RESPONSE TO INVITATION OF SUBMISSIONS FOR TREASURY SOCIAL IMPACT INVESTING DISCUSSION PAPER

by

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Submission by Brightlight Impact Advisory

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Introduction

Thank you for the opportunity to provide a submission into the Social Impact Investing Discussion Paper.

We are eager to see the further development of social impact investing within Australia, and to see Australia become a regional and global leader in the field. Australia already has a track record of pioneering in this space, and it is an opportune time to consider further the involvement of the Australian Government in impact investing.

About Brightlight

Brightlight provides impact investment consulting and funds management services to asset owners across private, philanthropic and government sectors. Brightlight enables clients to solve some of the world's most pressing problems by catalysing impact investment while maintaining the highest levels of financial rigour. Our mission is to change the world by creating an environment in which long-term investing, human flourishing and environmental stewardship go hand in hand.

Brightlight was created after the impact investment team at Christian Super was spun out of the $1.2b Superannuation Fund, to form a new investment management and impact investment advisory firm. Christian Super has a track record of over a decade in making impact investments in Australia and overseas. Brightlight continues to advise on and grow Christian Super's existing impact portfolio, while leveraging our extensive experience, networks and capabilities to support a wider range of impact investors. Brightlight has also bolstered its team with leading impact investment practitioners from across the investment banking, debt advisory, social entrepreneurship and funds management fields. This team of dedicated impact investment professionals has over seven decades of investment experience and over two decades of combined experience in making impact investments.

Brightlight Group exists to provide solutions to some of the challenges that are rightly identified in the Australian Government Social Impact Investing Discussion Paper as inhibiting the growth of the market, in particular:

- Broadening the scope of investors in the market to help develop standardised approaches and improve liquidity.
- Sharing due diligence costs for investors and intermediaries to make impact investing more accessible.
- Providing institutional-quality advice on social impact investments.
- Supporting the development of the evidence base for social impact investing.

Overview

1. What do you see as the main barriers to the growth of the social impact investing market in Australia? How do these barriers differ from the perspective of investors, service providers and intermediaries?

We share the views expressed in the discussion paper in relation to the main barriers to growth in social impact investing in Australia. As noted above, Brightlight exists to overcome many of these challenges.

Scalability is a key issue. Impact investments in Australia to date have been small and illiquid. The small size of these investments also makes them inaccessible for most institutional investors, who are looking to allocate pools of tens or hundreds of millions of dollars at a time.

This small scale also leads to problems with **costs**, as these types of investments have been expensive to construct, analyse and invest in.

Along with scalability and costs comes **fragmentation**. There is a lack of co-ordination across industry, and varying approaches between the Australian government and each of the State governments. This consultation represents an opportunity to harmonise and provide consistency in terms of structures and approaches to impact investing.

2. What do you see as the future for social impact investing in Australia: for example, can you foresee the development of new structures for social impact investing?

Impact investing carries enormous potential for the Australian government to address social issues more effectively and efficiently, by enabling risk-sharing between government and other parties, and by providing a framework to develop more cost-effective initiatives in priority policy areas.

We believe that Australia has the potential to become a regional and global leader within impact investing. A number of factors position Australia well to play this role:

- The strength and stability of our financial system.
- The large pool of assets held by superannuation funds and other institutional investors.
- A track record of innovation.
- A highly educated workforce with the ability to connect purpose, mission and financing.

We are concerned that Australia, despite these relative advantages, is at risk of falling behind. Others, such as the UK, US and Europe, are making significant strides, and there is likely to be competition from Singapore as a regional leader in the space. There is a limited window of opportunity for Australia to take a leading role in the region.

However with the right level of support from government and a proactive approach by industry, we can leverage Australia's initial innovations in impact investing into a world-leading capability that can be exported to the region and the world.

There are a range of steps that can be taken to encourage this.

Firstly, by focussing on enabling larger sources of capital to access social impact investments. At the moment much of the conversation in Australia is focussed around small-scale deals that are financed by High Net Worth Individuals (HNWI) and PAFs. Participation from larger asset owners and institutional investors has been minimal. This does not reflect the global experience, where the conversation is being driven by very large philanthropic foundations and asset owners, including pension funds, insurance companies and banks. Australia's largest source of unlocked capital for social impact investing is institutional investors in general, and superannuation funds in particular.

