NOTICE


The results of Ernst & Young's work, including the assumptions and qualifications made in preparing the submission, are set out in Ernst & Young's submission dated 27 February 2017 ("Submission"). The Submission should be read in its entirety including the transmittal letter, the applicable scope of the work and any limitations. A reference to the Submission includes any part of the Submission. No further work has been undertaken by Ernst & Young since the date of the Submission to update its content.

Ernst & Young has prepared the Submission for the benefit of The Treasury and has considered only the interests of The Treasury. Ernst & Young has not been engaged to act, and has not acted, as advisor to any other party. Accordingly, Ernst & Young makes no representations as to the appropriateness, accuracy or completeness of the Submission for any other party's purposes.

No reliance may be placed upon the Submission or any of its contents by any recipient of the Submission for any purpose and any party receiving a copy of the Submission must make and rely on their own enquiries in relation to the issues to which the Submission relates, the contents of the Submission and all matters arising from or relating to or in any way connected with the Submission or its contents.

Ernst & Young disclaims all responsibility to any other party for any loss or liability that the other party may suffer or incur arising from or relating to or in any way connected with the contents of the Submission, the provision of the Submission to the other party or the reliance upon the Submission by the other party.

No claim or demand or any actions or proceedings may be brought against Ernst & Young arising from or connected with the contents of the Submission or the provision of the Submission to any party. Ernst & Young will be released and forever discharged from any such claims, demands, actions or proceedings.

Ernst & Young have consented to the Submission being published electronically on the Treasury website for informational purposes only. Ernst & Young have not consented to distribution or disclosure beyond this. The material contained in the Submission, including the Ernst & Young logo, is copyright and copyright in the Submission itself vests in Ernst & Young. The Submission, including the Ernst & Young logo, cannot be altered without prior written permission from Ernst & Young.

Ernst & Young's liability is limited by a scheme approved under Professional Standards Legislation.
Dear David

**Australian Government Social Impact Investing Discussion Paper - EY Submission**

Ernst and Young (EY) welcomes the opportunity to provide comments on the Australian Government’s Social Impact Investing Discussion Paper (January 2017).

This Submission sets out EY’s views on the potential roles of the Government to enable a thriving social impact investing market, the principles to guide the Government’s involvement in the market, and the barriers to market growth.

Furthermore, please note we have outlined our response to regulatory barriers in Appendix A and we would appreciate it if this section of the Submission remains confidential and not publicly released.

**Purpose of our Submission and restrictions on its use**

This Submission was prepared solely for the purpose of responding to the Australian Government’s Social Impact Investing Discussion Paper and should not be relied upon for any other purpose. Our Submission may not have considered issues relevant to any third parties. Any use such third parties may choose to make of our report is entirely at their own risk and we shall have no responsibility whatsoever in relation to any such use.

No reliance may be placed upon this Submission or any of its contents by any recipient of the Submission for any purpose and any party receiving a copy of this Submission must make and rely on their own enquiries in relation to the issues to which the Submission relates, the contents of the Report and all matters arising from or relating to or in any way connected with this Submission or its contents.

We disclaim all responsibility to any other party for any loss or liability that the other party may suffer or incur arising from, or relating to, or in any way connected with, the contents of this Submission, the provision of this Submission to the other party or reliance upon this Submission by the other party."

The confidential component of our Submission (Appendix A) should not be provided to any third parties without our prior approval and without them recognising in writing that we assume no responsibility or liability whatsoever to them in respect of the contents of our deliverables.

Liability is limited by a scheme approved under professional standards legislation

We would welcome the opportunity to discuss any aspect of our Submission in more detail with you should you require further rationale or clarification.

Yours sincerely

Alex Martin, Partner

*Please note: Appendix A has been removed as it includes information of a confidential nature.*
### Table of contents

1. Introduction ................................................................................................................................................. 1

2. EY Response: The role of the Australian Government .................................................................................. 5
   2.1 Barriers to the growth of the social impact investment market and the role of the Australian Government .............................................................................................................. 5
   2.2 The future for social impact investing in Australia .................................................................................... 15
   2.3 Opportunities for social impact investing ................................................................................................. 17
   2.4 The role for data in social impact investing .............................................................................................. 20

3. EY response: Australia’s Social Impact Investing Principles ........................................................................... 23

4. EY Response: Reducing regulatory barriers ................................................................................................. 27

Appendix A Reducing regulatory barriers ........................................................................................................ 28
1. Introduction

Ernst and Young (EY) welcomes the opportunity to provide comments on the Australian Government’s Social Impact Investing Discussion Paper (January 2017).

The discussion paper explores ways the Australian Government can develop the social impact investing (SII) market and seeks views on a whole of government position on SII including:

► The potential role of the Commonwealth Government in the SII market
► Principles for social impact investing to guide Commonwealth Government involvement in the SII market
► Possible Commonwealth regulatory barriers to the growth of the market

The social impact investing market

The concept of a market is an effective way of understanding how SII works and how it differs from other approaches, and also in understanding the potential of and constraints on social impact investing.

On the demand side there are a range of organisations that are seeking funding, both recurrent and capital, to achieve their missions and goals relating to social outcomes. Many, but not all, of these are not-for-profit organisations (NFPs) and have operated on the basis of philanthropic funding and fee for service, including government contracts, which are often short term. Many NFPs do not have strong balance sheets or internal sources of finance needed to access appropriate and affordable finance. For this reason, combined with an unwillingness to take on debt in some cases, NFPs are often under-capitalised, unable to use equity capital, and do not use debt finance to access capital.

The emergence of social enterprise over the last twenty years is a response to the limitations of the traditional NFP model. Social enterprise can take the form of organisations which are established to achieve social outcomes using an enterprise approach to facilitate financial sustainability. Social enterprise can also take the form of projects or initiatives formulated by an organisation that generate both social outcomes and financial returns. As described by Social Enterprise UK, an organisation can be categorised as a social enterprise if it:

► has a clear social and/or environmental mission
► is commercially viable
► reinvests the majority of its profits to achieve its mission
► is majority controlled as a result of its social mission

On the supply side, in addition to government and philanthropic bodies, there are a wide range of investors that allocate their capital to achieve social outcomes and differentiate themselves from...
other funders by seeking “measurable social and/or environmental outcomes in addition to a financial return”\(^5\). Social investors balance their desire to achieve both social outcomes and financial return and therefore the level of financial return can vary from protecting the principal to achieving commercial rates which are commensurate to the risk.

Matching demand to supply of capital in what is a nascent SII market is complex and therefore intermediation is required. This can be achieved through:

- Intermediary organisations including specialists that encourage, promote and facilitate linkages between market actors
- Social investment funds
- Market mechanisms such as social benefit bonds

A key aspect of intermediation, if the potential for social impact investing is to be realised, is supporting the transformation process for service providers, investors and also government. In addition to accessing private capital, social impact investing focuses attention on:

- achieving social outcomes
- the measurement of both social outcomes and value for money (which can be realised in financial returns)
- the achievement of long term social outcomes in a financially sustainable way

Functioning and growth of this nascent market can also be facilitated by the use of layered investment or blended capital which is the strategic use of finance and philanthropic funds (i.e. grants) to mobilise private capital to achieve social outcomes. This blended approach can facilitate the transformation process.

The potential for co-creating social and commercial value is also recognised by businesses as reflected in the increasing interest in creating shared value and purpose led transformation. Businesses can therefore play an active role in social impact investing, including intermediating demand and supply.

