

The Treasury
Langton Crescent
PARKES ACT 2600
AUSTRALIA

27 February, 2017

CENTRE FOR SOCIAL IMPACT SUBMISSION TO TREASURY:

Social Impact Investing Discussion Paper

The Centre for Social Impact (CSI) welcomes the opportunity to submit its views on the Treasury Discussion Paper, *Social Impact Investing*.

In this submission we respond to a number of the questions presented in the discussion paper. Specifically:

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?
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?
3. Are there any Australian Government legislative or regulatory barriers constraining the growth of the social impact investing market?
4. What do you see as the role of the Australian Government in developing the social impact investing market?
- 5 & 8. 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? Are there opportunities for the Australian Government to collaborate with State and Territory Governments to develop or support joint social impact investments?
6. Are there areas where funding through a social investment framework may generate more effective and efficient policy outcomes than direct grant funding?
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?
10. Are there opportunities for the Australian Government to form data sharing partnerships with State and Territory Governments, intermediaries and/or service providers?
11. We are seeking your feedback on the four proposed Principles for social impact investing.
23. What guidance in particular would provide a desired level of clarity on the fiduciary duty of superannuation trustees on impact investing?
24. To what extent are the current arrangements for program related investments appropriate?
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?

Who we are

CSI is an academic research and education centre, working to achieve better social outcomes for all Australians. CSI is an independent, not for profit collaboration working across three of Australia's leading universities: UNSW Sydney, Swinburne University of Technology, and The University of Western Australia. We act as a catalyst for social impact by creating positive, meaningful and sustainable change for the benefit of our community, and particularly for those at disadvantage as a result of complex, long term systemic issues. We create knowledge through our academic and applied research. We focus on knowledge engagement through teaching and public engagement activities with the ultimate aim of affecting policy and practice, improving outcomes for those in need.

Background

CSI's research examines our social purpose ecosystem. We tackle complex social problems and examine how people, organisations, groups and sectors work to respond and are experts in measuring and reporting how, why and under what circumstances outcomes are achieved. We have particular expertise in cross sector partnerships, outcomes measurement and different funding instruments to achieve social change.

Our response to the discussion paper draws on evidence from recent research that CSI has led or been a partner to. The sources drawn on include: Evaluation of the Social Enterprise Development and Investment Funds (SEDIF) (for Department of Employment); Giving Australia 2016 (for Department of Social Services, sponsored by Prime Minister's Community Business Partnership); The Opportunities, Risks and Possibilities of Social Impact Investment for Housing And Homelessness (for Australian Housing and Urban Research Institute (AHURI), forthcoming), and Finding Australia's Social Enterprise Sector (FASES) 2016 (conducted with Social Traders).

Question 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?

Social impact investing in Australia is still in its early stages. There has been considerable growth in social impact investment activity since 2011, in part catalysed by the SEDIF. However, this growth came from a very low base (Barraket, Muir et al. 2016). Some of the main barriers to the growth of social impact investing are outlined below:

General

There is some confusion regarding the definition and conceptualisation of social impact investment. For example, the AHURI research found variations in levels of understanding between groups and the SEDIF evaluation demonstrated a misunderstanding that social enterprise and social impact investment are two ends of the same market. A resource that provides clarity and guidance regarding the definition and constructs of social impact investment is important for different actors and potential actors in the market to better understand, explore and make the most of opportunities.

Investors

Evidence from CSI research projects confirms that there has been relatively limited take-up by:

- *Philanthropic investors*, due to factors such as a lack of investment opportunities and deals; the bespoke character of these deals, associated transaction costs and challenges of due diligence; uncertainty over the duties of trustees for below-market investments, and associated caution among trustees.
- *Institutional investors*, including superannuation funds, due to lack of deals of sufficient scale, relative due diligence costs and the need for market-related returns associated with fiduciary duties.
- *Investors* also face barriers relating to risk and return levels without the same scale of guarantors as overseas (e.g. large philanthropic organisations who guarantee a certain proportion of private investment potentially at below market returns through layered investments).

