

**Contribution to the project of the Foundation Centesimus Annus Pro Pontifice
for Voluntary Solidarity Funds (VSF)**

The growth of inequality not only reduces economic growth and social cohesion. In an end-world where resources per inhabitant are declining, it raises the risk of conflict and increases migration.

One can only agree with Gouverneur Bonnici's economic analysis. It converges with a more historical and social viewpoint. Since the beginning of time, dominant classes have believed that trickle-down to the poor makes them richer. Throughout history this egocentric viewpoint has provoked revolts, revolutions, wars. Today the growth of inequality and the drop in natural resources per habitant can only enhance the risk of conflict as well as political, economic, and climatic migration that is increasingly dramatic for the migrants and less and less accepted by the destination countries.

2. The challenge of inequality of income and wealth between countries and social classes should be addressed by macroeconomic policies (notably tax and customs) as well as social policies. Major economists, such as Anthony Atkinson and Thomas Piketty, show the urgency of a new economics based on the real world, instead of on ideology. The VSF project could focus on greater equality of opportunity for individuals, which has a microeconomic character, easier to break down.

If the Church's word can usefully influence public policy, its influence would be even greater if based on concrete action. Given limited resources, the VSFs should be directed to the support of individuals rather than to whole populations. They can usefully complement the actions of the Church and associations such as Caritas, which are inspired more by charity than by an economic and financial approach. Creation of the VSFs has two main justifications : first it would increase the impact of the Church on serving the poor by increasing the scale needed to solve poverty and inequality problems, which charity donations cannot solve. Second, it will allow the Church, which criticizes rightly the drifts and perversions of the financial sector, to show concretely the way, by entering the field of social impact investment .To apply the words of Pope Francis, the Church, too, must combat « the fetish of money » and the dominance of a « faceless economics ».

3. In a world undergoing rapid change, the parable of the talents and the right to economic initiative, affirmed by John Paul II and based on recognition of the creativity of every human being, could constitute the doctrinal basis of the VSFs.¹

In the encyclical « Sollicitudo, rei socialis », John Paul II recalls the importance of the right to economic initiative of all economic actors, in the face of bureaucratic states that erase their creative personality and contribute to concentrating wealth in the hands of a minority. This right, which applies also to the capitalist system, is becoming more and more fundamental at a moment in history when inequality is growing between those who are working and those who are jobless. It concerns both official unemployment and the « hidden unemployment » of the informal sector, where the lack of capital and/or land denies value to work.

In comparison with the Church's doctrine on poverty and worker conditions, that relating to unemployment and exclusion is little developed. There is an obligation for charity *vis-à-vis* the poor, but no systematic policy to help people in difficulty escape from it, by their own efforts. As it happens, economic evolution in countries of the North, based on new technologies, deindustrialization, and the growth of the service sector, like population growth and the rural exodus in countries of the South, create massive unemployment, which wage-paid employment cannot absorb by itself.² Creating jobs depends on the right to economic initiative for all, a right which itself presupposes two conditions: access to capital and a favourable legal framework. At this stage the main obstacles are: nonbank institutions denied the right to borrow in order to on-lend, too low ceilings on interest rates, return on capital out of proportion to that characteristic of the real economy, complexity of rules, and the weight of social charges and/or taxes that burden self-employment.³

4. In the long term, the VSFs could finance the development of the sacred rights « terra, techo, trabajo »⁴, as defined by pope Francis, or even, all sort of social business⁵ focusing on essential goods such as agriculture, water, energy, health and education. We propose however, that to start with, the VSFs give priority to microcredit⁶ enabling excluded persons to develop income generating activities, to become actors of their own life and active members of their community.