**Roles for Government**

Government can fulfil a range of demand, supply and intermediation roles in the social impact investing market. It can also act as a market steward by not only regulating the functioning of the market, but also by creating an enabling environment that will support market growth.

The Government supports and regulates NFP organisations through the Australian Charities and Not-for-profits Commission (ACNC), which was established in 2012. The ACNC’s objectives include supporting and sustaining a robust, vibrant, independent and innovative NFP sector, and promoting the reduction of unnecessary regulatory obligations on the sector.\(^6\)

---


The Australian Government has also supported the development of social enterprises in various way including through the stimulus package, co-funding the establishment of the Social Enterprise Development Investment Funds (SEDIF), and commissioning social impact bonds. The Australian Government also played an instrumental role in developing innovative social enterprises such as Goodstart Early Learning.

The Australian Government has also adopted social impact investment as a policy instrument in relation to the aid program in the Indo-Pacific region. We also acknowledge that SII can contribute to other Commonwealth Government initiatives especially the Australian Priority Investment Approach to Welfare (the Investment Approach) which uses actuarial data and analysis to estimate the future cost to the welfare system of specific cohorts. A Try, Test and Learn Fund has been established to assist the development and testing of innovative welfare interventions for these cohorts.

The EY response

This response sets out EY’s views on the potential roles of the Commonwealth Government to enable a thriving social impact investing market, the principles to guide the Commonwealth Government’s involvement in the market, and the barriers to market growth.

Whilst we recognise there is currently a focus on specific barriers to and propositions for market growth, we believe a whole of system approach is required in the early years of growing the social impact investment market.

This document has been structured to answer the questions outlined in the SII Discussion Paper, but does not necessarily answer them in the order provided in the Discussion Paper. We have addressed these questions as they relate to each section of this paper, which is set out as follows.

This first section has introduced EY’s response to the SII Discussion Paper. The second section of this Submission discusses EY’s response to the role of the Australian Government. This includes barriers to the growth of the SII market and the role of the Australian Government, the future of SII in Australia, the opportunities for SII, and the role of data in SII. The third section discusses EY’s response to Australia’s SII Principles. The fourth section discusses EY’s response to reducing regulatory barriers.

Disclaimer

This Submission has been prepared solely for the Australian Government in response to its Social Impact Investing Discussion Paper dated January 2017. Any commercial decisions taken by the Australian Government are not within the scope of our duty of care and in making such decisions.

---


you should take into account the limitations of the scope of our work and other factors, commercial and otherwise, of which you should be aware of from sources other than our work.

The Submission has been prepared in response to the Australian Government’s Social Impact Investing discussion paper and should not be relied upon by any other person.

The information contained within this Submission represents known information as at the date of preparation, however it is acknowledged that this information is subject to change and collection of data is ongoing.

No reliance may be placed upon this Submission or any of its contents by any recipient of the Submission for any purpose and any party receiving a copy of this Submission must make and rely on their own enquiries in relation to the issues to which the Submission relates, the contents of the Report and all matters arising from or relating to or in any way connected with this Submission or its contents.
2. EY Response: The role of the Australian Government

2.1 Barriers to the growth of the social impact investment market and the role of the Australian Government

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1. What do you see as the main barriers to the growth of the social impact investment market in Australia? How do these barriers differ from the perspectives of investors, service providers and intermediaries?</td>
<td></td>
</tr>
<tr>
<td>4. What do you see as the role of the Australian Government in developing the social impact investing market?</td>
<td></td>
</tr>
</tbody>
</table>

There are a range of barriers to the growth of the social impact investment (SII) market in Australia which relate not only to service providers, investors and intermediaries, but also to Government. These barriers are often multi-faceted and relate to interdependencies between the different market actors. EY therefore adopts a system view to understand the barriers to social impact investing and how the full potential of social impact investing can be realised.

In considering each of these barriers we have suggested roles for the Australian Government in developing the social impact investment market.

2.1.1 Lack of market capability and capacity

The SII market is nascent, with many of the actors lacking in experience in this particular market. Whilst there are a lot of knowledge resources available locally and internationally this doesn’t necessarily mean that organisations and investors are able to utilise SII. This lack of market maturity is reflected in the number and scale of SII transactions and relatively high transaction costs.

Information asymmetry is a problem for all markets, including the SII market. It is important that common language and definitions are established, especially given the diverse range of market participants. A number of agencies engaged in SII have developed glossaries which help to guide market participants\(^\text{13}\). However, there is still scope for considerable confusion including the terms social impact investing, impact investing, social investment, and social finance. "Social finance“ has the broadest definition which is “an approach to managing money to solve societal challenges”\(^\text{14}\) and “impact investing” may offer clarity by including both “environmental impact investing“ and “social impact investing“. The emergence of the investment approach using actuarial data and analysis adds further confusion, especially as the New Zealand government uses the term “social investment“ to describe a new approach to government spending\(^\text{15}\).

As you would expect in a new market, much of the knowledge resources have focussed on the “why“- the rationale for service providers, investors and government to explore SII. However, for the market to grow there needs to be an emphasis on the “how“- the mechanics of SII.

The United Kingdom’s Cabinet Office has addressed the “how“ by establishing the Centre for Social Impact Bonds, which provided general information, a social impact bond toolkit, including

---

\(^{13}\) “Glossary”, Impact Investing Australia website, [https://impactinvestingaustralia.com/resources/glossary/](https://impactinvestingaustralia.com/resources/glossary/), accessed 24 February 2017


standardised approaches to lower transaction costs, a series of case studies, and information on funding sources16.

**Capacity building: Organisations**

The importance of this has been recognised by the leading proponents of Social Benefit Bonds (SBBs). For example, the New South Wales (NSW) Government has established the Expert Advice Exchange to facilitate service providers to access professional advice. EY has supported this initiative and has run a series of workshops to help service providers to understand the mechanics of SBBs, including what investors and government are looking for. Queensland Treasury has established a similar initiative, Queensland Advice Connect.

EY along with other organisations run SII capacity building workshops and assist individual organisations to develop SII propositions on both pro bono and fee bases. For example, SII features significantly in EY’s pro bono “Learning for Purpose” workshop series and EY’s ”NGO Strategy for Success” support program17. These capacity building initiatives recognise that for many organisations SII constitutes a change in or adaptation to their business model and for some a change in organisational culture. SII capacity building therefore needs to cover governance and leadership (both board and senior executive) and key organisational functions, including finance, operations, and monitoring and evaluation.

There are a number of areas where capacity building is essential including:

- Outcomes definition and measurement
- Monitoring and evaluation
- Performance measurement systems
- Innovation
- Collaboration

SII requires rigorous definition and measurement of outcomes. Australian NFPs and social enterprises are embracing this and have, or are in the process of developing, outcomes measurement frameworks and systems. Since 2010 there has been increasing use of the Social Return on Investment (SROI) methodology which has its origins in social enterprise and SII. Many NFPs and government agencies also encourage the use of Results Based Accountability (RBA). Both methodologies share key elements such as stakeholder engagement, program logic or theory of change, identification of outcome metrics, and the use of a counterfactual.