Intermediaries

Intermediaries play an important role in social impact investing. Firstly, they act as brokers between the demand and supply-side investors (including charitable trusts), who may lack familiarity with social impact investment and often require intermediation to identify investment opportunities and facilitate transactions. Secondly, they provide intermediation between investors and service providers. This can assist service providers to understand what is required by investors and navigate social impact investment opportunities and initiatives.

CSI research, including the FASES 2016 report, confirmed that existing intermediaries are well-regarded among both investors and organisations seeking capital. Nonetheless, Australia has insufficient numbers of specialist intermediaries to support a strong social impact investment ecosystem (Barraket, Mason et al. 2016). Insufficient foundational investment in SEDIF limited what was possible in building the market (Barraket, Muir et al. 2016).

Demand-side organisations (including service providers)

Public policy to support market development has been supply-led; it has not always taken adequate consideration of the needs of social impact providers, including not for profit organisations, social enterprises and social businesses. There have thus been limitations in the effective structuring of social impact investing. Importantly, there has also been a lack of attention to the development of other forms of social finance – including patient capital, community capital, blended finance and guarantees – to better serve the capital needs of some social benefit providers. Consequently, there have been difficulties matching social impact investing supply to demand.

In the United Kingdom (UK), widely seen as the most mature social impact investment market (Nicholls 2010), studies have also questioned the absorptive capacity of demand-side organisations. Lyons (2016), for example, found low demand for non-traditional forms of capital among social enterprises. Similarly, the UK Government's Social Investment Taskforce (2014: 29) found 'more capital available than demand-side organisations could reasonably absorb'.

Much of the capacity building activity and attempts to enhance investment readiness are privately-driven in Australia (for example, the Impact Investment Ready Discovery Grants and Impact Investment Readiness Fund). Government should consider adopting a supply focused approach to building the capacity of service providers to participate in the social impact investment market.

Question 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?

Consolidation and use of existing forms will be important for the future development of social impact investing in Australia. We examine this in regard to the three main forms of social impact investing (Discussion Paper: 10): social impact investment funds, social impact bonds (SIBs), and social enterprises.

Social impact investment funds

Specialist social impact investment funds are relatively scarce in Australia compared to the UK and the United States (US). Those currently accepting investment are largely operated by a small number of specialist intermediaries and are small-scale and bespoke. Growth is stymied by regulatory barriers which limit the involvement of superannuation fund investors and – to a lesser extent – philanthropic investors through charitable trusts including Private Ancillary Funds (PAFs) and Public Ancillary (PuAFs) (discussed below). There are clear opportunities to grow social impact investment funds using existing structures, subject to regulatory amendments.

There are other opportunities for scale, including models that refine existing structures, and have not yet been trialled in Australia. An example includes the housing bond aggregator model identified by the Affordable Housing Working Group of the Council on Federal Financial Relations (2016b) and Impact Capital Australia (Addis, McCutchan et al. 2015). This example might also work in conjunction with specific tax incentives (discussed below), which would rely on significant public investment from the Australian Government.

Social impact bonds

SIBs are payment-by-results instruments. They rely on an intermediary that brokers the arrangement through which investors can recoup their capital investment (which typically resides with a not for profit service provider), as well as an additional financial return – which may vary from an agreed maximum percentage through to nothing – based on achievement of agreed results.

SIBs have been successfully piloted within the current institutional framework (including the Newpin Social Benefit Bond widely identified as a successful globally SIB). The challenges related to implementing SIBs and the negative community effects of SIB failures in the US have been well-documented. Evidence from some examples of SIB implementation also raise questions about the extent to which they are leveraging new capital in support of social issues versus reorganising existing capital (particularly from philanthropy) with greater transaction costs involved. There are a number of reforms including both ‘soft’ policy reforms and ‘hard’ legislative reforms that could improve their efficacy. These can occur within the existing structures and are described below (see Q3).