¹ Suppression of the right to economic initiative is strongly condemned by John Paul II in the encyclical Sollicitudo rei socialis, which appeared in 1987. This places the communist and capitalist models back to back: "Experience shows us that the denial of this right, or its limitation in the name of an alleged "equality" of everyone in society, diminishes, or in practice absolutely destroys the spirit of initiative, that is to say the creative subjectivity of the citizen. As a consequence, there arises, not so much a true equality as a "leveling down." In the place of creative initiative there appears passivity, dependence and submission to the bureaucratic apparatus which, as the only "ordering" and "decision-making" body - if not also the "owner"- of the entire totality of goods and the means of production, puts everyone in a position of almost absolute dependence, which is similar to the traditional dependence of the worker-proletarian in capitalism

² Wage paid labor represents 50% of the total labor at world's level, but only 20% in Africa and Asia.

³ Annex 1 presents the Association pour le Droit à l'Initiative Economique created in France in 1988, an example of Microfinance Institution, sharing, ahead of its time, VSFs principles

⁴ Land, roof, work.

⁵ Social entrepreneurship targets, in general, social and environmental goals. It combines market logic with the common good. It is expanding rapidly in the face of economic and financial abuses. In Europe, one new enterprise out of four is a social enterprise.

⁶ Microcredit developed rapidly in the emerging countries for the last 40 years, and more recently in Europe and in the USA. The number of its clients in the world is estimated around 106Million facing a market of about 1.5Billion

As already brought out in Dublin, the VSFs' objective could be to combat inequality of opportunity directly, by opening access to credit and providing business development services for people excluded from the labor market, and in particular by promoting the development of self-employment and income-generating activities by people in difficulty. At the same time, realizing this objective requires advocacy *vis-à-vis* public opinion and the government to adjust the legal framework, which, in industrial countries, was designed for wage-paid labor and does not take into account the specificities of self-employment.

The VSFs could be classified as social impact funds⁷, taking advantage of their acquaintance with methods; but in three respects they could differ from other funds of the same type:

- In accordance with the Church's social doctrine, VSFs would be based on recognition of the creativity of every human being, regardless of his or her level of wealth or education - a creativity often denied to the poor.
- VSFs would associate financial capital (equity, debt, guarantee, and, if appropriate, start-up grants) with human capital (volunteers, young people interested in social entrepreneurship or village mutual aid in emerging countries where that still exists.) by developing social links and creating an ecosystem that enables poor people to build their own destiny.
- In face of the abuses of « shadow banking » and other financial techniques detrimental to the common good, the funds should develop virtuous financing in the service of people and sustainable development. They should give priority to labor over capital, and strengthen the link between finance and the real economy. They should maximise the direct social, economic and environmental impact of their operations, allowing the Church to benefit from their example in order to influence public policies and private actions, whether conducted by NGOs or multinational enterprises.

In order to realize their objectives, the VSFs would work in partnership with agencies belonging to other faiths,⁸ but also with public national and international institutions, enterprises conducting actions of social responsibility, social impact funds, etc.

They should take a social entrepreneurship approach that combines market logic with that of the common good. In a second phase, the VSFs could expand their activity in this direction. Regarding geographic coverage, the first funds should probably be established in predominantly Christian countries so as to be able to mobilize the necessary resources. These resources should be subject to investment in the country where they are raised, as well as in poorer countries.

⁷ In the operations they finance, social impact funds look for a measurable social and/or environmental impact, along with a return (or financial balance) that guarantees their longevity. The sector is expanding rapidly. The social impact investment was invented in 2007. Its assets under management reach to day \$60 Billion and are expected to grow up to \$500Billion before 2020.

⁸ A number of other religions share the tradition of tithing, or of the zakhat (one of the pillars of Islam).

5. An organization of investment funds, departing from either the base or the top of the pyramid, requires a parallel organization charged with obtaining grants to finance technical assistance (TA) for microfinance institutions (MFIs) and business development services (BDS) for the final beneficiaries.⁹

At this stage of reflection, one can imagine two types of solutions:

As regards investment funds:

- Creation of funds on a national or regional scale, suggested in Governor Bonnici's note would have the advantage of greater proximity between donors and beneficiaries, but would require an enormous effort whose results would be, *à priori*, very unequal. In order to respond to the needs of all, including those not located in proximity to the funds, it would be necessary to establish a central fund that could intervene especially in countries lacking their own funds, and in specific and/or multinational projects.
- Creation of a fund of funds that would invest in subsidiary funds meeting its criteria, whether they already exist or await establishment. The fund of funds could be located in a country such as Luxembourg, whose legal framework is particularly adapted to this type of activity. It would intervene through existing social impact funds or funds to be established in different countries or regions, without serving exclusively adherents of a particular faith.

