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27 February 2017

Manager, Housing Unit
Social Policy Division
The Treasury
Langton Crescent
Parkes ACT 2600

By email: socialimpactinvesting@treasury.gov.au

Dear Sir/Madam,

Social Impact Investing Discussion Paper

Please find attached Philanthropy Australia's submission in response to the Australian Government's Social Impact Investing Discussion Paper.

Philanthropy Australia thanks the Treasury for the opportunity to make this submission and we would welcome the opportunity to discuss the matters raised in the submission further.

In this regard, please do not hesitate to contact Krystian Seibert, Advocacy & Insight Manager, on (03) 9662 9299.

Yours Sincerely,

A handwritten signature in black ink, appearing to read "Sarah Davies".

Sarah Davies
Chief Executive Officer

Philanthropy Australia Submission – Social Impact Investing Discussion Paper

1. Introduction

About Philanthropy Australia

As the peak body, Philanthropy Australia's purpose is to serve the philanthropic community to achieve more and better philanthropy.

The community we serve consists of funders, grant-makers, social investors and social change agents working to achieve positive social, cultural and environmental change by leveraging their financial assets and influence.

Informed, independent and with reach and credibility, Philanthropy Australia gives our members a collective voice and ability to influence and shape the future of the sector and advance philanthropy.

We also serve the community to achieve more and better philanthropy through advocacy and leadership; networks and collaboration; professional learning and resources; and, information and data-sharing.

Our membership consists of approximately 800 trusts, foundations, organisations, families, individual donors, professional advisers, intermediaries and not-for-profit organisations.

A growing number of our Members have an interest in impact investing, with some now starting to make impact investments as a way of complementing their grant-making.

The Significance of Impact Investing

The scale of the social challenges we confront in Australia means that no one entity or sector can be expected to address these challenges by itself.

Rather, a collaborative approach is needed. This involves government, philanthropy, business, not-for-profits, social enterprises and communities working together to devise, fund, implement and evaluate new approaches to achieving social change.

In addition, we need to be able to deploy as many tools as possible to assist with this task. This includes exploring and developing different funding approaches, which will grow the funding available to support efforts to achieve social change, as well as increase the effectiveness of this funding.

It is for this reason that Philanthropy Australia has a strong interest in growing impact investment in Australia and improving its accessibility to philanthropic organisations – given its potential as an innovative approach for funding social change and its role amplifying existing grant-making practices.

As the peak body for philanthropy in Australia, we already work to support the growth of impact investing market in Australia. We do this through initiatives such as the Impact Investment Ready Discovery Grant program.¹ This provides not-for-profit organisations with grants of up to \$50,000 to explore pathways towards financial sustainability and plant the seed for future impact investment propositions through capacity building.

¹ For more information, see: <http://www.impactinvestmentready.com.au/discoverygrant-about>

We also facilitate knowledge sharing amongst our Members, a number of whom are starting to allocate part of their assets in impact investments.² Although the amounts invested may still be relatively small, the momentum of interest in impact investment is growing within the philanthropic sector and we expect this to continue.

Philanthropy Australia's Response to the Discussion Paper

Philanthropy Australia therefore welcomes the release of the Social Impact Investing Discussion Paper (Discussion Paper), as it provides an opportunity to discuss concrete and tangible steps which the Australian Government can take to support the growth of impact investing in Australia.

Given the Discussion Paper is set out in three separate sections addressing different issues, Philanthropy Australia's submission responds to each of these sections in turn.

2. The Role of the Australian Government

The Australian Government has an important role to play in supporting the growth of impact investing in Australia. Without active engagement from governments at both the Federal and State/Territory level, the potential for impact investment in Australia will not be realised.

Impact Investing Australia has articulated three areas in which the Australian Government can support growth in impact investing:³

- **Building the market**, through:
 - Providing leadership that signals interest and legitimacy, inspiring confidence for actors to participate; and
 - Contributing to early infrastructure and derisking to encourage market development and incentivise innovation and efficacy.
- **Participating in the market**, through:
 - Encouraging and leveraging private capital into appropriate priority policy areas; and
 - Collaborating to develop greater outcomes orientation.
- **Market stewardship**, through:
 - Exercising the role of regulator and legislator with the suite of policy levers used to shape markets; and
 - Removing unnecessary regulatory barriers, and creating disincentives for harm and influence where capital is directed.