The fundamental importance of outcomes definition and measurement is also recognised by many Australian government agencies which are now investing in developing these capabilities. The importance of this aspect of capacity building was recognised by the UK Cabinet Office which led them to commission the development of a guide to SROI18. Over the last ten years the measurement of social value and its role in government commissioning has become mainstream. In 2013, the UK Government introduced the *Public Services (Social Value) Act* which requires government commissioners to think about how they can also secure wider social, economic and environmental

---

16 “Centre for Social Impact Bonds”, UK Knowledge Box, [https://data.gov.uk/sib_knowledge_box/home](https://data.gov.uk/sib_knowledge_box/home), accessed 24 February 2017
17 For further information on Learning for Purpose and NGO Strategy for Success please contact Les Hems (EY)
benefits. The Social Value Awards were introduced to recognise and celebrate good practice in commissioning and providing social value\(^{19}\).

In 2016 the Social Impact Measurement Network of Australia (SIMNA) was incorporated to provide a platform for professionalising social outcome measurement and provides formal and informal capacity building support for individuals and organisations\(^{20}\).

SIMNA sits within the broader community of evaluation practitioners which is also embracing outcomes measurement and the measurement of social outcomes\(^{21}\); however there is a lot to be done. For a variety of reasons including funding and capabilities, many programs delivering social outcomes have not been subject to an outcomes evaluation and very few have been evaluated through randomised control trials (RCTs), which is the gold standard for evaluation. It is therefore not always possible to be confident of “what works”. This problem is particularly acute for Indigenous programs where only 8 per cent have been evaluated and “few used methods that actually provided evidence of the program’s effectiveness”\(^{22}\).

A key component of evaluation is access to government data relating to target cohorts and especially baselines for client outcomes against which you can measure program performance. The specific issues relating to data are considered below in Section 2.4.

The organisational transformation required to effectively engage in SII also involves establishing and maintaining performance measurement systems that integrate inputs, activities, outputs and outcomes so that it is possible to assess both benefits and costs. Some NFPs and social enterprises are adding the outcomes measurement component to existing systems, some are purchasing proprietary or developing bespoke systems, whilst others are struggling to invest in integrated performance measurement systems. There may be opportunities for government and/or industry bodies to contribute to the development of generic systems that can be widely used and reduce the costs for individual organisations and remove one of the barriers preventing organisations to engage in SII.

The prevalence of social problems and impotence of existing programs has led to increasing emphasis on innovation and focus on prevention, early intervention and breaking the cycle of disadvantage for vulnerable clients. Australian government agencies are increasingly recognising the importance of innovation and are increasingly using co-design methodologies to engage more effectively with services providers and clients to understand “what works”. Whilst NFPs and social enterprises often engage in “pilot” programs there is limited recognition of formal research and development (R&D). Given the evident need for innovation there may be scope for government to incentivise investment in R&D as part of social impact investment initiatives. However, as investors will generally only invest in proven programs, there will need to be earlier upfront investment in innovation where the expectation is for failure rather than success (as per venture capital models).

One aspect of innovation is the development of collaborative relationships including cross-sectoral collaborations. Social Benefit Bonds are an example of cross-sectoral collaboration as they engage NFPs, government, intermediaries and private investors. There is also potential to collaborate to achieve vertical integration in order to better link services for clients. This is best exemplified by the

---


first social impact bond in the UK which was based on a collaboration of a range of different service providers into the “One Service”\(^23\). There is also potential to collaborate with organisations that deliver the same services in order to achieve scale. SII may provide an opportunity to stimulate collaborative behaviour in order to achieve better social outcomes and financial returns.

<table>
<thead>
<tr>
<th>The Commonwealth Government could consider how it can contribute to:</th>
</tr>
</thead>
<tbody>
<tr>
<td>► Establishing a common language, concepts and definitions</td>
</tr>
<tr>
<td>► Capacity building in relation to outcomes measurement</td>
</tr>
<tr>
<td>► Increasing the number and quality of program evaluations</td>
</tr>
<tr>
<td>► Improving access to relevant government data</td>
</tr>
<tr>
<td>► Developing system wide performance measurement systems</td>
</tr>
<tr>
<td>► Incentivising innovation and R&amp;D</td>
</tr>
<tr>
<td>► Facilitating collaborative behaviour to achieve better social outcomes and financial returns</td>
</tr>
</tbody>
</table>

**Capacity building: Social enterprise**

A range of predominantly state based organisations such as Social Traders in Victoria\(^24\) are actively promoting social enterprise including providing case studies and running competitions to support social enterprise\(^25\). Social enterprise is gaining greater recognition more generally as illustrated by social entrepreneur Bec Scott of STREAT who was the 2016 National Social category winner for EY’s 2016 Entrepreneur Of The Year awards\(^26\).

Whilst there is great merit in this specialist approach during the market establishment stage, in moving to market growth consideration should be given to how social enterprise can feature more prominently in mainstream economic development activities. This includes government programs such as Business Enterprise Centres Australia\(^27\) and Commonwealth and State governments’ innovation and economic development strategies\(^28\).

**Capacity building: Investors**

Impact Investing Australia provides a range of accessible resources for organisations and investors including case studies. For investors, it provides resources for both philanthropic social investors (trusts, foundations, family offices and high net worth individuals) and institutional investors\(^29\). The

---


active involvement of superannuation funds such as Christian Super Fund\(^{30}\) and Australian Ethical\(^{31}\) indicate that some institutional investors have a combination of capacity, capability and appetite for SII.

**Capacity building: Intermediation**

Given the importance of intermediation, the Australian SII market needs a diverse range of competent intermediary organisations to engage with both organisations and investors, and to be able to develop sound SII propositions which can proceed to transaction and be replicated at scale. Social Ventures Australia is the longest standing and leading SII intermediary. A range of new, specialist intermediaries have also entered the market over the last few years and professional advisory firms, such as EY, are also now active participants.

The nascent nature of the market means that the short term commercial viability of these intermediary activities is challenging. This barrier has been recognised by leading SII actors. The NSW and Queensland Governments’ social benefit bond programs both have funds and mechanisms to facilitate organisations accessing advice and support to develop SII propositions. Similarly National Australia Bank (NAB) in partnership with Impact Investing Australia and The Difference Incubator have established the Impact Investment Readiness Fund (IIRF). The IIRF provides “grants of up to $100,000 for NFPs and social enterprises to purchase specialised capacity building support from advisory, financial, intermediary and legal service providers”\(^{32}\). In the UK Big Society Capital (BSC) has done a lot of work around identifying the key components needed to make a strong intermediary organisation.\(^{33}\)

In 2012 the United Kingdom’s Cabinet Office established the Investment and Contract Readiness Fund (ICRF) to help social ventures become better equipped to compete for public service contracts and to secure social impact investments. Grantees received between £50,000 and £150,000 for up to 20 months capacity building support and professional advice. Grantees were challenged to achieve at least £500,000 of social impact investment or over £1 million of public service contracts. Half of the grantees met this challenge and a total of £233 million public service contracts and SII was secured from £13.2 million grants – an £18 return on every £1 granted.

---

The Commonwealth Government could consider how best to contribute to a national approach to SII capacity and capability building including:

- Supporting the development of SII knowledge resources which focus on the how as well as the why
- Developing new (or contributing to existing) initiatives which provide grants or patient capital to facilitate access to support and professional advice for organisations and strengthen intermediaries

The active involvement of the Australian Government in capacity and capability building would support the transformation process and send a clear signal of Government’s commitment to SII which may be influential with the leadership of organisations and social investors.