In either case :

- the funds' target populations would be chosen strictly on the basis of their situation of exclusion: e.g. unemployed, refugees, young people from low-income neighborhoods, landless peasants, etc.;
- the clients would be provided also with business development services in order to help them surmount obstacles and restore social links;
- there will a rigorous evaluation of the funds' social impact.

The funds selected on the basis of these criteria would be labeled «Voluntary Solidarity Funds.»

The financial instruments utilised for the benefit of intermediaries, which, at least to start with, would be microfinance institutions, would consist of equity, debt, guarantees, social bonds, etc.

As regards TA and BDS entities :

With technical assistance and business development services needing both volunteers and subsidies, two solutions appear possible:

- Entrust the collection and management of these resources to an existing agency such as Caritas, which would probably save money;
- Create one or more foundations to collect and distribute grant resources, which would distinguish the project more clearly. In this case the choice is between a type of foundation that disburses funds as they are collected, or a type that

⁹ Annex 2 presents Helenos, a project of investment and technical assistance funds, being currently under discussion with potential investors and donors, which could be considered as a forerunner of VSFs.

disburses income from an endowment. In both cases, the choice of host country is important, since it may affect the tax benefits accorded to the donors.

6. Raising investment resources and grants by the Church, based on voluntary sharing of income and wealth

It is important that collection of funds for investment and technical assistance for final beneficiaries should not displace parish contributions or gifts to charity. This requires a properly identified fund-raising campaign aimed at both grants and investments organised around three axes:

- Beginning with funds belonging to the Church, with a view to reducing luxury consumption in a spirit of solidarity. The idea of participation by the Church, equivalent (at least at the beginning) to the gifts and participations of the faithful, is very interesting. As regards investments by the Church or religious congregations, a pedagogical effort is required to avoid confusion between social impact and socially responsible investment.
- Fund-raising that focuses on persons likely to share part of their income with the poor, as well as on family offices that are willing to use part of their wealth to invest for the benefit of the poor.
- A search for partners who are in a position to cofinance activity of the fund of funds or of national and regional funds. These partnerships could give the whole system significant leverage.
- Eventually, in a second phase, introduction of a special type of bonds.

In its pilot phase the fund of funds (or the whole set of local funds established in connection with the project) would require a relatively small amount of investment,, increasing over time.

5. Next steps

Establishing the whole arrangement presupposes both internal agreement within the Church and a feasibility study looking at:

- Ways and means of collecting investment funds and donations; examination of potential sources of inspiration such as SIDI in France and Oikocredit in Holland,¹⁰ as well as the methodology of Social Impact Investment. The experience of the anti-poverty funds launched by Bill Gates, Warren Buffet or Mark Zuckerberg in the USA is likewise relevant.
- The arrangements to be instituted: fund of funds + subsidiary funds or regional/national funds + a central fund;
- Legal and tax analysis leading to choice of statutes for both, investment funds and foundations or associations financing technical assistance and BDS;

¹⁰ Oikocredit and SidI have been created more or less at the same time, with the same objective : the development of microfinance. Oikocredit is a protestant cooperative located in Holland which collects funds also in Germany and France. SIDI has been created by the Catholic Committee against Hunger and for Development , with the support of some congregations and of the Crédit Coopératif..

The fund raising policy of Oikocredit focuses on a higher income segment of potential investors, than SIDI. The return on capital is close to 2% at Oikocredit and close to 0% at SIDI. The net assets are 600M at Oikocredit and 21M at SIDI. Oikocredit provides mainly debt. SIDI provides both debt and capital

- The country(ies) or regions to be given priority;
- Population groups to be given priority: e.g. unemployed youth, Romas, refugees, etc.
- Appropriate information to avoid mingling with parish contributions, as well as with a Church commitment to financial investment in general, which some parishoners could view with mistrust.