Social enterprise

The description of social enterprise provided in the Discussion Paper (p. 31) is not consistently applied. It is also not consistent with the definition most commonly used in the Australian social enterprise sector or Australian public policy (including public policies specifically targeted at social enterprise development). While there is no universally used definition of social enterprise in Australia, the most commonly employed in public programs derives from FASES 2010, in which social enterprises were defined as organisations that aim to fulfil a mission consistent with public or community benefit, trade to fulfil their mission, and reinvest a substantial proportion of their profit or surplus in the fulfilment of their mission. In broad terms, social enterprises are businesses that aim to attain social outcomes and financial sustainability, some of which are structured as for-profits and able to distribute profits to owners (or limited distribution to members such as cooperatives) (Barraket, Collyer et al. 2010; Barraket, Mason et al. 2016).

The Discussion Paper describes social enterprises as appealing to social impact investors as they can receive equity investments. However, Australia’s most significant mapping of social enterprise has found the vast majority of social enterprises in Australia are not for profits and make relatively minimal use of external finance, particularly equity.¹ That is, the bulk of social enterprises are not profit distributing (asset locked) and are precluded from distribution of profits. Beyond their legal form, many social enterprises do not seek to generate financial returns beyond financial sustainability, as their business models involve sinking additional resources directly into the execution of their social purpose (e.g. carrying a productivity cost in order to provide transitional labour market opportunities for disadvantaged job seekers). A major finding of the SEDIF evaluation was that social enterprise and social impact investing are not necessarily the supply and demand ends of a single market. Social enterprises require diverse forms of social finance and, while there is no question that some models of social enterprise can benefit from social impact investment, this is a very small proportion of the overall social enterprise sector.

There are implications - as noted in the Discussion Paper - with respect to social enterprises’ access to social impact investing and existing legal forms. There is some debate, but as yet fairly minimal evidence, regarding the need and demand for new forms that facilitate equity investments. International models include Community Interest Companies² (CICs) in the UK and Benefit Corporations³ in the US (the L3C model

¹ While there is some scope to structure social enterprise as a not for profit that can receive equity investments this is complicated and relatively rare (Justice Connect model, <https://www.justiceconnect.org.au/new-social-enterprise-guide>).

² CICs are limited companies which operate to provide a benefit to the community they serve. They are not strictly ‘not for profit’, and CICs can, and do, deliver returns to investors. However, the purpose of CIC is primarily one of community benefit rather than private profit. Whilst returns to investors are permitted, these must be balanced and reasonable, to encourage investment in the social enterprise sector whilst ensuring true community benefit is always at the heart of any CIC’ (Department for Business Innovation & Skills 2016: 3).

referenced is not of utility in Australia). The Australian Government should investigate the need, advantages and disadvantages for these legal forms (or a hybrid model). This is consistent with the advice of the Prime Minister’s Community Business Partnership Impact Investing and Partnerships Working group.

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

The transactions costs (including measurement) and the smaller scale of social impact investments may make it difficult to deliver sufficient social impact investments with market returns.

Superannuation funds have been identified as a large pool of funds for social impact investing. However, superannuation funds are ‘financial first investors’ (as defined in the Discussion Paper, p. xii), requiring risk adjusted financial returns equivalent to mainstream investments due to the requirements of the sole purpose test in the Superannuation Industry (Supervision) Act 1993 (Australian Government 1993).

Fiduciary duties also present barriers for other types of investors such as trustees of charitable trusts (including PAFs) and there is a lack of clarity on current rules governing the use of Program-related Investments (PRIs) and barriers relating to the current treatment of PRIs made by PAFs specifically (see Q24).

More broadly, investors seek stability in the investment environment and a mitigation of risk, which has implication for government policy. For example, in affordable housing and renewables, where institutional investors have expressed an interest in investing, there has been a lack of policy and regulatory certainty, or inconsistency of policy. For example, the National Rental Affordability Scheme (NRAS) commenced in 2008 and was discontinued in 2014, at a time when administrative issues were resolved and it was attracting greater interest (Rowley, James et al. 2016). Investment in renewables has been hindered by changes in state and territory and Commonwealth policies.

