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Response to Social Impact Investing Discussion Paper

We welcome the opportunity to consult on the issues raised in your thoughtful Discussion Paper.

About Australian Ethical

Australian Ethical Investment Limited was established in 1986 to manage the retirement and other savings of Australians in an environmentally and socially responsible way. Our Charter guides not just our investment activities but the ethos of our entire business. Under our constitution 10% of profits are required to be distributed to not for profit charitable, benevolent or conservation organisations.

Today we manage over $1.8 billion in superannuation and managed funds for over 30,000 Australians and have distributed over $2m to charitable causes through our community grants program.

Australian Ethical's long term, ethical investing approach is strongly aligned with impact investing. Our Ethical Charter guides us to invest to advance the alleviation of poverty, sustainable food production, responsible consumption and sustainable buildings and the amelioration of pollution, (amongst other things). We continue to look for new ways to use our investment influence to achieve impact. We recognise that as well as more responsible *business-as-usual*, investment is needed in innovative *business-unusual* to meet those social and environmental needs which traditional business models are failing to address.

Submissions on selected questions

Question 4: What do you see as the role of the Australian Government in developing the social impact investing market?

Key roles of government include:

- paying for all or part of the social and environmental outcomes delivered by impact businesses
- catalysing development of new impact business models and markets through strategic investment or other support e.g. provision of loss protection

- policy frameworks which assist the development of new business models and markets by pricing or otherwise regulating negative and positive externalities
- helping social projects and enterprise get 'investment ready', including through strategic grants, capacity building and published guidance
- sharing government data and methods for measuring social 'impact'. Often social impact organisations struggle to access the metrics and data needed to demonstrate impact. This will also help build investor capacity to analyse impact investments
- support in facilitating supporting legislation that assists to catalyse the market (see answer to Question 28).

In fulfilling these roles, government should be prepared to experiment and innovate (with the attendant risk of failure of individual programs), in order to support the development of the most efficient and effective social impact business and investment models. In doing this government should aim to encourage participation by a wide range of potential impact investor types, from investors focussed on market returns through to philanthropic donors for whom tax deductibility will be a major consideration. Government should also stand ready to scale support for innovative programs which are successful – to achieve rapid scaling of investment and impact.

Although government policy should change over time to take account of changing circumstances and experience, government should specify longer term objectives and principles alongside current detailed policies, so that investors can form reasonable expectations about how future policies will develop.

The above roles and approach from government demand long term bipartisan commitment to development of the impact investment market in Australia.

There are long term budgetary benefits to government in a healthy impact investment market as social impact is delivered in ways that are not a burden on the public purse.

Question 7: What Australian Government policy or service delivery areas hold the most potential for social impact investing? Are there any specific opportunities you are aware of?

'Additionality' should be a key consideration when assessing impact investment opportunities. Government should prioritise facilitation of impact activities which promise business or finance solutions to help address a social or environmental need which is unmet or under-served by traditional business models and government programs.

As another general comment, care needs to be taken to safeguard against exploitation of those in need. The intended recipients of a service should be supported to make informed choices about the use of the service to best advance their own interests, and to ensure they have the information and power to hold service providers to account for appropriate delivery of the promised service. This

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may be challenging where target clients are socially or financially disadvantaged. For vulnerable clients, there need to be measures such as:

- a framework for government or other independent scrutiny of service delivery
- avenues for clients to secure effective redress in case of mistreatment e.g. an easily accessible industry ombudsman
- increased levels of service provider responsibility and accountability to ensure that the needs of clients are met.

Question 11: We are seeking your feedback on the four proposed Principles for social impact investing.

Well designed and transparent impact metrics are critical to ensuring adherence to the four principles. The following factors need to be carefully considered in this context:

(1) Impact metrics should be empirically robust, recognising that impact measurement is in its early stages in many domains, and that the evolution of new and more robust metrics needs to be supported. If available, impact metrics should have a strong evidence base i.e. the correlation with positive impact outcomes should be well established. However, where there are not applicable established metrics, government (and investors) should also be prepared to support more 'experimental programs' provided they are designed in a way which will help advance the development of appropriate metrics for the applicable domain.