Conclusion

As explained in paragraph 3, the right to economic initiative, advocated by Pope John Paul II, requires two preliminary conditions: access to capital, and a favorable legal environment.

- Establishment of Voluntary Solidarity Funds will definitely bring an important contribution to ensuring access to capital for all. Their establishment and extension is important for three reasons :
 - It will translate the Church's social doctrine into action, involving the creativity of human beings, the right to economic initiative, and the place given to the poor. The Church cannot criticise the abuses of financial capitalism credibly without showing what it means *via* financial institutions that serve the common good and respect human dignity. ;
 - It corresponds to the current phase of economic change and involves the financial sector, where divergence from Christian and humanist ethics is particularly severe. By developing virtuous finance, supported by investors who share this ethic, it constitutes a counter-example, more effective than simple words and creates a virtuous circle of financial, economic and social policies.
 - The results of access to microcredit far exceed the financial return on the investment. Through the trust placed in them, the unemployed recover trust in themselves. By building a project, they recover hope and social links. Starting as poor and/or welfare recipients, they become creators of wealth and recover both their dignity and their place in society.
- Regarding the legal environment, VSFs and their bottom-up approach will be effective if, at the same time, the effort to reform the financial system and especially its impact on the real economy, unemployment, and growing inequality is addressed. The challenge is not to cover microfinance under banking regulations, which are already too complex for the banks, but to define a set of rules compatible with the type of clients, products, and methods of this specific part of the financial system, aimed at ensuring access to basic financial services for all.

The same effort is needed as regards the legal framework of self-employment and enterprise creation. While the ILO estimates the number of self-employed world-wide at 50% of total labor (80% in South Asia and Africa), a large majority of the self-employed living in developing countries still work in the informal sector without any social rights, while in developed countries these social rights and the labor code in general are still defined in the context of wage labor and are not adapted to self – employment.

Annex 1

Association pour le droit à l'initiative économique (Adie) in France (An example of a microfinance institution serving the poor and sharing VSF principles ahead of its time)

Origin: Association created in 1988, in France, by three volunteers without start-up capital

Mission:

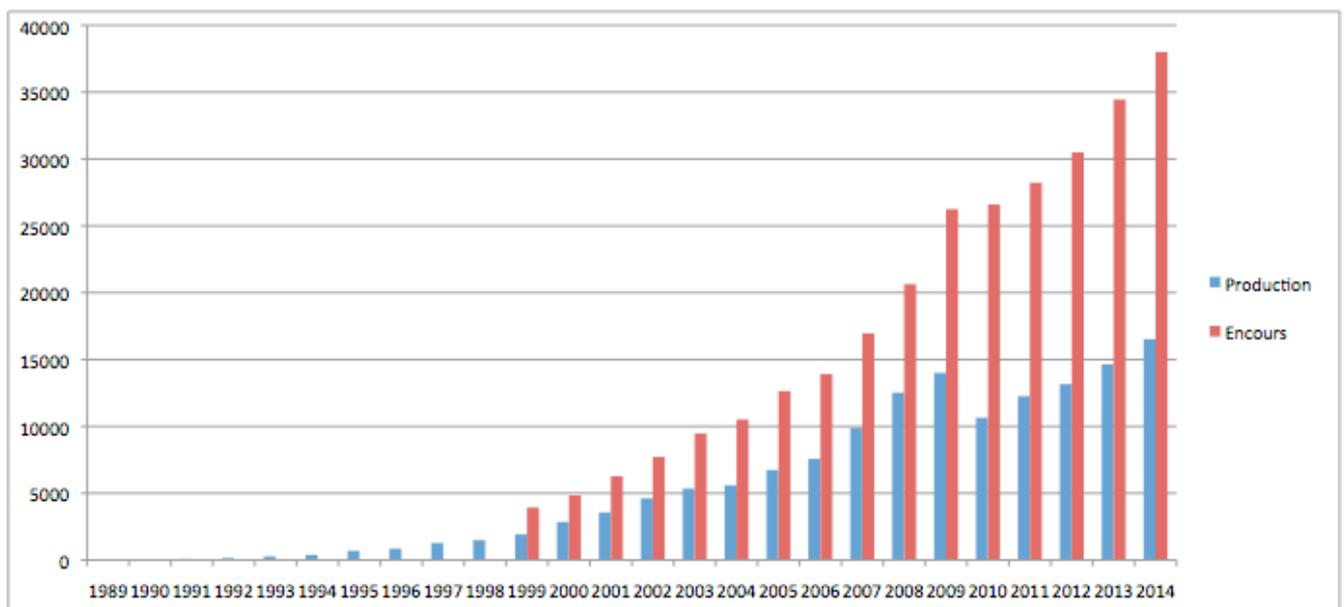
- Finance the creation and development of microenterprises by unemployed people.
- Provide them with the training and advice needed for their project to succeed.
- Use this experience on the ground to improve the legal framework of microcredit and microenterprises.