These issues reinforce the importance of government:

1. Bringing down transaction costs through shared systems (e.g. a high quality outcomes measurement system)
2. Cross-subsidising layered investments that allow for different rates of risk-return, including market and below-market returns
3. Clarifying PRIs for charitable trusts
4. Redressing policy gaps that present risks to the success of a social impact investment (e.g. reinstatement of an improved NRAS)

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

The Australian Government has clear roles to play in catalysing market development, policy and regulation, stewardship and funding.

As noted above, the Australian Government can draw from successful models implemented overseas. For example, in the area of affordable housing, the NRAS was a modification on the long term Low Income Housing Tax Credit (LIHTC) model in the US; and the Affordable Housing Working Group of the Council on Federal Financial Relations’ (2016a; 2016b) recommended approach of a bond aggregator is modelled on Affordable Housing Finance in the UK.

The Australian Government can also draw examples from other countries for the development of enabling policy environments.

Public policy for enabling social enterprises to ensure absorptive capacity

As noted above policy-makers must be cautious not to treat social enterprises and social impact investment as two ends of the same market. However, strengthening the investment readiness of social enterprises has

³ B Lab certifies for-profit companies as Benefit Corporations when they meet rigorous standards of transparency, accountability and social and environmental performance (B Corp 2016).

implications for the efficacy of social impact investment markets. That is, a robust social enterprise sector will better contribute to the absorptive capacity for social impact investment capital.

There are commonalities among policy frameworks for strengthening social enterprises internationally. A study that mapped policy frameworks in the European Union observed six key elements of an enabling policy environment. These include:

- *Specific legal forms* that facilitate social impact investment such as CICs in the UK, the ex lege in Italy is a defined legal status and the Benefit Corporation
- *Preferential tax treatment* such as Social Investment Tax Relief (discussed below) to incentivise supply through tax benefits
- *Specialised support*, often through intermediaries, such as mentoring and business development (primarily a state jurisdiction issue in Australia, although federal support would be beneficial)
- *Social procurement* in public service contracts to promote demand and market access for social benefit providers
- *Standardised impact measurement* and reporting frameworks
- Measures to grow the supply-side of *social impact investment markets* (Wilkinson, Medhurst et al. 2014: 50).

Many countries also adopt coordinated social enterprise strategies, such as that recently launched by the Victorian Government.

The 2016 FASES study found that social enterprise policy in Australia is piecemeal and exposed to political change. All levels of government could provide policy responses, with local government assisting with market development, and state and federal government supporting development of organisations, stimulating policy design innovation and enabling regulation (Barraket, Mason et al. 2016: 31). However, given the number of industries in which social enterprises operate, industry regulation could override any generic developments for social enterprises (Barraket, Mason et al. 2016: 53). The study's survey found over 80 per cent agreeing that new opportunities would be encouraged by government policy support, with the majority of the remainder neutral (Barraket, Mason et al. 2016: 28). 46 per cent of respondents were neutral on a new legal form helping social enterprises to achieve their goals, with 32 per cent agreeing and 22 per cent disagreeing (Barraket, Mason et al. 2016: 27-28).

Public policies for enabling SIBs

Policy interventions and initiatives for SIBs normally take the form of 'soft' instruments including: grant funding for infrastructure and technical assistance for SIB development (targeted at intermediaries and service providers) and strategies and policy frameworks that place payment by results contracts at the heart of public policy. 'Hard' regulatory and legislative reforms include: tax relief and incentives for investors and public finance reforms to provide budgetary certainty.

Guffaston-Wright, Gardiner et al. (2015: 33-4, 134-5, 137) have provided a summary of UK and US government support for the SIB 'ecosystem' including:

- The UK's Social Investment Tax Relief 2014 legislation that provides tax benefits for individuals investing in qualifying social enterprises including SIBs, as a percentage of the amount invested and deferral of capital gains tax in certain circumstances.
- The UK's Centre for Social Impact Bonds (within the Social Investment Finance Team in The Prime Minister's Cabinet Office) which analyses and facilitates the market through the provision of information and tools, and by building an evidence-base and showcasing innovation in public service delivery through SIBs.
- The UK's 2012 Social Outcomes Fund (£20 million) which provides additional funds for SIBs, using central government funding where the savings apply to multiple departments that would be difficult for one department to fund.