(2) Impact metrics should be practical i.e. they should be able to be measured, monitored and reported in a credible, efficient and objective way; they should not be able to be gamed.

(3) Impact needs to be assessed holistically i.e. impact metrics need to take account of both intended positive impacts as well as actual and potential, present and future, harms that may be caused to people, animals or the environment.

(4) 'Additionality' should be a key consideration when assessing impact investment opportunities. Government should prioritise facilitation of impact activities which promise business or finance solutions to help address a social or environmental need which is unmet or under-served by traditional business models and government programs.

(5) Requirements for independent assessment or verification of impact should be carefully considered. Ideally assessment should be by a qualified independent party who is not paid by the assessed organisation.

In relation to the risk sharing principle, this should extend to sharing of the risk of 'disruption' of the impact program by other more effective means of delivering the relevant impact. For example, the public or private sector should not be unduly restricted (or discouraged through onerous penalty arrangements) from pursuing alternative programs or policies which may offer better value for money.

Lastly, section 4.2 of the discussion paper refers to ‘a focus on outcomes that align with the Australian Government’s agenda’. We understand the importance of this, but at the same time repeat our earlier comment under Question 4 that, although government policy will change over time to take account of changing circumstances and experience, government should specify longer term objectives and principles alongside current priorities, so that investors can form reasonable expectations about how future policies and priorities will develop. This requires bipartisan support for key guiding principles which will underpin the long term growth of the impact investment market in Australia.

Question 12: Are there any issues other than those identified relating to control that would suggest the options presented will not be sufficient to solve the problem?

Will one effect of these potential changes to control provisions be that investors/donors in a PAF may have less protection (because of the lesser disclosure requirements which apply for sophisticated investors)? If so, what is the rationale for them being afforded lesser protection than investors in funds which make non-impact investments?

Question 23: What guidance in particular would provide a desired level of clarity on the fiduciary duty of superannuation trustees on impact investing?

Regulators around the world have recognised the importance of key institutions to take account of systemic risks in their decision making. Climate change is an example of one such risk, and so is the risk of social and economic disruption caused by conditions such as entrenched disadvantage. Guidance would be welcomed which recognises the capacity of trustees to take into account systemic risks of all types in their investment decision making. Also, clarity that trustees are <u>not prohibited</u> from allocating parts of their portfolio to impact investing <u>provided that</u> other obligations under the SIS Act are complied with (fund objectives, diversification, liquidity etc.). This clarification is possibly best achieved through a review of Superannuation Prudential Guidance note 530, paragraphs 34, 35 and 36.

Question 28: Have you faced a legal impediment as a director of a social enterprise from making a decision in accordance with the mission of the enterprise, rather than maximising financial returns, that only a change in the legal structure could resolve? If so, what amendment to Commonwealth legislation, regulation or ASIC guidance would you consider is needed to address this problem?

We support the proposed ‘benefit company’ amendments to the Corporations Act being advocated by B Lab Australia and New Zealand. Australian Ethical Investment participated in the working group which drafted these amendments.

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The Benefit Company embodies a sustainable approach to business which recognises the responsibility of companies to their many stakeholders, from shareholders, employees and customers through to society-at-large. This is not a new idea: Australian Ethical Investment has lived this understanding of the role of business since we were established 30 years ago. We re-affirmed this when we became a B Corp in 2014.

Our own experience demonstrates that this approach to business is aligned with the long term interests of all company stakeholders. Unfortunately many directors and executives feel constrained by narrower understandings of their fiduciary duties, and often choose not to pursue strategies which promise better outcomes for all. The proposed Benefit Company changes to the law give shareholders the option to remove this perceived constraint and let companies thrive by building successful sustainable businesses which maximise value for society. In addition, some clarification of the existing business judgement rule would be useful.

Question 29: Would making a model constitution for a social enterprise assist in reducing the costs for individuals intending to establish a new entity? What other standard products or other industry led solutions would assist in reducing the costs for individuals intending to establish a social enterprise?

See our response to Question 28.

We would be happy to discuss and consult further on these or any other issues relevant to the development of the impact investment market in Australia.

Yours sincerely

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