Clients:

Unemployed and welfare recipients of whom 28% are barely literate and numerate. Emphasis placed on vulnerable groups: women, young people, residents of low-income neighborhoods, Roma, etc.

Results

Growth of Production and Loans Outstanding



Results

Credit

- Active clients: 44,000
- Loans outstanding: €104M
- Number of loans since 1989: 179,000
- Number of loans in 2015: 18,000
- Average loan : €4,000
- Loss rate: 3.13%

Business Development Services

- Enterprises created since 1989 : 116,000
- Borrowers' 2-year survival rate: 70%
- Economic integration of borrowers: 84%

A national network



118 branches, 350 field offices, 470 staff, 1,600 volunteers

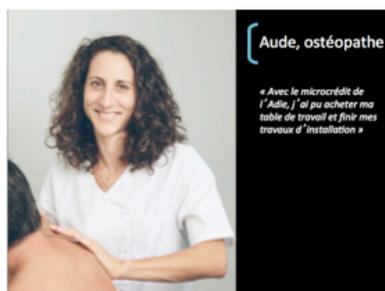
Changes in the law on behalf of nonbank institutions

- An amendment to the bank law, allowing microcredit institutions to borrow in order to on-lend
- Ceiling on interest rates removed for loans to enterprises
- Access to Banque de France data base on loan repayment
- Possibility of soliciting donations from individuals to finance loans

Changes obtained for self-employment and microenterprises

- Creation of enterprises recognised as a vehicle of integration into the labour market
- Simplification of the regulations governing creation of enterprises
- Statute of auto-entrepreneur

Portraits of creators



Annex 2.

Helenos Project

(A facility comprising an investment and a technical assistance fund to develop the microfinance network in Europe on behalf of vulnerable groups, sharing principles of ethics and social impact.)