---


\(^{33}\) Kearney, Claire, “Publishing the Building Blocks…the key components of a strong intermediary”, *Big Society Capital Blog*, 1 December 2016 (accessed via [https://www.bigsocietycapital.com/latest/type/blog/publishing-building-blocks%E2%80%A6-key-components-strong-intermediary](https://www.bigsocietycapital.com/latest/type/blog/publishing-building-blocks%E2%80%A6-key-components-strong-intermediary), 24 February 2017)
2.1.2 Uniting market participants

One of the biggest barriers to the growth of the SII market is the lack of a forum to unite market participants. There are many participants and stakeholders with an interest in SII and they range from NFPs, social enterprise, investors, government and business. Each stakeholder has different requirements for participation in terms of financial returns and outcomes, and these are actually dispersed over a spectrum from impact-led to commercially-led. This diversity of requirements is similar to commercial capital markets, such as cash, fixed interest, domestic and international equities, private equity, and alternative asset classes.

The challenge is engaging the various participants in a simple open forum to understand their objectives in terms of social outcomes and financial risk and return, in order to progress a SII proposition. This forum is needed to provide overall leadership and a focus for market capability and capacity building through education, access to information and professional services. There is an ongoing need for this to occur in Australia if the market is to continue to develop.

Globally, this initiative is being led by the Global Social Impact Investment Steering Group (GSG) which was created in August 2015 as the successor to the Social Impact Investment Taskforce, established by the G8. This group was charged with “catalysing a global social impact investment market across a wider membership.” The GSG is led by Sir Ronald Cohen and its members include 13 countries plus the EU. It also brings together leaders from the finance, business, philanthropy and government sectors across the globe, as well as network organisations that are supportive of social impact investment.

The GSG is focussed on increasing momentum in the social impact investment market by promoting a unified view of impact investment, facilitating knowledge exchange, and encouraging policy change in member countries.

National advisory boards are led by sector representatives to examine ways of accelerating the growth of impact investment in the market. The boards, chaired by the sector representatives for each member, comprise leaders of investment organisations, social enterprises, philanthropic foundations, and social impact investment organisations.

This work has been undertaken by the Australian Advisory Board, supported by Impacting Investing Australia (IIA). IIA has acted as the secretariat and execution arm of the strategy in Australia. In other countries this work has been funded by government and large NFPs. However, this is not the case in Australia and there is a risk this work will not continue without such support.

The Commonwealth Government could consider options how best to contribute to developing and sustaining a forum to unite market participants.

2.1.3 Wholesale capital fund and imperfect markets

Many social impact investment initiatives have required government or philanthropists to lead, which has been followed by more commercial capital. This has been the case with microfinance in the developing world – arguably the forerunner to SII - whereby philanthropic leadership has helped
banks to understand that risk adjusted returns are an attractive option. This has led to USD$10 billion of private capital flows into this market\textsuperscript{36}.

Government can play an important role in market development. This can help to address the significant financial risks investors can otherwise face when organisations are not ready for SII and do not fully understand the market, which in turn constitutes a significant barrier to the development of the market. Investment in capability and capacity building service providers and intermediaries will help market development, however government can play a more proactive role in the early stages of market development by reducing risk to investors through mechanisms such as capital guarantees or underwriting propositions in addition to the co-investment in funds like SEDI. Government could also use incentives to encourage social impact investors to apply their capital to specific government policy goals. Both approaches can be used to modify the risk/return calculation and make social investment more attractive to investors.

In the United Kingdom the focal point for uniting market participants and shaping market growth has been Big Society Capital (BSC). BSC’s vision is for “a vibrant, diverse, well capitalised and sustainable social investment market in the UK, through which charities and social enterprises can access appropriate and affordable finance and support to grow their positive impact on society”\textsuperscript{37}. BSC not only acts as a champion for SII but it also holds wholesale capital which is deployed through social investment finance intermediaries. These intermediary funds include:

- Social banks such as Triodos, Charity Bank, and CAF Venturesome
- Social impact bonds such as the IAAM adoption social impact bond
- Affordable housing funds, for example Resonance
- Specialist place-based funds, for example Northstar Ventures
- Specialist issue funds, for example Community Generation Fund for community ownership of renewable energy
- Bridges Evergreen Fund provides long term funds for larger scale and well established social ventures
- Bethnal Green Ventures and Mustard Seed provide early stage funding to accelerate their development
- The Foundation for Social Investment provides small loans to social organisations
- Crowdfunding platforms to stimulate public engagement in personal social investment

The sources of wholesale capital included deposits held in dormant bank accounts and the four UK high street banks. The BSC model is accelerating quickly as evidenced by its 2016 achievements, as follows\textsuperscript{38}:

- The total amount of capital signed and including matched funding is £893 million
- Almost half a billion GBP drawn down plus match funding


£340 million has been allocated to intermediary funds

£142 million has been drawn down

The volume of finance arriving at the frontline has more than doubled. In the past, the delay between BSC receiving funds as a wholesaler, committing them to intermediary investors, and finally arriving with social organisation has been an issue, although drawdown is now catching up according to BSC. However there is more capacity building work to do on this - helping charities and social enterprises make informed decisions about whether SII is the right type of finance for them; getting guidance on which social investors might be most relevant; and making the contracts and legal aspects as straightforward as possible39. BSC has been actively involved in a range of initiatives to help organisations become investment ready such as the ICRF.

The impressive growth in SII has been achieved despite the fact that BSC is restricted to investing in asset-locked social organisations40. This means that there is likely to be a natural cap on the size of the market in the UK in the future41. If BSC’s remit was extended to include ‘profit-with-purpose’ companies then this would potentially enhance SII activity.

While we recognise that wholesale capital is important, it’s not the only consideration. It is also imperative that all aspects of market dysfunction and barriers to market growth are addressed, and this would best be addressed in the early years of growing the social impact investment market.

The Commonwealth Government could consider the merits of a wholesale fund for SII capital or underwriting a fund held by another financial institution.

2.1.4 Barriers for Government

Government is ultimately responsible for the regulation of the SII market and specifically to ensure the interests of market participants are protected and not exposed to inappropriate levels of risk. SII sits within the broader context of financial regulation and presents challenges due to the dual objective of achieving social outcomes and financial returns. Similarly, service providers operate within the regulatory environment overseen by the Australian Charities and Not-for-profit Commission (ACNC) as well as other regulatory systems relating to service quality. For SII to achieve its full potential, it will therefore be necessary for Government to refine and adapt existing regulatory systems. These regulatory issues are addressed in Section 4.

The previous sections have outlined the government’s role of market stewardship and proactively creating an enabling environment for SII by: supporting the development of market capability and capacity; and establishing a forum for uniting market participants. Government can also use a range of policy levers to shape the SII market by reducing the risk to investors and providing incentives to allocate capital to government policy priorities.

In addition to addressing the barriers for other market actors, there are also barriers within government that need to be recognised and addressed. These include:

- The constraints associated with the four year forward estimates period

---

40 Registered charities, community interest companies and non-distributing co-operatives all have asset locks
Shared Commonwealth and State government interests

Forward estimates

One of the broad constraints for government is the 4 year forward estimates period which in the context of SII and the Investment Approach provides a relatively short term focus on cash costs and savings. For SII, especially social impact bonds, this may make it challenging for government to justify committing funds to achieve expected long term benefits before they are fully realised.

Youth pathways to employment

For example, a social impact bond (SIB) is developed based on a program that provides pathways to employment for young people exiting the justice system which will operate for 5 years and is expected to significantly reduce long term unemployment for this cohort and generate short and long term benefits for government in terms of cost avoidance and income tax contributions.