HNWI and PAF investors have an important role to play, but the capital landscape is a continuum where Not-For-Profit, Wholesale (Family Office and HNWIs) and Institutional (Pension Funds, Insurance Companies, Government Asset Owners) each play their role. In our view, the institutional voice is lacking from many of the discussions in the impact investing space. The absence of this voice makes it harder to take a leadership role in the region.

We believe that government can encourage more participation from institutional investors through targeted interventions and policy shifts, as well as through convening strategic conversations around the direction of social impact investing.

Secondly, by exploring the participation of Sovereign Asset Owners in social impact investing. To date, there has been minimal engagement from sovereign asset owners. We would highlight the opportunity for government to encourage sovereign asset owners to explore participation in the impact investment market.

Government should not mandate such investment, as these asset owners need to be free to pursue investment strategies in light of their objectives. But government can encourage these influential sovereign asset owners to explore how impact investing could fit into their own asset management strategies, and a natural fit in many areas between the long-term objectives of these investors and long-term desired government policy outcomes.

The consideration of impact investing by organisations such as the Future Fund, VFMC, T-Corp, Funds SA, GESB and others could have substantial beneficial effects, without requiring any additional government funding, by:

- Positioning Australia's sovereign funds as among the world's leaders in impact investing; early adopters in the impact landscape.
- Providing a further evidence base to demonstrate that impact investing can be done at scale.
- Sending a strong signal to the market that impact investing is worthy of consideration by large, professional, institutional asset owners.
- Influencing other large institutional investors (including superannuation funds) into the space.
- Lifting the quality of the whole industry through increasing professionalism and rigorous performance & risk measurement & management.

Thirdly, by ensuring that there is a legislative framework for social impact investing. This is discussed further immediately below.

3. Are there any Australian Government legislative or regulatory barriers constraining the growth of the social impact investing market?

Government is able to ensure that the legislative framework for product development within social impact investing is fit for purpose, and is accessible to both wholesale and retail investors. Such a framework would need to allow for a mix of market rate investment returns, concessional capital and voluntary distribution donation, to ensure that different types of capital can be blended to ensure maximum impact.

Existing product development structures (PDS/Information Memorandums) often exacerbate the already high-cost nature of impact investments, and tend to segregate wholesale investors from retail investors, while creating impediments to capital structures that utilise blended capital. This creates a productivity drag on the placement of capital and the returns obtained on investments.

Any proposed legislative framework for social impact investing product structures needs to be proportional to establishment costs for potential products. We believe that the creation of a single product structure which enables social impact investment products to attract investment from a wide range of investors would allow a more efficient capital flow to impact investing.

Role of the Australian Government in Social Impact Investing

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

Government's role in developing the impact investment market is crucial and, in our view, can be focussed in five main areas, outlined below:

Helping to Build the Market

Government can play a role in supporting the development of those organisations and intermediaries who are working hard to build a viable and scalable impact investment market in Australia. This can be done by:

- Publically signalling positive intent with respect to positioning Australia as a regional and global leader in impact investing.
- Supporting those organisations that are engaging with the global impact investing market.
- Creating space for the largest pools of capital to allocate towards impact investing by clarifying regulatory ambiguities.

Participating in the Market

We see government as a crucial participant in the market, supporting the development of impact investing initiatives where natural market forces don't provide sufficient impetus and directing impact investing towards areas where it is most productive in producing the desired public policy outcomes. This can be done by:

- Exploring whether sovereign asset owners should be participants in impact investing.
- Convening and facilitating conversations across industry, government, not-for-profit and academic sectors to work together to address challenges in different and collaborative ways.
- Leveraging the government's balance sheet to provide guarantees for impact investments where needed.