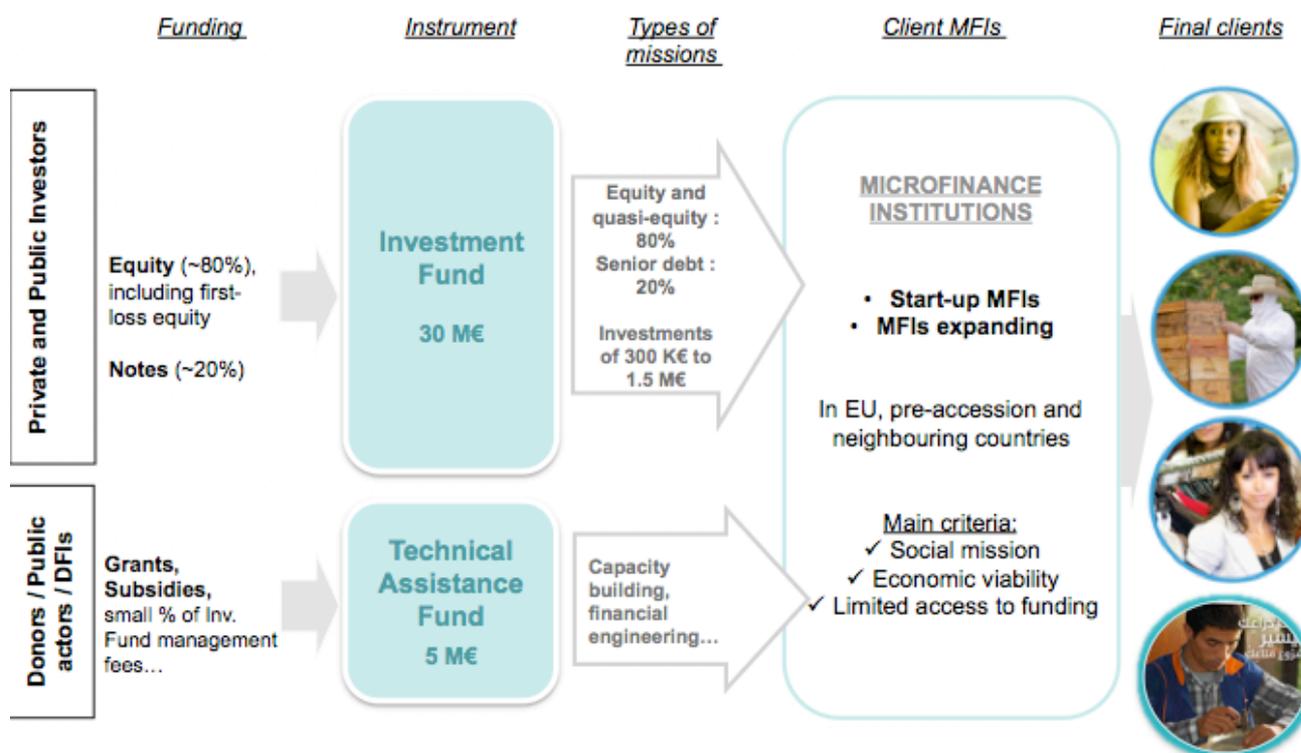
In Europe, creation of enterprises is becoming one of the principal vehicles of employment. A significant proportion of creators of enterprises (1/3 in France) come out of unemployment.

Unemployed people creating enterprises lack access to bank credit, and address themselves either to their family and friends or to microfinance institutions (MFIs).

MFIs have developed everywhere in Europe, in some countries (as in France) benefiting from the support of banks. *The European Initiative for the Development of Microcredit in Favor of Growth and Employment*, published in 2007, and the study entitled *Missing Entrepreneurs: Policies for Inclusive Entrepreneurship in Europe*, published by the EC and the OECD in 2013, recognised microcredit as the financial instrument of the new economy, where the role of self-employment has not stopped growing.

Out of 150 MFIs in 24 countries that responded to the European Microfinance Network survey in 2013, more than a quarter made less than 100 loans per annum, and cannot expand inasmuch as they lack access to the finance and technical assistance necessary in order to grow. Actually, development banks, like all the investment funds that are increasingly financing the microfinance sector, are not interested in MFIs younger than three years that need less than €1M of financing, especially for equity.

Overview of Helenos project



	1/ <u>Investment Fund</u>	2/ <u>Technical Assistance Fund</u>
Statute	SICAV <u>instiutionnelle</u> in Belgium	Association <u>Internationale Sans But Lucratif</u> (AISBL) in Belgium
Funding	80% of shares and 20% of notes held by institutional and corporate investors, including a "first loss" tranche	Small percentage of management fees, donations and subsidies
Targeted size	30 M€	5 M€
Types of intervention	<ul style="list-style-type: none"> - 80% equity and <u>quasi-equity</u> (<u>subordinated loans</u>, convertible <u>loans</u>,...) - 20% of senior <u>debt</u> <p>Investment per MFI ranging from 300 K€ to 1.5 M€ Equity in local currency, debt in local currency, € and US\$</p>	<p>Missions:</p> <ul style="list-style-type: none"> - Support for MFI start-up and expansion - Capacity building - Financial engineering and support for fund raising - Impact measurement tools, etc.
Term	10 years	