Private capital is provided through the SIB with an expectation that there will be coupon payments during the 5 years the program is operating and final payments a year later. The NFP has working capital to deliver the service for 5 years. During the first 4 years of the SIB the Commonwealth Government would be able to account for the ongoing coupon payments on the basis of welfare savings that are expected to arise from the achievement of employment outcomes. However, the final reward and repayment of the principal capital is outside of the 4 year forward estimates window, and the long term welfare cash savings are realised well beyond the lifetime of the SIB and beyond the 4 year forward estimates window as well.

There is therefore a challenge associated with the mismatch in the timing of payments when interim outcomes are realised and the expectation of lifetime outcomes. There are a number of possible mechanisms for dealing with this, arising especially from insurance and reinsurance techniques for both risk sharing and for distributing a share of long term benefits before the actual outcomes have fully played out.

On the other hand, social enterprises and SII funds are more enduring in nature than a SIB and may constitute effective mechanisms for accessing and distributing returns as they arise over time and may not be as constrained by government time limits.

The Australian Priority Investment Approach using an actuarial model provides the basis for Government to construct long term investment arrangements. The actuarial model tracks expected long term outcomes for identified segments of the population, and is a means to provide a shared baseline and monitoring system for the emergence of results. The Investment Approach moves the focus from the short term cash impacts to an understanding of the expected shift in long term outcomes, moving to a ‘balance sheet’ view from a ‘income statement’ view, via the use of a ‘liability valuation’.

In addition, the Investment Approach can also create a ‘single source of truth’, which reduces the barriers caused by differing perspectives on the likely outcomes for cohorts and interventions. This is analogous to any market where transparent understanding of risk assists in ‘making the market’. Each investor doesn't need to price the risk in the same way, but they are more likely to arrive at a mutually acceptable price if they both have the same view of the underlying process.

Many government agencies are now developing strategies to commission services based on “securing the best outcomes, at the best value and ensuring continuous review of whether services achieve success in addressing the needs of citizens”. This strategy is being realised through “Outcomes Based Contracts” (OBC) which can be called Payment by Results (PbR), Payment for Outcomes and Payment for Success. These OBCs often use proxies or lead indicators (hence use of PbR) for achievement of outcomes and can therefore operate within the 4 year forward estimates.

OBCs offer clarity in terms of the definition of social outcomes and government payments but do not directly engage with private capital. However, service providers may need access to working
capital to deliver the OBC services and may therefore seek social impact investment using a more traditional debt finance arrangement. Social impact investors may be attracted to organisations that deliver services under an OBC.

The use of PbR mechanisms has expanded rapidly in recent years internationally, especially in human services. In 2015 the UK national Audit Office estimated that £15 billion of public spending was through PbR. As noted above, the Investment Contract Readiness Fund was very successful in helping organisations win public service contracts. However, it is important to note that OBC is not without its problems, especially in relation to implementation. A key learning is that the charity sector has faced challenges in winning these OBCs in some policy areas.

The Commonwealth Government could develop a range of mechanisms to account for funding where the benefits to Government accrue during and outside of the 4 year forward estimates period. These mechanisms include:

► Insurance and reinsurance techniques for both risk sharing and for distributing a share of long term benefits
► Government investment in social enterprises and SII Funds allows for returns to be realised and performance measured both within and beyond the 4 year forward estimates period
► Establishing longer term parameters where the Australian Priority Investment Approach is used
► Developing commissioning strategies based on Outcomes Based Contracting

Shared Commonwealth and State government interests

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?

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

In key public services, such as health, policy and funding responsibilities are shared between Commonwealth and State governments. This presents a challenge for SII, especially social benefit bonds, where short and long term benefits in terms of cost saving and cost avoidance are shared between levels of government. Both Commonwealth and State governments should therefore contribute to the repayment of capital and the reward payments.

As outlined in the Social Impact Investing Research Report prepared by EY for the Prime Minister’s Community Business Partnership and the Department of Social Services, joint investments may be necessary in areas where the Commonwealth and State/ Territory governments share responsibilities (i.e. health and education policy) in order for the cost savings from better outcomes to be fully realised, and for successful programs in one State to be replicated nationally. However,

---


this adds another layer of complexity and bureaucracy and, to date, none of the state commissioned social benefit bonds have involved the Commonwealth Government and have therefore focused on public services which are solely or primarily State government responsibility.

As outlined in the EY Report\(^44\), the Commonwealth Government could consider establishing a funding mechanism to support State Government SII activities\(^45\). This could also include top up reward payments where cost savings and other benefits accrue to them. This funding could be targeted at policy priorities such as Indigenous communities, employment pathways for vulnerable people, homelessness, family violence, and social cohesion.

The Commonwealth Government could also consider developing mechanisms so they can actively engage in State government-led SII initiatives where there are shared responsibilities and benefits.

For example, in the area of education policy, if an early education and childcare SII is justified on the basis of cost savings, then both Commonwealth and State governments may need to jointly develop such an investment as some cost savings might also be generated as a state government level (i.e. primary or secondary education). Such a proposition is in formulation in NSW.

The NSW Office for Social Impact Investing released a statement of opportunity relating to improving outcomes through early childhood education that generates “multiple developmental and learning benefits for all children that persist through schooling and well into adulthood. These benefits are often greater for children from disadvantaged backgrounds.”\(^46\) The responsibilities for this cohort in this policy area is shared and this is recognised by the National Partnership Agreement on Universal Access to Early Childhood Education (NP UAEC). Some of the Commonwealth funding available under NP UAEC is based on State governments achieving outcome benchmarks including “the proportion of children enrolled for 600 hours in an early childhood education program in the year before school”. In formulating social benefit bond propositions the State can factor in contributions from the Commonwealth to repay capital and make reward payments to investors\(^47\) \(^48\).

2.2 The future for social impact investing in Australia

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?

Whilst traditional philanthropy and government funding will continue to be used to generate social outcomes, as we engage potential SII market participants and work to align diverse interests, the opportunity to identify new approaches, instruments and sources of capital is immense.


\(^{48}\) This SII transaction is currently being evaluated and the precise nature of Commonwealth and State Government contributions is unknown.
If we think of SII or “Social Finance” as being a broader approach to finding solutions for the financing challenges of projects or issues that generate measurable or identifiable social and/or environmental outcomes, rather than just a specific instrument, such as a social benefit bond or outcomes based contract, then the spectrum of capital financing solutions should be as broad as that seen in purely for-profit capital markets.

2.2.1 Innovation in financial instruments

The notion that a NFP may list a security whether that be a bond with a fixed or variable coupon, a property trust or an equity security in the stock market is conceptually realistic and attainable. However, this does not mean that such a security is the only or preferred solution. Hybrid securities or solutions where discounted financial returns are attached to measurable social or environmental outcome as a further example may also be appropriate but, by definition, may appeal to a different market of capital providers.

In some cases it may be possible to get such a degree of alignment that different investors are investing with different underlying objectives in the same instrument for the same level of return, and perhaps where the social or environmental outcomes are valued by some investors and ignored by others.

