



Australian Government

Prime Minister's Community Business Partnership

Prime Minister's Community Business Partnership (the Partnership) submission to the Treasury on the exposure draft of amendments to the Private Ancillary Fund Guidelines 2009 and the Public Ancillary Fund Guidelines 2011

I am writing on behalf of the non-government members of the Prime Minister's Community Business Partnership (the Partnership) to make a submission on proposed amendments to the Private Ancillary Fund (PAF) Guidelines 2009 and the Public Ancillary Fund (PuAF) Guidelines 2011.

The Partnership has been appointed to advise the Australian Government about practical strategies to foster a culture of philanthropic giving, volunteering and investment. Information about the Partnership including its membership and terms of reference is at <http://www.communitybusinesspartnership.gov.au>.

The Partnership is exploring mechanisms to increase levels of giving in Australia. The Partnership recommends a streamlining of both regulations and legislation to ensure the growth and efficiency of the philanthropic sector. The aim is to grow giving by introducing new donors to the sector, including mid-tier donors as well as high net worth individuals to build sector capacity. The Partnership supports the reduction in red tape and barriers to giving and volunteerism. For this reason we are broadly supportive of the suggested amendments to the guidelines but have made some suggestions detailed below.

The major change required is outside the scope of the change to the guidelines and will require legislative change but we wish to highlight that an amendment to the *Income Tax Assessment Act* 1997 to enable Ancillary Funds (AFs) to distribute to other AFs is something we recommend that the Government progresses. Changes to the PAF/PuAF legislative framework should allow for distributions from AFs to other AFs (for example, a PAF to a PuAF [DGR Item 2] run by a community foundation). Currently this is not possible and it prevents a number of situations including enabling AFs to pool funds together to meet a large need from a community or charity. It has specific application where a community foundation needs funds for a regional disaster. Without this change, red tape will continue to be imposed and community foundations and other organisations will continue to confront a barrier to attracting new donors. It is enabling the community to work together to address a need or specific issue where AFs working together are better than AFs contributing separately.

This is the first review of PAF guidelines since 2009 and PuAF guidelines since 2011. It is recommended that this sort of comprehensive review of the guidelines take place on a regular basis every five years and is timely at this point.

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The key changes discussed herein are:

1. Introduce portability for PAFs;
2. Update both PAF and PuAF guidelines to reflect the introduction of the Australian Charities and Not-for-profits Commission (ACNC);
3. Remove red tape by ensuring that material provided to the ACNC is not also requested separately by the Australian Taxation Office and allow smaller private funds to seek a review instead of an audit;
4. Update the investment strategy rules to, amongst other things, ensure funds must consider both their status as a registered charity and conflicts of interest in preparing and maintaining a strategy;
5. Give greater clarity in the guidelines for Social Impact Investing and Program Related Investments;
6. Allowing Ancillary Funds to provide loan guarantees over borrowings of DGRs; and
7. Potentially reducing the minimum annual distribution rate.

1. Portability for PAFs: The Partnership is in agreement with Clause 32 of the draft guidelines to allow for portability but recognises that if this clause could be introduced prior to 1 July 2016, it would allow for PAFs that wish to wind up in this financial year to do so without incurring audit and other associated costs for the following financial year.

The Partnership is also concerned that the proposed change to Schedule 2:24:50 may have the unintended consequence of reducing portability by preventing a PuAF sub fund from being transferred to PAF. Many people commence their philanthropic journey by establishing a sub fund of a PuAF and as they become more committed and involved and the contributions to the fund grow they have a corpus that is more suitable to be managed as a PAF. The Partnership would be keen to see this pathway encouraged and portability made as simple as possible.

Allowing PuAFs to accept distributions from other Ancillary Funds is also critical to the proper functioning of portability. This is referenced above with the need for legislative change to allow PAFs to donate to Item 2 DGR Community Foundations and other PuAFs. It is hoped more work will be done in this area as a matter of urgency. During roundtables the Partnership held with the sector in 2015, portability was highlighted as one of the key factors for donors.

If needed, appropriate guidelines will prevent the concerns around recycling of funds between AFs to meet the annual distribution level.

2. Updating Guidelines to reflect ACNC: These changes are sensible and fully supported by the Partnership.

3. Amendments to ensure ACNC and ATO reporting are not duplicated: This is important and changes in this regard are supported by the Partnership. Consideration should be given to the cut-off level for determining a smaller fund which is currently \$500,000. It may be more appropriate to set the level for a smaller fund at a fund size below \$1 million, in line with the current PuAF guidelines rather than the current recommendation of \$500,000.