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Helenos' business plan can be summarized as follows:

Financial Performance	<ul style="list-style-type: none"> • IRR equity shares (10 years): 5-6% • Debt remuneration (10 years): EUR+1,5% • Distribution of profit from year 8
Investment and portfolio	<ul style="list-style-type: none"> • 30 M€ invested in over 35 beneficiaries • Minimum entry amount: 300 K€, maximum: 1.5 M€ • Average amount: 800 K€ • Expected Closing: End of 2015 • Equity portfolio (~45%): <ul style="list-style-type: none"> - 19 capital investments during the first 4 years - For capital, expected exits: 7/8 years for start-up MFI and 7 years for expanding MFI - Exit multiple (sale amount/initial investment amount): on average 1.8-2x after 7 or 8 years of investment - Write-off of equity: 5.5% reduction per exit (total of 700k€ over 10 years) • Quasi-equity portfolio (~35%): <ul style="list-style-type: none"> - 16 investments adapted to different statutes of MFIs (ex. associations): subordinated debt or other quasi-equity investments during the first 7 years of the fund. Average maturity : 7years • Debt portfolio (~20%): <ul style="list-style-type: none"> - 12 amortized loans during the 7 first years. Average maturity of 4 years • Provisions: <ul style="list-style-type: none"> - Default risk: 0.5%/year of debt portfolio (total of 400 K€ over 10 years) - Currency risk: 0.5%/year of the equity portfolio
Funding	<ul style="list-style-type: none"> • 80% equity: <ul style="list-style-type: none"> - 4 M€ of A shares (<i>first-loss shares</i>) - 20 M€ of B shares • 20% debt: 6 M€ of notes
Other hypothesis	<ul style="list-style-type: none"> • Costs include 2.5% management fees (of which 65 K€ transferred to the TA fund) • Debt rates: 80% of portfolio invested at fixed rates (for variable rates, use of swaps) • Currency: Equity investments in local currency and debt in EUR (with currency risk hedged)

Helenos's current status

The project is benefiting from the interest or commitment of several agencies:

1. It enjoys the support of the EIB group, which likes Helenos' complementarity with its programs and those of other investors. This support is to be realised primarily through:

- the EaSi programme, successor to Progress. EaSi is being financed by the European Commission, pending signature of the EC-EIF agreement. This is expected by mid-2016, making it possible to sign a *first loss* financing agreement in an amount of around €4M.

- the Social Impact Accelerator, managed by the EIF, which may back Helenos' portfolio to the extent of around €5M.

2. In the public sector, the Caisse des Dépôts (France) envisages a participation of €2M, while the Cassa Depositive Prestiti has agreed to appraise Helenos' application. Other members of the European Association of Long-Term Investors (notably the KfW and ICO) have shown interest in the project, and Adie International and Crédit Coopératif will present it to them in a January meeting in Brussels. Finally, the Council of Europe Development Bank may participate in funding the project if they can obtain a guarantee.

3. Among private investors, Crédit Coopératif and the BRED have committed €3.3M. The project is under study by the asset management departments of Axa and Amundi. BNP Paribas intends to participate in debt financing. Contacts are underway with other banks and investment funds.

In the social economy sector, Banca Etica and Phitrust are studying the project.

The Fédération Bancaire Française, which has judged Helenos positively, is facilitating contacts with European banks. Beyond its impact on employment creation and social cohesion, Helenos is of direct interest to the banking sector. By creating a capital market for start-up MFIs, it will allow banks to participate in their development, with a clientele that can only grow.

Helenos is an example of a facility comprising both an investment fund and a technical assistance fund open to start-up MFIs. Its twin objectives are profitability and social impact. In the future it may find its place in the galaxy of Voluntary Solidarity Funds of the Foundation Centesimus Annus Pro Pontifice.