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SOCIAL STOCK EXCHANGES, THE CATALYSTS IN SOCIAL FUNDING - FRAMEWORK AND THE WAY FORWARD

Opening Note

The philosophy of 'Vasudheiva Kutumbakam' is part of India's ethos and, social responsibility and philanthropy are inherently ingrained in the heart of its citizens. Many donate to social causes, in their own ways, with a sense of duty and many business houses have long been taking up the mantle of discharging their social responsibility for decades.

With the push of Corporate Social Responsibility (CSR) requirements under the Companies Act, 2013 and the gentle nudge of the National Guidelines on Responsible Business Conduct evolved by the MCA in 2018, more companies have been immersing themselves in social projects. We can see that the regulatory and funding ecosystems are transforming with increased emphasis on social impact. As the investor community is becoming more sensitive to the social impact of their investments, the reporting framework for business enterprises is evolving into a triple-bottom-line approach with reporting on Environmental, Social and Governance (ESG) aspects mandated for the Top 1000 companies by market capitalization.

While the fund inflows to non-profit organisations (NPOs) are on the rise, there is also an increasing need to ensure whether funds reach the right beneficiaries and to dispel concerns over NPOs becoming conduits for malpractices like money laundering. A transparent framework under which NPOs can raise funds and perform their functions becomes the need of the hour. This is where Social Stock Exchanges (SSEs) become necessary in today's context. The impact that the SSEs can have in the realm of NPO funding is significant as they bring in the much-needed transparency to the ecosystem by mandating disclosures by the NPOs onboarded by them.

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Regulatory Framework

The concept of SSEs in India was proposed in the Budget Speech for the Union Budget 2019-20.¹ Thereafter, SEBI constituted a Working Group on SSEs in September 2019 to discuss the possible structures and mechanisms to facilitate raising of funds and the associated regulatory framework. The Working Group gave its report in June 2020, which gave a holistic set of recommendations to enable fund-raising structures and to provide for robust standards of social impact and financial reporting.² The Working Group envisaged that the SSEs can be set up within the existing stock exchanges as they already have the necessary infrastructure, and also recognized the need for creation of a capacity building unit for the sector. The Working Group clearly recognized

the role of both NPOs and for-profit social enterprises (FPEs) in social-economic development and included both in the umbrella of 'social enterprises.' The report recommended that social enterprises that wish to avail of the benefits of SSEs must commit to making disclosures under a reporting framework. Different fund-raising instruments, notably, the Zero-Coupon Zero-Principal Bonds (ZCZP Bonds) are discussed in the report. The report also contained recommendations to the Government on effecting enabling changes in the CSR framework and a trading platform for CSR-spends. The report further observed that in other countries the concept of SSEs took the form of matchmaking platforms, that are distinct from existing exchanges and are catering to either FPEs or NPOs but not both, or in the form of listing of alternative investment instruments on the existing exchanges.

Both BSE and NSE have set up SSEs under the framework and at present, well more than two dozen social enterprises have registered on the platforms for committing to disclosure and reporting requirements. A capacity building fund has been established under NABARD. An SSE Advisory Committee has also been set up by SEBI.

This report was followed by the constitution of a Technical Group on SSE in September, 2020 for spelling out the nitty-gritties in respect of the vision evolved by the Working Group. The Technical Group submitted its recommendations, which was released for public comments in May 2021.³

The above reports and public consultations were followed by amendments to various SEBI Regulations in July 25, 2022 to operationalize the concept of SSEs. The SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 was amended to provide for eligibility conditions for identifying social enterprises and conditions for issuance of ZCZP instruments. The SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 was amended to provide for obligations of social enterprises. Amendments were made to SEBI (Alternative Investment Funds) Regulations, 2012 to provide for investments in securities issued by social enterprises. ZCZP instruments were also notified as a 'security' under the Securities Contract (Regulation) Act, 1956. Later a circular establishing the framework for SSE was issued by SEBI in September, 2022, followed by another in October, 2022 to provide for requirements on the Governing Council of SSEs.

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Proposed Measures towards Enhancing Flexibility in Framework

Following the developments in SSE scene and feedback from stakeholders, SEBI conducted a brainstorming session and came out with a consultation paper towards improving flexibility in SSE framework in August, 2023.⁴

Although the window for submitting suggestions has ended, it is worthwhile to note the issues identified and the proposed recommendations.