4. Update Investment Strategy rules: where the fund is a registered charity it is sensible to ensure the avoidance of perceived or actual conflicts of interest in the making of investments with related parties or entering into related party transactions with donors. The Partnership is supportive of these amendments.

It is recommended that the guidelines recognise AFs as wholesale investors. This has currently not been considered and this would allow for greater flexibility for AFs and their investment choices.

5. An area that the Partnership considers should be addressed and encouraged in the guidelines for the investment strategies of AFs is the inclusion of Social Impact Investing structures to better serve the philanthropic sector. There is a need for clarity for AFs undertaking social impact investing. Impact investing is something that could be greatly encouraged through the use of AFs. When discounts to commercial interest rates for eligible entities (DGR recipients) are offered by AFs the difference should be counted toward the minimum distribution requirement of the AF. If below market rentals are charged for community housing, the differential in rental rates should be calculated towards the minimum distribution requirement. In this way, AFs could be more encouraged to participate in impact investing. Impact investing can have outcomes that are highly beneficial to the community, is good government policy, and is in line with AF's purpose whilst also providing a return (which may be lower than the market rate).

Program Related Investments (PRIs) is an area that AFs could participate in to grow innovative impact and social investments in Australia. A PRI can be in the form of a loan, an equity investment or a guarantee. The Partnership is supportive of a model that permits PRIs to DGR1s, consistent with current limitations of AFs and of this being incorporated into the AF guidelines. This would go some way to facilitate the incorporation of PRIs into the Australian environment without the need for legislative change. Sufficient protections could be put in place to prevent abuse.

6. Allowing AFs to provide loan guarantees over borrowings of DGRs: the Partnership is supportive of this as it will allow AFs to provide greater assistance to the DGRs they were established to support. It is important that these loan guarantees only be given to entities that otherwise would be entitled to receive donations from the PAF. Consideration that a loan guarantee should be taken into account in relation to the annual distribution is important. This could be given effect by the DGR applying for a commercial loan without the guarantee and then calculating the differential in the reduced interest rate that would apply if the loan is instead guaranteed by the AF. These third party guarantees should be consistent with the governing rules of the fund.

7. Potentially reducing the minimum annual distribution rate: The Partnership does not believe there is a strong case for changing the currently accepted rate of 5 per cent for PAFs and 4 per cent for PuAFs. Data provided to the Partnership by the Australian Taxation Office shows that 56 per cent of PuAFs and 46 per cent of PAFs distribute above the minimum distribution rate. Administration costs for PuAFs are 4.7 per cent of the fund's net assets, with PAF administration costs at 1 per cent of the fund's net assets.

Current guidelines are simple and easy to understand and are broadly accepted by both the AF providers and the charitable sector that receives the funds. The recommended changes introduce a level of complexity and uncertainty that is not warranted at this stage.

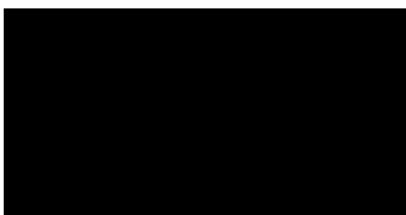
The Partnership believes there is a case for making the distribution rate the same for PuAFs and PAFs at 5 per cent but it should be noted that there are many differing strategies for disbursements of funds and the average AF distributes in excess of the minimum amount already. Average distribution rates for PuAFs are significantly above the current rate at 22.1 per cent of the market value of the fund's net assets whilst the average distribution rate for PAFs is 8.8 per cent.

A majority of AFs are designed as longer term vehicles and so they adopt a diversified investment approach consistent with portfolio theory to produce long term income growth and these portfolios are influenced by much more than current interest rates as they invest in a combination of fixed interest, shares and property as well as potentially a range of social investments. The recognised long term expected return for a well-diversified balanced investment portfolio is 4 per cent above inflation. These types of portfolios will have several years of negative overall returns as well as other years of excessive returns but on average will produce close to the indicative return of 4 per cent above inflation.

The suggested changes to guideline 19.1 do not account for years where AFs suffer negative performance and would unreasonably introduce a greater level of uncertainty to both donors and recipient DGRs. For all of these reasons the Partnership does not recommend a change to the current distribution level.

I would be happy to meet with you to discuss this submission further. Please do not hesitate to contact me via the Partnership secretariat at partnerships@dss.gov.au.

Yours sincerely



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Member

Prime Minister's Community Business Partnership

12 February 2016