Regulating the Market

It is government's responsibility to ensure that the regulatory environment for investment is stable and supportive. With respect to social impact investing, this can be done by:

- Ensuring that active language around impact investing is incorporated in all relevant aspects of regulation.
- Removing unnecessary regulatory barriers.
- Setting key objectives and policy outcomes to be addressed
- Ensuring that the impact investing industry stays on-mission and does not create negative outcomes.
- Establishing appropriate structures to ensure appropriate regulatory oversight..

Providing Policy Certainty, Harmonisation & Consistency

One of the most critical roles that the Australian Government can play is in ensuring that the environment in which social impact investing occurs is stable and consistent. One of the barriers to impact investing is a lack of consistency across the different approaches by different levels of government to social impact investing. This can be overcome by the Australian Government taking the lead in:

- Convening different levels and branches of government in Australia to adopt standardised frameworks for structuring, funding and measuring the performance of impact investments (and in particular social impact bonds or pay-for-success models).
- Providing medium-term and long-term policy certainty in areas of opportunity for social impact investing, giving investors confidence to place their capital at risk over multiple political cycles.

Establishing Policy Initiatives

Finally, our view is that government is a key stakeholder in establishing the policy initiatives that will drive impact investment. By creating social impact bonds, pay for success initiatives and other impact investment structures, government has the opportunity to explore ways of delivering equivalent or improved policy outcomes at lower cost, effectively transferring some of this risk to the private sector. To achieve this, government can:

- Articulate costs to government of various policy interventions and outcomes.
- Provide certainty in relation to government's explore alternative funding models (including social impact bonds and pay-for-success outcomes) in particular policy areas.
- Identify ways in which social impact investments that provide benefits across multiple levels of government can be funded.
- Providing subsidies, if appropriate, to encourage private capital investment into priority areas.
- Co-funding impact investments in strategic areas.

While there are likely to be opportunities to strategically deploy government capital to encourage the development of impact investing in Australia, and these should be considered, we do not believe that government's primary role is to directly fund the growth of the industry.

5. Do you see different roles for different levels of government in the Australian social impact investing market? For example, the Australian Government as co-funder with State and Territory Governments continuing to take the lead in developing social impact investments?

We believe that the different levels of government in Australia are well placed to play different roles in the development and maturing of the impact investment ecosystem. Using the five key roles articulated above:

Role	**Australian Government**	**State & Territory Governments**
Helping to Build the Market	Signals intent to work across all levels of government to help build the market.	Minimal role
Participating in the Market	Participates where possible.	Participates where possible.
Regulating the Market	Takes responsibility for regulating the market.	Minimal role

Providing Policy Certainty, Harmonisation & Consistency	Takes lead in creating co-ordinated policy certainty and harmonisation across all levels of government.	Participates in policy harmonisation to ensure consistency.
Establishing Policy Initiatives	Sponsors social impact investments to provide cost savings to government in areas of responsibility.	Sponsors social impact investments to provide cost savings to government in areas of responsibility.

Using this framework, the Australian government takes the lead on regulation, policy harmonisation and measurement frameworks, particularly where assessing the benefits to government can be done on a holistic basis across different levels of government. State and Territory governments play a key role in identifying areas of policy involvement and support, as well as identifying government assets that could consider incorporating social impact investing approaches.

Co-funding opportunities would emerge in areas where there are benefits to both the Australian Government and State and Territory governments from using impact investment approaches to achieve particular policy outcomes.

6. Are there areas where funding through a social investment framework may generate more effective and efficient policy outcomes than direct grant funding?

There is an increasing evidence that funding through a social investment framework can be more effective in delivering policy outcomes than direct grant funding. The success of the Newpin Social Impact Bond in NSW is one example, but across social impact bonds, development impact bonds, pay-for-success models and other forms of impact investing there is ample evidence to support the idea that all parties can benefit through using social impact investing.

In our view, the areas that are most appropriate for impact investing are those where:

- There are specific policy outcomes that government wants to achieve.
- The policy areas involved are sufficiently significant to enable a substantial amount of capital to be invested.
- Capital can be recycled or distributed to investors from project to project rather than being consumed over the course of the project or intervention.
- There are known costs to government of a failure to achieve those policy outcomes.
- There is a clear baseline or control group from which success can be measured.
- It is possible to create a structure in which financial interests of investors and those responsible for service delivery are very closely aligned with the desired policy outcomes.

