadneedle's chief executive.