- The US is establishing a similar national fund to the UK's Social Outcomes Fund. The US's federal agency, the Corporation for National and Community Service, has also established a Social Innovation Fund which has awarded eight organisations grants to develop SIBs. Massachusetts and Utah have passed legislation authorising SIBs and eight other states have introduced legislation.
- Various US legislation applying to investment in SIBs: the Community Reinvestment Act 1977 (leveraged for banks); the Tax Reform Act for Program Related Investments; and the Riegle Community Development Regulatory Improvement Act of 1994 for Community Development Finance Institution (CDFI) Funds.

Guffaston-Wright, Gardiner et al. (2015: 130-9) further summarise legislation and policy frameworks relating to exploring, designing and implementing SIBs in Australia, Canada, the UK and US (at federal and state levels). Types of legislative support include scoping, pilot, authorisation, financing and incentives for financing. Government action supporting SIBs includes technical assistance, scoping, incubating, pilot, financing (grants, start-up costs, payment of intermediaries), issuing Requests for Information (RFIs) and Requests for Proposals (RFPs) and commitment.

As noted in the Discussion Paper, governments may need to change legal conditions to facilitate payment for outcomes, including allowing payment to intermediaries and in years following the fiscal year in which the contracts are executed (Burand 2013: 476-7; Guffaston-Wright and Gardiner 2015: 6; Instiglio 2014: 14).

This may require the establishment of sinking funds, trusts or special purpose vehicles. Changes may also be required to procurement procedures and to allow the intermediary to make decisions, for example, selecting the service provider. Governments may also need to provide clarity on the tax treatment of SIBs (equity and debt components) and for international investors (Burand 2013: 476-7; Guffaston-Wright and Gardiner 2015: 6; Instiglio 2014).

In a review of the early years of SIBs, Dear, Helbitz et al (2016: 48-9) found three common factors government should consider:

- Dedicated staffing for SIBs and other payments by results program as well as champions for individual SIBs (including external intermediaries or advisors)
- Structures that transition changes in government and priorities and staff
- Combining funding sources, particularly where outcomes are spread across multiple departments, for example the UK Outcomes Fund.

The impact of SIBs has been seen as relatively small given the amount of structuring that is required. SIBs are complex and exhibit bespoke features. They require significant intermediation due their complex structure, substantial resources in development, and extensive due diligence for investors, which lack familiarity with the model. The lack of an easily replicable model also can present prohibitively high transactions costs. These challenges have resulted in a perception that the complexity of the development process limits their utility to social policy challenges. There is also, as yet, limited evidence about their effectiveness and efficiency in delivering social outcomes.

Public policy for enabling social impact investing funds

Access to capital (grants and loans) for social enterprises is a challenge particularly from traditional sources (Brackertz and Moran 2010; Social Investment Taskforce 2000). This has resulted in multiple policy interventions aiming to grow social finance.

This development commonly takes market infrastructure forms such as specialist funds targeted at intermediaries (Wilkinson, Medhurst et al. 2014). Intermediaries provide repayable loans and other forms of finance including equity (where legal form permits) and quasi-equity (feasible). However, forms of equity are rare in Australia as most social enterprises are structurally precluded from distributing profits (Addis, McLeod et al. 2013).

Improving investment readiness has been a less common focus but one example is the now closed Investment and Contract Readiness Fund established by the UK Government. In Australia, the SEDIF is a clear example where government has established an investment fund and mobilised over 124 per cent of the public funding in private finance. It financed 64 social enterprises with strong direct effects in scaling social impacts and capacity building, and had modest indirect capacity building effects for 424 social enterprises which were financed or had financing declined (Barraket, Muir et al. 2016).

Big Society Capital and Access - The Foundation for Social Investment

The UK Government also established Big Society Capital (BSC) in 2012 with £400m of unclaimed assets in dormant bank accounts and £200m from the largest four retail banks. It has invested in 14 intermediaries, many focussing exclusively or partly on social enterprise (BSC 2017).