An example of this is the Murray-Darling Basin Balanced Water Fund49, which has brought together social impact investors, environmental grant makers, family offices, institutional investors, and potentially corporate partners to invest for a variety of different reasons. These reasons include:

► an impact investment at scale generating measurable environmental, cultural and social outcomes
► exposure to water as an undervalued asset
► an opportunity to invest in, and support innovative agricultural practices
► an opportunity to invest in an “alternative asset” generating uncorrelated equity like financial returns
► providing exposure to a commodity/agricultural asset potentially as a hedge against other agricultural investments

The ability to align interests of diverse players has encouraged potential investors to explore the potential in other environmental spheres such as Carbon, Blue Carbon and Bio Diversity markets.

There is also substantial potential application to securitise the monetisation of savings for interventions in the health and education sectors, community building and social welfare, and sustainable housing markets. These investments could be in the form of debt or equity investments or through the creation of social property trusts. These could potentially lead to mergers and acquisitions, and the establishment of alliance structures within the NFP sector funded by private sector finance, which would facilitate scale and potentially more efficient outcomes and increase competitiveness.

Alternative investment assets, annuity products and Green and Social Infrastructure Bonds are also potential instruments that could be used to align the interests of public policy, private capital, and social and environmental outcomes. For example, the Washington DC Government has established the Stormwater Retention Credit Training Program to fund green infrastructure.

2.2.2 Accessing new investors: Family Business Philanthropy

One of the reasons impact investing is gaining momentum as a credible approach by philanthropists, corporate foundations, shared value proponents and investors is that it enables the most precious of all capital forms, philanthropic capital, to be leveraged by other forms of capital (that may require some level of return). More than two-thirds of the 525 global respondents in the recent EY Family Business Philanthropy report indicated that “their wealth is dedicated to social impact investing.”50 As more participants are engaged, the potential for new ideas and policy contributions grows, particularly in areas where the demand for public funding exceeds budgetary capacity.

2.3 Opportunities for social impact investing

| 6. Are there areas where funding through a social investment framework may generate more effective and efficiency 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? |

2.3.1 Place based initiatives and blended capital

There is increasing interest in developing place-based initiatives that facilitate collaboration between interested parties across government, community and business to develop innovative integrated approaches to addressing community problems. Many of these initiatives use the Collective Impact methodology which emphasises the importance of engaging all material stakeholders, clearly defining and measuring outcomes, and commitment to an integrated program of mutually reinforcing activities.

EY is actively involved in a number of Collective Impact initiatives including development of the Broome Model. The approach is based on working with communities to identify priorities and also strengths and resources. The initiatives start with an exploratory approach to addressing a priority, which can be described as the “try” phase, and if the activities look promising then stakeholders commit to a longer period of intensive activities, which can be described as the “test and learn” phase. These two phases are supported and funded by a range of interested parties including philanthropic bodies, native title holders, business, and government agencies. A key aspect of the “test and learn” phase is the measurement of short and long term benefits and costs, specifically assessing the feasibility of securing long term sustainable funding through an outcomes based contract and social impact investment mechanism called a Collaborative Investment Partnership.51

Currently, this process is undertaken in a piecemeal fashion however, the process would be greatly facilitated by the establishment of a vehicle to facilitate layered investment or blended capital that strategically uses a combination of finance and philanthropic funds to mobilise private capital to achieve social outcomes.

The US Government operates a Social Innovation Fund (SIF) that “awards grants to identify, validate, and grow promising approaches to challenges facing local communities”52. The SIF now operates a Pay-for-Success (PFS) fund which allows government to partner with the private sector to fund proven community-based solutions. The PFS fund “leverages philanthropic and private

dollars to fund services up front, with the government, or other entity, paying after they generate results".  

The Commonwealth Government could consider developing a comparable fund for place-based initiatives that would sit within or alongside the cohort focused Try, Test & Learn Fund.

### 2.3.2 Co-creating commercial and social value - or shared value

A range of Australian businesses are going beyond corporate social responsibility and sustainability to proactively co-create commercial and social value - or shared value. Shared value is defined as “policies and practices that enhance the competitiveness of companies while improving social and environmental conditions in the regions where they operate. It is a business strategy focused on companies creating measurable economic benefit by identifying and addressing social problems that intersect with their business.”

The Commonwealth Government could consider developing a comparable fund for place-based initiatives that would sit within or alongside the cohort focussed Try, Test & Learn Fund.

Australian businesses have adopted a number of approaches to create shared value including through social impact investing. For example, in 2015 Bendigo Bank has developed a Social Impact Loan Program related to of the Alliance Bank model. From a financial perspective, the Alliance Bank has 40,000 customers and transacts over $1 billion in banking business and from the perspective of the community, the social enterprises employ over 150 people through 22 branches maintaining strong community connections and knowledge.

Another example of shared value is based on a partnership between a financial institution, Suncorp Group and an NFP, Good Shepherd Microfinance, which allows people on low incomes to access an essential insurance policy. One in five Australian adults do not have general insurance which means that their essential household assets at risk. A new insurance product was conceived through this partnership that delivers both social and commercial value.

Many co-operatives have shared value institutionalised in their business model, delivering social value in a financially sustainable way. In 2015 EY authored a report for the Business Council of Co-operatives and Mutuals entitled ‘Public Service Mutuals: A third way for delivering public services in Australia’. This White Paper explored a range of different approaches for existing co-operative and mutual enterprises to enter into or expand their public service activities. An example of this is the acquisition by Australian Unity of the Home Care service from the NSW government in 2015.

Similarly, the report sets out how a co-operative business model may be advantageous for certain types of social enterprise especially where engagement with employees (worker co-op) and clients (consumer co-op) is essential for achieving outcomes. A co-operative structure can also facilitate

---


collaboration between organisations (enterprise-owned co-op). The report also set out co-operatives’ needs for working capital to achieve their full shared value potential.

We believe that there is considerable potential for further SII initiatives through businesses and co-operatives developing shared value strategies.

2.3.3 Opportunities relating to specific policy fields

The Social Impact Investing Research Report prepared by EY for the Prime Minister’s Community Business Partnership and the Department of Social Services identifies several policy areas where the Australian Government might consider using a social impact investment approach in order to achieve its goals. These policy areas are referred to in the Discussion Paper – early education and child care; employment education and further training; social and affordable housing; rural and regional aged care; financial exclusion; health services; and disability services. Some examples where there are existing SII approaches are outlined below:

► Early education and childcare: The use of an outcome focused approach to deliver and support an evidence-based early learning program, which has been shown to deliver improved primary school education outcomes and is able to address the needs of vulnerable children (i.e. US Head Start).

► Employment, further education and training: For the government’s Jobactive program, elements of PbR are already incorporated, however, there are successful SII programs that serve specific cohorts such as young people not in employment, education and training.

► Affordable housing: Facilitating greater direct institutional investment in affordable housing projects via legal and regulatory change.

► Financial inclusion: DSS is already exploring the benefits of CDFIs (Community Development Financial Institutions).

► Aged care: Similar approach to the Newquay Pathfinder for Integrated Care UK that is funded on a PbR basis.

► Health: There are examples of SII in health which have demonstrated positive benefits to individuals and government. These include Shared Pathfinder UK (funded by Big Society


64 There are numerous and well established examples of CDFIs in the UK, UK and Canada, as well as DSS’s current CDFI pilot.