- Minimum issue size and application size for NPOs issuing ZCZP: The high thresholds for minimum issue size (Rs. 1 crore) and application size (Rs. 2 lakhs) for ZCZP instruments have been considered deterrents, especially for smaller NPOs. The recommendation is to reduce the minimum issue size from Rs. 1 crore to Rs. 50 lakhs to accommodate the fundraising capabilities of NPOs in the early stages of the SSE; and, to reduce the minimum application size from Rs. 2 lakhs to Rs. 10,000 to allow a larger number of investors, particularly regular donors, to participate.
- Allowing entities registered under Section 10(23C) and 10(46) of the Income Tax Act, 1961 on SSE: The recommendation is that NPOs with registration under Section 10(23C) and Section 10(46), which may not have an 80G certificate, should still be eligible for registration with the SSE.
- Relaxation of the requirement of absence of pending notices or ongoing scrutiny by Income Tax authorities: The recommendation is that NPOs with pending notices or ongoing scrutiny by the Income Tax should be allowed on SSE provided they disclose this information at the time of registration and any fines or penalties are disclosed, after effecting payment or preferring an appeal within 7 days. Nonetheless, the SSE should maintain the discretion to reject the applications if the notices are serious enough to jeopardize the NPO's registration under the applicable sections of the Income Tax Act, 1961.
- Substituting the term 'Social Auditor' with 'Social Impact Assessor': The recommendation is to change the term from 'Social Auditor' to 'Social Impact Assessor' to

remove the negative connotation and encourage a positive view of the social sector.

- Relaxation of the requirement for disclosure of past social impact in SEBI specified format: The recommendation is that NPOs should be able to provide details of past social impact in their existing format rather than converting it to the SEBI-prescribed format, which could be costly and time-consuming.

Achievement of the United Nation's Sustainable Development Goals needs the participation of both Government and private sector. The involvement of social enterprises in closing the gap is significant, especially in a country like India, where grassroot level transformation and capacity building is required to ensure availability of essential services to all and to foster equitable and sustainable development of the nation as a whole.”

- SEBI's power to relax provisions of SSEs in the ICDR Regulations: The recommendation is that SEBI should have the authority to relax provisions related to the SSE, based on the recommendations of SSE, to foster the development of the SSE. It is suggested that this power could be time-bound, such as for a period of 12 months.

Food for Thought

At present, ZCZP Instruments, although listed on SSEs are not available for trading in the secondary market, and an investor will not be able to trade in them nor redeem their investments.

If trading of CSR spends between companies is something foreseeable, the possibility of permitting trading in ZCZP instruments is something to be considered. Price discovery may be allowed to reflect the social impact of the NPO. As an alternative, to prevent any volatility, trading may be permitted only at face value. In any case, it is something that warrants consultation with the public and stakeholders. The purpose of permitting trading will be that a person who has invested in these and in need of funds or dissatisfied with the NPO's performance may be able to exit it, and a person who wants to contribute to a particular cause may be able to do so even after the offer period in the NPO, while keeping the corpus of the NPO intact.

Concluding Remarks

Achievement of the United Nation's Sustainable Development Goals needs the participation of both Government and private sector. The involvement of social enterprises in closing the gap is significant, especially in a country like India, where grassroot level transformation and capacity building is required to ensure availability of essential services to all and to foster equitable and sustainable development of the nation as a whole. SSEs have immense potential to act as catalysts driving this transformation beyond imagination.

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Dr.Ranjith Krishnan is into full-fledged academics for the last 21 years. He has worked in senior positions in educational bodies viz. NISM and ICSI where he had handled diverse portfolios such as teaching, research, training, preparation of academic backgrounders, etc. He is a member of the Board of Studies and Advisory Boards in several educational institutions and has contributed in drafting of syllabus for the Undergraduate / Post Graduate courses. He holds a Ph.D. in Management and postgraduation in multiple disciplines including Law and Human Resource Management.

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 3. https://www.sebi.gov.in/reports-and-statistics/reports/may-2021/technical-group-report-on-social-stock-exchange_50071.html
 4. https://www.sebi.gov.in/reports-and-statistics/reports/aug-2023/consultation-paper-on-flexibility-in-the-framework-on-social-stock-exchange-sse-_76054.html