In 2015 the UK government established, Access - The Foundation for Social Investment in partnership with The Big Lottery Fund (Access 2015). Through a £45m Growth Fund (£22.5m grant from The Big Lottery Fund, £22.5m loan from BSC) its objective is to assist early stage social enterprises access social investment to move beyond pilot to scale, by providing 'small, affordable and flexible finance'. The Cabinet Office also provided £60m to Access as an endowment to support capacity building. Other forms of government support can include tax credits (e.g. LIHTC in the US or guarantees such as Affordable Housing Finance in the UK) which offer investment at scale and are facilitated through intermediary investment managers.

As noted in the Discussion Paper (p. 8) and by the Affordable Housing Working Group of the Council on Federal Financial Relations (2016b), social impact investment is complementary to and not a replacement for government funding.

Question 5 & 8: 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? Are there opportunities for the Australian Government to collaborate with State and Territory Governments to develop or support joint social impact investments?

The roles for different levels of government in the social impact investing market relate to their different roles as regulators and/or funders which vary for different areas of service delivery.

As the primary providers of services, State and Territory governments are taking the lead in payment-by-results contracts, including SIBs. However there is scope for Commonwealth involvement in the development of best practice documentation and measurement across the States and Territories. Consistent documentation would result in lower costs (including legal) over time. Convergence of outcomes measurement across the States and Territories would lower transaction costs over time and provide investors with the opportunity to compare different social impact investments for risk, return and impact. By agreeing standard timeframes for savings and considering different departments for areas of saving, the effectiveness of the interventions could be compared.

More generally, and as discussed in Q.1 and Q.3 above, the establishment and measurement costs of some social impact investments mean it is difficult to deliver a market return. Federal, State and Territory Governments can provide grant funding for establishment, due diligence and measurement costs. However, there is potential for the Commonwealth to provide this funding for social impact investments being developed at the State/Territory Government level.

In areas, such as housing and homelessness, where both federal and State or Territory Governments have responsibilities, coordination is important for investors, service providers and may help to improve outcomes for beneficiaries.

All levels, including local governments, can adopt procurement policies to support service providers with social impact investment finance (as recently announced by the Victorian Government in its Social Enterprise Strategy; 2017).

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

Social impact investing will not be suitable for all social services. Opportunities only exist where the investment in the policy or intervention can result in financial and social returns. Therefore, it will not be an appropriate model where:

- Costs of the intervention are higher than the financial return and social returns
- There is not sufficient readiness or capability in the service provision market
- Markets are thin and the returns are low
- Outcomes are likely to take very long periods of time (beyond the appetite for investors) and clear incremental pathways cannot easily be established regarding short and medium term progress

There is difficulty, however, in outlining specific service areas where social impact investment may be effective or ineffective because international and local evidence is not yet strong. It is important that sound outcomes measurement frameworks are established and that the evidence base is built regarding areas of highest effectiveness and areas of potential risk.

Further, it is important to distinguish between social innovation (new and improved responses to complex social problems) and innovations in financial mechanisms that support social policy agendas.

Social investment models have the potential to leverage new sources of finance and bring together investors, providers and beneficiaries. However, it is not known how much capital there is (or would be) available and how much money would be displaced from traditional granting sources, and whether outcomes would improve if funding was displaced.

A significant promise of social impact investment is the shift to track, understand and reward based on outcomes. This reflects the trend to outcomes and payment-for-results, rather than the historic funding of activities. It will be important to understand where outcomes occur, for who and under what circumstances and to track which groups could be left behind. It will be important that different mechanisms for funding social services remain, including the continuation of government block grants where investment approaches are not appropriate.

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?

Social impact investment funds

The SEDIF research suggests that ‘bricks and mortar’ investments have the most potential, such as social and affordable housing, and physical infrastructure for not for profits, because of the security provided by real assets.