Capital)\textsuperscript{66}, the National Health Co-op ACT\textsuperscript{67}, as well as the PbR arising from the US known as the Blue Cross Blue Shield Alternative Quality Contract.\textsuperscript{68}

- Disability services: Similar approach to the Share Lives incubator in UK\textsuperscript{69}. Alternatively, a PbR mechanism could be used to provide intellectual disability services similar to the National Health Service in England which introduced a pilot program in 2013.\textsuperscript{70}

As observed in the SII Research Report\textsuperscript{71}, it is important to note that social issues and responses are complex and often interconnected. This can often best be managed by bringing together multiple services and using intensive case management or co-ordination. In the context of SII, this highlights the importance of provider consortia, the need for collaboration between government agencies, and the complexities associated with estimating overall government cost savings.

### 2.4 The role for data in social impact investing

| 9. What are the biggest challenges for implementing the Australian Government’s public data policy in the social impact investing market? What can the Australian Government do to address these challenges? |

**Access to data**

The Australian Government will need to provide access to the data required in order to facilitate the measurement of social impact investment outcomes.

**Australian Priority Approach to Welfare**

The Australian Government will need to develop the use of the Australian Priority Approach to Welfare. This will include the following:

- Data being made available by the Australian Government as planned, in multiple layers of aggregation for the general public, to highly aggregated data for trusted users in a secure environment at (or close to) an individual level

- Using the model to support any initiatives developed under the “Try, Test and Learn” approach, including the modelling of the intervention on the cohort and tracking outcomes over time

---


The Commonwealth Government could consider facilitating extensions to the current dataset to include state level data, for example connecting child protection, youth justice and adult justice outcomes at the state level to welfare and health outcomes at the Commonwealth level.

This will require investment in secure infrastructure, commitment from all participants to supplying cleansed and linkable data to a shared data centre that is updated on a regular frequency and commitment to positively overcoming barriers to sharing sensitive data in an effective manner.

**Principal challenges**

The two main challenges we have identified that relate to the implementation of the Australian government’s public policy data in the social impact investing market are:

1. Difficulties which could potentially arise with the interpretation of the relevant legislation.
2. The need to access the technical skills required to manage and interpret data.

The Australian Government could provide further support the Australian Computer Society Data Sharing Framework Working Group to unlock some of these challenges, particularly in respect of interpretation or revision of legislation, including participating in State/Territory level discussions where appropriate.

Furthermore, the Government could develop accessible but appropriately protected datasets for baseline, scenario testing and monitoring of cohorts under consideration. It may be a matter of starting small and expanding over time.

Overall, it will be essential for the Australian Government to ensure that the technical skills and capacity are there to manage and interpret the data.

In addressing these challenges, the Australian Government could also consider the model of the Social Investment Unit in New Zealand in relation to the development of the Social Investment Measurement Map, Social Investment Analytical Layer, and 'proof-of-concept' approaches.

The Integrated Data Infrastructure developed by Statistics New Zealand is one example of a possible infrastructure and set of processes and protocols for appropriately sharing linked, longitudinal data across agencies at a highly granular level.

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

There are numerous opportunities for the Australian Government to form data sharing partnerships. In doing so, it will be important to encourage active collaboration, as passive collaboration will not be enough.

**Developing appropriately protected, linked, longitudinal datasets**

The New Zealand Integrated Data Infrastructure (IDI) initiative is a large research database containing microdata about people and households. The data is sourced from government agencies,
the 2013 Census, and non-government organisations. The data is used by researchers to help improve outcomes for the population.\textsuperscript{72}

The Australian Government could consider the development of appropriately protected, linked, longitudinal datasets based on New Zealand’s IDI initiative.

Identifying savings that can be monetised and form the basis of impact investment opportunities

The opportunity to identify savings that can be monetised and form the basis of impact investment opportunities is very significant, particularly in areas such as education, indigenous affairs and health. Green Urban environments could be financed via education and health budgets where the impact of green infrastructure, such as water fountains and tree plantings, can be proven to lower temperatures and generate lower allergy counts. In some indigenous communities this can lead to outcomes such as reducing disease or increasing hygiene which would otherwise have become major impediments that resulted in high school absenteeism. For example, One Disease aims to eliminate crusted scabies as a public health concern through patient self-management\textsuperscript{73}.

\begin{itemize}
\item \textsuperscript{73} “Our Mission”, One Disease website, http://onedisease.org/our-mission/, accessed 24 February 2017
\end{itemize}
3. **EY response: Australia’s Social Impact Investing Principles**

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

We would suggest that the underlying presumption should be that commercial principles underpin the development of social impact investments. If commercial principles are not used, propositions will be founded on the concept of philanthropy. That said, individuals, family offices and philanthropic endowments as providers of social impact capital are growing (although the size of this capital pool is limited). Where environmental or social factors align with the objectives of professional investors, some may be willing to accept a discount for identifiable non-financial returns. Most commercial investors will require the non-financial factors to be on top of a broader market return.

**Australia’s Social Impact Investing Principles**

Our response on each of the proposed four principles developed to guide the Australian Government’s participation in the SII market is set out below. It is however important to place these four principles in the context of “projects with Australian Government involvement”\(^{74}\). Further principles could be developed to shape the Government’s role in supporting the development and growth of the SII market and the active participation of other market actors without government involvement. One of those principles could relate to the encouragement of innovation and continuing evolution of the SII market.

**Principle 1 – Value for Money**

*Social impact investments should only proceed when they represent value for money: that is, when the expected benefits for the Australian Government outweigh the costs*

Value for money (VFM) is a founding principle for government expenditure and is based on a clear understanding and expression of the goals and purpose of expenditure. The achievement of cash savings, future cost avoidance and productivity gains to Government are integral to VFM. The VFM principle is therefore a key component in an OBC that provides the basis for government involvement in SII, where financial returns paid by government should be dependent on the achievement of agreed measurable social outcomes.

The concept of VFM is evolving to recognise both broader value creation and longer time periods for benefits to be accrued. SII is often based on broader and longer term value creation. This evolution is evidenced by the UK’s Social Value Act which “require public authorities to have regard to economic, social and environmental well-being in connection with public services contracts; and for connected purposes”\(^{75}\). Similarly, the Australian Priority Investment Approach is based on investment now for long term benefit which extends the timing of benefit parameters in a VFM assessment.

Many SII involve the sharing of benefits across Commonwealth and State and Territory Governments which means that a full VFM assessment should reflect this. Currently, VFM assessments are usually limited to either Commonwealth or State / Territory. This principle could embed this full VFM assessment for government involvement in SII propositions.

---


The Australian Government could consider minor refinements to Commonwealth Procurement Rules to accommodate broader and longer term value creation.

**Principle 2 - Robust outcomes based measurement and evaluation**

SII should include outcomes-based measurements to monitor the progress, risk and returns of the investment and a robust and transparent evaluation method to determine the investment's impact and efficacy.

EY supports this principle and the importance of the rigour of outcomes-based measurement and evaluation. This principle is important for all market actors noting that increasingly the investor providing the capital is the most incentivised to demand, pay for, and assess the outcomes achieved.

SII is therefore encouraging the clear definition of outcomes and the development of robust methodologies that not only measure outcomes, but also monitor performance. There are considerable risks relating to perverse incentives in client selection and poor design in terms of robust counterfactuals that can undermine not only individual SII propositions but also SII more generally.

It is important to note that robust outcomes based measurement and SII evaluation methodologies and approaches in many cases are still in development but progress is being made. Opportunities to use robust methodologies such as randomised control trials and quasi-experiments should be taken, however, alternative pragmatic approaches may be necessary including the formulation of baselines using historical analysis and benchmark studies. Developmental methodologies could also be utilised not only to facilitate continuous improvement but also to recalibrate financial returns and social outcomes.