Some areas where this may be able to achieved are:

- Affordable Housing
- Disability Housing
- Incarceration and Recidivism
- Long-Term Unemployment
- Homelessness
- Drug & Alcohol Addiction and Drug & Alcohol-related crime
- Overseas Aid & Development
- Education
- Conservation & Environmental Preservation

The specific areas will need to be explored further as the government identifies policy priorities.

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?

As indicated above, we believe that there is an opportunity for the Government to develop some form of policy guideline or other encouragement for sovereign asset owners to consider impact investment allocations. This would be a relatively simple step but could have a strong catalytic effect. These entities in some part are influencers of the broader institutional landscape, and their consideration would show that large institutions (including Superannuation providers) can successfully allocate to impact investments at a size and scale that is relevant to their asset profiles.

We would recommend that any such guidance be broad in its scope, allowing for a broad spectrum of investments that are genuinely impactful but which are appropriate for an institutional investment portfolio.

Such an approach would begin to destroy some of the most common myths associated with the difficulty of impact investing, by proving that impact investing can be done at scale, that deals can be assessed appropriately and that it is possible for fiduciary investors to engage thoughtfully and professionally with the space.

Beyond this, we believe that the most promising opportunities are in areas where there are proven models (such as Foster Care and Disability Housing) or where there is substantial scale (such as Affordable Housing).

8. Are there opportunities for the Australian Government to collaborate with State and Territory Governments to develop or support joint social impact investments?

A number of the areas where social impact investing offers potential solution overlap jurisdictions. Structuring effective impact investments in these areas will require co-ordinated policy development, and a willingness to share the contribution towards the investment in order to achieve cost savings across different levels of government. The ability to identify these cost savings and attribute them to various levels of government will be necessary if we are to use social impact investment to solve cross-jurisdictional challenges.

Additionally, intentional dialogues between state and federal mandated sovereign asset owners may assist with evaluating any scope for impact investing in their portfolios.

9. What are the biggest challenges for the implementing the Australian Government's public data policy in the social impact investing market? What can do the Australian Government do to address these challenges?
10. Are there opportunities for the Australian Government to form data sharing partnerships with State and Territory Governments, intermediaries and/or service providers?

Aside from our comments above in relation to the importance of developing a consistent measurement framework across the various levels of government, we have little to add in relation to data challenges and opportunities.

Australia's Social Impact Investing Principles

11. We are seeking your feedback on the four proposed Principles for social impact investing outlined in this section.

At a high level, we think it is helpful to have Principles. However we have concerns that the framing of these principles is quite narrow, and not necessarily conducive to encouraging innovative approaches that benefit all parties, including government.

The principles appear to be tailored towards government funding of social impact investing through either social impact bonds or pay for success instruments. We have argued above that some of the most important roles that government can play relate to general market development and maturity rather than funding. There may be times when government support needs to be targeted towards the development of market infrastructure rather than the creation of social impact bonds or other particular instruments. The principles have little to contribute to those roles of government.

There are also references to how social impact investments have been designed internationally – indicating that all of the financial risk is transferred to investors. While this is true for some social impact bonds and most payment for success approaches, it is not necessarily true of the social impact investing market more broadly. One of the benefits of social impact investing is that it enables different risks to be transferred among different parties, to align all parties towards achieving the desired social outcomes.

The principles represent an opportunity to capture a harmonised approach along the lines that we have outlined above to ensure stability and consistency across government approaches. We are aware that other submissions are addressing this in more detail, and would encourage further consultation on this particular issue, to ensure that the framework and principles developed can apply across all levels of government, and can be used to ensure that government achieves its objectives in engaging with the sector. Ultimately, we would hope that this would lead to a reframing of these principles to encompass:

- The way that government engages with and makes decisions about impact investing.
- The role that government plays in the impact investing market.
- Guidelines in relation to particular types of instruments which government may use.
- Guidelines around accountability and measurement.