This has been illustrated with the significant support for the housing bond aggregator from community housing providers, intermediaries and institutional investors (Council on Federal Financial Relations 2016b).

Some social infrastructure funds and property funds own social assets (e.g. schools, hospitals, water treatment plants) that enable the provision of services by services providers, often under public private partnership (PPP) models. However, these funds do not typically measure social outcomes and would not fall under the definition of social impact investing.

Social impact bonds

The availability of baseline data for the comparison of outcomes from SIBs will vary by State and Territory and may result in particular service delivery areas having more or less potential.

In 2016 intermediary Social Finance, which has played a prominent role in the growth of SIBs providing the foundational model at Peterborough in 2010, established an Impact Bond database of SIBs. It shows as of June 2016 there have been 60 Impact Bonds launched with US\$216 million of capital raised. The social impact areas were as follows: 24 workforce development (40%), 12 housing/homelessness (20%), 8 child and family welfare

(13.3%), 5 health (8.3%), 5 criminal justice (8.3%), 5 education and early years (8.3%) and 1 adults with complex needs (1.7%; Social Finance 2016).

Further research is needed to determine whether and to what extent these SIBs delivered financial and social returns. The model is relatively immature, the evidence-base still emergent, and the potential for replication within and across jurisdictions is challenging.

Social enterprises

Social enterprises can use diverse forms of social finance. The SEDIF evaluation identified the need for diverse forms of social finance – including patient capital, blended finance, guarantees – to support the work of SME social enterprises (Barraket, Mason et al. 2016).

Question 10: Are there opportunities for the Australian Government to form data sharing partnerships with State and Territory Governments, intermediaries and/or service providers?

The development of common outcomes measurement frameworks and tools, linking data and providing de-identified aggregated reporting across governments could:

- facilitate comparison of outcomes across programs
- assist to minimise (or inform) risk taken by investors and government
- reduce individual transaction costs.
- help to inform evidence based policy in Australia and, in turn produce beneficial outcomes for individuals, communities and the broader society.

It will be important to consider and apply high standards of privacy, ethics, benchmarks for different groups, quality indicators and real time, accessible reporting.

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

The four proposed Principles are important. In addition to value for money; robust outcomes-based measurement; fair sharing of risk and return; and a focus on deliverable and relevant social outcomes, we suggest adding a fifth principle:

- “Do no harm”.

Do no harm is a principle successfully embedded and widely understood in health, humanitarian, foreign aid, and environmental protection areas. It would be beneficial to add this principle to social impact investment. More broadly, this should be applied if market failure occurs and alternative funding and social supports are needed.

Some additional considerations for the four principles outlined include:

- *Value for money*
 - It is important to understand that different investors have different expectations of ‘value’ (e.g. philanthropic investors will often have lower expectations of financial return than finance first investors)
- *Robust outcomes based measurement*
 - Reasonable pathways for measuring outcomes are important. These should be based on clear theories of change and provide stepping stones for measuring changes in the short, medium and longer term
 - In determining who benefits from social impact investment, it is important to note that evidence will not always be available to confirm levels of attribution to outcomes. As the Discussion Paper outlines, RCTs or quasi-experimental design can be adopted, but these can be prohibitively expensive and may result in a barrier to investment. Further, since complex problems require collaborative, holistic solutions, it may be more cost effective to understand contribution than attribution
- *Fair sharing of risk and return*

- The expectation of service providers to hold ‘risk’ could limit the market pool of service providers able to take part in social impact investment
- It may lead to unexpected consequences regarding ‘cherry picking’ clients who will have the highest returns for the lowest costs, which will be problematic if it is at the expense of beneficiaries with greater needs
- In different social areas, government will need to accept a higher level of risk and/or decrease the risks of others contributing capital
- Stable policy and regulatory contexts will be critical to help decrease the real and perceived risks faced by investors and service providers
- *Deliverable and relevant social outcomes*
 - We suggest also adding “evidence that the service provider can deliver outcomes to the cohort targeted” to the list of factors
 - There may be risks in transferring funding to a social impact investment market before there is readiness to deliver outcomes

Different types of social impact investment may require flexibility in the application of the principles, but the principles can be applied across the suite of SII instruments.