One of the aspects of evaluation which is potentially problematic is attribution of achievement of outcomes to the SII. Whilst the theory behind attribution is sound it is important to recognise that SII often involves multiple services and the integration of these services indeed some are based on the co-ordination of integrated services. It is therefore important to consider contribution as well as attribution and in some cases of SII, it is contribution which is the most important assessment.

The costs associated with this may be considerable but it is essential that outcomes measurement and evaluation are embedded in SII propositions and will support the market growth. Whilst some of these costs can be embedded in the financial transaction, there needs to be considerable investment in the broader development of capabilities in relation to outcomes measurement and evaluation. This investment is essential for the growth of the SII market and itself will generate returns in the form of better SII propositions and greater confidence in the SII market. There is also a strong case for this investment in terms of broader benefits to organisations to be able to demonstrate their impact and to Government in commissioning services.

As noted earlier, the Australian Government could consider investing in developing the capability of all market actors in relation to outcomes measurement and evaluation.

**Principle 3 – Fair Sharing of Risk and Return**

The risks and returns of a social impact investment should be fairly shared between the Australian Government, investors and service providers.

---

As the SII market develops an open forum will be necessary so that the required risks and returns for all market participants can be negotiated in a manner that will attract the requisite capital dependant on the risk being taken. In addition to the Australian Government, investors and service providers, it is important to recognise the risks and returns for intermediaries.

Intermediaries are often necessary to mediate between market actors and negotiate a situation where all actors are incentivised to engage. Intermediaries can play an active ongoing role in SII and have “skin in the game”, for example, in the Peterborough social impact bond Social Finance UK fulfilled a strategic role to ensure the One Service delivered the outcomes to trigger reward payments to investors.

Government, as well as private and philanthropic capital, may need to lead to demonstrate that perceived risk is not reflective of the actual risk. The use of blended capital or layered investment to engage diverse market actors may be an effective approach to reduce risks. Over time, as the market develops, a more competitive market mechanism would be expected to emerge, causing confidence to grow and the flow of capital to increase. For example the development of microfinance was facilitated by government and philanthropy, which has led to substantial flows of institutional capital on commercial terms.

Government can use a range of mechanisms to facilitate the sharing of risks and returns as the market develops including: use of a standing charge to provide ongoing cash flow where outcomes take time to be achieved; minimum guarantees and capital protection; and co-investment (including in blended capital or layered investment propositions). Over time the sharing of risks and returns can be re-calibrated.

SII propositions, such as social benefit bonds, typically have mechanisms embedded in contracts to reduce risks, ensure fair returns and limit losses. These mechanisms are often linked to performance in achieving outcomes, including minimum performance levels that trigger termination of contracts. Given the level of innovation of these financial instruments and programs, a formal review point in SII contracts would reduce longer term risks and support long term returns.

Australian Government could consider:

- Mechanisms to ensure there is an open forum for SII propositions to be developed and that all market actors have the necessary capability, and intermediaries are able to function effectively
- Methods to reduce the perceived risk of market actors especially investors but also service providers
- Developing guidance on formulating contracts that ensure that risks and performance in terms of outcomes and financial return are monitored and formally reviewed

Principle 4 - A deliverable and relevant social outcome

SII propositions should have a strong case for being able to successfully address social and/or environmental problems which are priorities for the Government.

EY supports this principle and believe it could be linked to the principle of VFM to emphasise that government’s involvement in SII is addressing a priority, and adds value and impact when compared to alternative approaches.

This principle is based on all market actors having the capacity and capability to design and implement a SII proposition. Government, through traditional procurement including qualification and preferred supplier regimes, considers the suitability of governance arrangements, management capability, sustainability of the business model, and financial vulnerability. Government, in assessing organisations, also considers the track record and quality of service provision, often through compliance with regulations or accreditation systems. A key element of service quality in the human
service sector is the strength of relationships service providers have with government agencies, other service providers, the community and clients. The importance of relationships with clients is essential as Government is increasingly interested in client directed care and person centred design.

Government also considers the evidence base to support interventions, especially where there are vulnerable clients. However, it is important to recognise that SII can be used to target cohorts where existing interventions have been unsuccessful and innovation is required. SII can also fill gaps in government service provision and provide a focus on prevention, early intervention and breaking the cycle for vulnerable cohorts such as preventing chronic conditions, intervening early to keep families together, and housing first to break the cycle of homelessness.

While it is important to strive for successful social impact investments, it is also vital to be able to learn from failures and adapt accordingly in order to be able to foster innovation. This represents an important means through which innovative approaches to social impact investment can help to encourage more accountability.

Increasingly, government and service providers are recognising the importance of learning feedback loops and continuous improvement to refine service delivery and program specifications. This learning approach can be embedded in government contracts and be linked to service review gateways that assess outcome performance and facilitate a re-calibration of financial returns.

As noted in the earlier sections, government also requires investment in capacity building to ensure there is strong leadership; robust data sets and analytical capability to define outcomes, formulate counterfactuals and measure outcome performance, and competent contract management to execute outcomes based contracts that ensure VFM.

Australian Government could consider:

- Supporting the development of guidance on the key success criteria for organisations and government agencies engaging in SII
- As previously stated, investing in building the evidence base for effective SII including learning from failure
- Mechanisms to encourage innovation where there is no evidence of effective interventions
- Providing guidance on the use of service review gateways in contracts to re-calibrate and optimise social outcomes and financial returns
4. **EY Response: Reducing regulatory barriers**

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

The Financial Services Inquiry raised a number of issues relating to financial regulations which may restrict SII and specifically constrain some types of investor and some types of investment. The specific questions identified in the Discussion Paper cover these issues and have been reviewed extensively by a range of interested parties including Impact Investing Australia.

In terms of legislative barriers, the previous sections have highlighted:

- The challenges of SII propositions where responsibilities and benefits spread across Commonwealth and State and Territory jurisdictions.
- The challenges of SII propositions where responsibilities and benefits spread across multiple agencies especially at State and Territory level.
- A broader scope for considering value for money and the time over which benefits to government can be measured including the constraints of the four year forward estimates.

Overall, we consider that the *Corporations Act 2001*, the legislation administered by the Australian Charities and Not-for-Profits Commission and the other State based legislation for non-corporate entities provide a robust and sufficiently varied framework for individuals and entities to invest in projects or entities who wish to pursue social impact objectives. These legal frameworks have been established over a number of years in response to community and business requirements and case law. They also have the requisite disclosure and other protections for investors.

Please refer Appendix A for further information on the specific issues.
Appendix A  Reducing regulatory barriers

*Please Note: Appendix A has been removed as it includes information of a confidential nature.*
About EY
EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organisation and may refer to one or more of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organisation, please visit ey.com.

© 2017 Ernst & Young, Australia
All Rights Reserved.

ED 0217

In line with EY’s commitment to minimize its impact on the environment, this document has been printed on paper with a high recycled content.

Ernst & Young is a registered trademark. Our report may be relied upon by Commonwealth Treasury for the purpose of EY’s Submission to the Australian Government’s Social Impact Investing Discussion Paper (January 2017). We disclaim all responsibility to any other party for any loss or liability that the other party may suffer or incur arising from or relating to or in any way connected with the contents of our report, the provision of our report to the other party or the reliance upon our report by the other party.

Liability limited by a scheme approved under Professional Standards Legislation.

ey.com