Reducing Regulatory Barriers

Private Ancillary Funds (PAFs)

Brightlight does not specialist in PAFs and does not have specific comments in relation to the issues raised in questions 12-22. We would reiterate that PAFs are an important part of the impact investing landscape, but that engagement with institutional investors is crucial to seeing a thriving impact investment sector in Australia.

Superannuation Law and Social Impact Investment

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

We concur that the existing legislation and regulatory framework does not prohibit superannuation funds from making impact investments, provided that such investments are consistent with their overall fiduciary investment strategy. This has enabled funds like Christian Super to forge ahead with a world-leading diversified impact investment portfolio that represents 10% of its total assets under management.

However, in our observation, Trustees of superannuation funds are generally risk averse. A lack of guidance in relation to the appropriateness of impact investing acts as a barrier, because Trustees default to the risk-averse position of avoiding anything not specifically permitted.

Published Brightlight research shows that impact investing offers valuable diversification benefits.[1] But APRA's current framing of diversification with respect to ethical investment contemplates only the risk of downside (insufficient diversification resulting from excluding certain industries) rather than the potential for upside (increased diversification, and avoiding exposure to high-risk investments).

We suggest that there are three areas where clarification would be helpful:

- Firstly, by specifically addressing ethical investment and impact investment approaches. Currently APRA's guidance is focussed on environmental, social and governance issues, and does not directly address ethical investment approaches or impact investments.[2] A more intentional use of language that addresses specific areas within a broader responsible investing banner would benefit market participants.
- Secondly, by shifting the onus of proof. APRA's current guidance places the onus of proof on Trustees to demonstrate specifically that the ESG component of an investment strategy presents no conflict with the requirement to act in the best interests of beneficiaries.[3] This effectively creates a default position of ignoring such factors, and places the risk on those who choose to adopt these factors.
- Thirdly, by articulating that there may be benefits associated with impact investing. APRA's specific guidance on diversification recognises only the risks associated with a lack of diversification caused by divestment from particular industries, rather than the potential improvements in overall diversification (not to mention risk-return profile) from ESG, Ethical and Impact Investments.[4]

Program Related Investments (PRIs)

Brightlight has no comments on questions 24-27.

Legal Structures for Social Enterprises

13. 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?
14. 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?

While a model constitution may be valuable, in our view this would not necessarily address some of the core challenges of executing on impact investments in Australia.

In the absence of specific profit-with-purpose structures, it is challenging embed a social mission in a company over the long term, particularly when compared with other jurisdictions. This potentially creates an unhealthy dichotomy between social purpose / not for profit and for-profit business,

[1] https://www.imca.org/sites/default/files/current-issues/IWM/IWM16NovDec_ImpactInvestingDiversifiedPortfolio.pdf
[2] APRA Prudential Practice Guide SPG530 Investment Governance, §34
[3] APRA Prudential Practice Guide SPG530 Investment Governance, §34
[4] APRA Prudential Practice Guide SPG530 Investment Governance, §34

ignoring the potential for business with an intention to create profit and social impact to make a substantial positive impact on society.

Accordingly, rather than focussing on a model constitution, we would recommend the development of a corporate structure model that is fit for purpose and reflects the expectations of society in relation to business.

Additionally, we have observed a range of structures being used for social impact investment funds, including a number of unregistered Investment Memorandums where government has minimal opportunity to ensure that risks are appropriately addressed. Greater harmonisation in the legal structure would assist with attracting investor capital as well as the continued establishment of innovative social enterprises.

We also note that there is a value in bringing consistency to the structures that enable capital flow, such as Social Impact Bonds and Social Impact Funds. In our view, a more consistent and simplified approach to these types of instruments would enable investors to conduct due diligence much more quickly and efficiently.

Conclusion

Once again, thank you for the opportunity to prepare a submission. We are committed to continuing to build a vibrant and sustainable impact investment industry in Australia, and look forward to working with government and other industry partners to achieve this.

We are available to engage with any aspect of our submission, or the impact investment industry more broadly, as needed. I can be contacted on 02 9352 5231 or by email: tmacready@brightlightia.com

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