As highlighted in the Discussion Paper (p. 14), government is not a participant in many social impact investments. Thus, while the aim of the proposed Principles is to guide the Australian Government in the development of the social impact investing market, it should clearly be stated that care should be taken by other market participants in adopting the Principles.

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

Superannuation funds require market rate risk adjusted financial returns due to the requirements of the sole purpose test⁴. Most superannuation funds consider environmental, social and governance (ESG) issues as part of their investment analysis because of their impact on the value and risk of the investments. This includes consideration of the corporate social responsibility (CSR) policies and practices of the portfolio companies, and engagement on particular issues.

With its dual returns (social and financial), social impact investing is more targeted (Responsible Investment Association Australasia 2016). Social impact investments are being considered by some superannuation funds, either for socially responsible member choice options or the fund as a whole. While the sole purpose test requires risk adjusted market returns for the fund as a whole, clarity could be provided on the fiduciary duty of trustees for socially responsible member choice options where the trade-off between returns and impact may be different if it is clearly disclosed to members in the product disclosure statements.

Question 24: To what extent are the current arrangements for program related investments appropriate? Should changes be made to:

24.1 recognise the total loan, rather than only the discount rate between a commercial rate and the concessional loan rate, for the purposes of meeting the ancillary’s funds minimum annual distribution; and 24.2 allow ancillary funds to make program related investments to non-DGR organisations

The current arrangements with regards to PRIs do not effectively promote social impact investment.

As outlined in the Discussion Paper, existing treatment constrains the ability of PAFs and PuAFs to make ‘impact first’ PRIs, beyond the narrow scope allowed by amendments to the ancillary fund guidelines. The

⁴ Under the Superannuation Industry (Supervision) Act 1993, the sole purpose test specifies that trustees must ensure superannuation funds are solely maintained to provide retirement (or death) benefits for members (Australian Government 1993).

implications are two-fold: it limits the availability of capital to a pool of DGR Category 1s and reduces the appeal of PRIs to ancillary funds due to limits on the annual distribution. The expanded treatment proposed in the Discussion Paper (pp. 30-31) should in principle address these issues.

As noted, there are significant implications of the extension of treatment to include non-DGRs. DGR categories are tightly regulated in line with other government regulatory and policy objectives. Caution must be taken when making this amendment and should be addressed within the wider, and ongoing, discussions around DGR status.

The report prepared by Philanthropy Australia for the Prime Minister's Community Business Partnership (Philanthropy Australia 2015: 22) has identified that this would also require 'relatively straight-forward' amendments to legislation with regulation with respect to Income Tax Assessment Act 1997 and ancillary funds.

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?

Over eight years of conducting research with the Australian social enterprise sector, the direct costs of incorporation have never presented as a barrier to entry in CSI staff's experience. Rather, the transaction costs of finding suitable legal advice and the capital costs of establishing particular businesses – both of which are arguably barriers to entry for mainstream SMEs – are identifiable challenges.

As detailed in relation to the findings of FASES 2016 above, it is not clear at this stage that a legal remedy is desired by the social enterprise sector, nor that this would remove barriers to entry or greater access to external finance. Much of the discussion of new legal forms presented during FASES 2016 focus groups with 75 participants related much more to increasing visibility and public legitimacy of social enterprises than it did to accessing finance or resolving legal constraints.

As identified in the SEDIF evaluation and above, access to diverse forms of social finance – including but not limited to social impact investment – is important to meeting the needs of diverse social enterprises. Further, finance first models of social enterprise development are often unsuccessful, with capacity building for new market entrants typically required in relation to: understanding and apprenticing the social problem they seek to resolve; establishing business model, governance and operations; developing peer support and networks; and fostering market opportunities. Attention to these issues – with government investment in specialist intermediaries – is likely to improve social enterprise start-up and performance. Educating legal and financial advisors about diverse business forms, including social enterprises, is also likely to improve the quality and accessibility of advice to start-up and established social enterprises.

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