The Discussion Paper proposes that the Australian Government primarily support impact investing in two ways – which partly align with the roles outlined by Impact Investing Australia:

- Creating an enabling environment; and
- Funding (or co-funding with State and Territory Governments) investments which would likely achieve savings to fund the intervention taking place (including paying for returns to investors, where required) and deliver better outcomes for Australians.

² For a recent case study which involves Philanthropy Australia Members, see the example of 'Yume' discussed on page 5 of this submission.

³ See: <https://impactinvestingaustralia.com/wp-content/uploads/Impact-Investing-Australia-Submission-to-Treasury-March-2015.pdf>

Philanthropy Australia supports the Australian Government's involvement in these two areas, but at the same time encourages it to view its role more broadly through the prism of the three areas outlined by Impact Investing Australia.

In particular, Philanthropy Australia believes that the Australian Government has a role to play building the market for impact investing.

A Compelling Case to Help Build the Market through Capacity Building

As noted on page 12 of the Discussion Paper, one challenge with growing impact investing in Australia is limited capacity to develop potential ventures to a stage where they are 'impact investment ready'.

Whilst there may be emerging ventures in which investments could be made, these opportunities are often not impact investment ready. Without appropriate support, including business advisory, financial or legal services, they will struggle to become investment ready.

Based on feedback from our Members and other stakeholders, Philanthropy Australia believes that the lack of appropriate investment opportunities is one of the biggest challenges for growing impact investing in Australia.

There is demand for investment opportunities – within the philanthropic sector and beyond – but there is an insufficient pipeline of impact investment ready organisations.

Philanthropy Australia and Impact Investing Australia, through their respective Impact Investment Ready Discovery Grant and Impact Investment Ready Growth Grant⁴ programs, already provide some capacity building support for organisations seeking to become investment ready. Both were developed in collaboration with the National Australia Bank, and were made possible due to their financial support as well as the financial support of additional donors in the case of the Impact Investment Ready Discovery Grant program.

However, if we are to realise the full potential of impact investing in Australia, then these programs are not sufficient by themselves. They are both time limited, and the amount of funding which philanthropy can direct towards such initiatives is also limited, hence the support available through these programs is relatively small. Other private sector stakeholders are unlikely to provide such capacity building support, given how early it is in the investment life cycle.

Therefore, Philanthropy Australia believes that the Australian Government also has a critical role providing capacity building support for organisations seeking to become impact investment ready. This support will assist in addressing the current under supply of such support and the insufficient pipeline of impact investment ready organisations that arises because of this.

The United Kingdom's 'Investment and Contract Readiness Fund' is an example of a mechanism used by a government in a similar jurisdiction to achieve this objective. The fund, established by the Cabinet Office, provided grants to promising 'social ventures' seeking to raise at least £500,000 in repayable investment or secure a public service contract of £1 million or more.

It is appreciated that given Federal Budget constraints, the Australian Government is limited in terms of funds it can expend and that any new policy proposals which involve funding must be carefully examined and provide compelling evidence in terms of the benefits provided.

In this regard, Philanthropy Australia believes that providing even relatively modest capacity

⁴ For more information, see: <http://www.impactinvestmentready.com.au/>

building support for organisations seeking to become impact investment ready is a worthwhile investment from the perspective of the Australian Government, for the following reasons:

- Capacity building funds have proven themselves in terms of providing a very strong return on the amount of support provided:
 - The United Kingdom’s ‘Investment and Contract Readiness Fund’ provided £13.2 million in grants, which unlocked £233 million in new investments and contracts for the organisations to which support was provided – this is a nearly **18-fold return** on the United Kingdom Government’s expenditure.⁵
 - Impact Investing Australia’s Impact Investment Ready Growth Grant has so far provided \$1.1 million in grants, which has unlocked \$37.75 million in new investments from capital raisings for the organisations to which support was provided – this is more than a **34-fold return** on the grant funding.⁶
- By providing grants to organisations which, if funded by impact investment, will pursue social and environmental innovation, this:
 - Helps provide new job opportunities within Australia
 - Helps achieve other Australian Government policy objectives in addition to job growth – for example, jobs created may assist those with disabilities to enter stable and fulfilling employment (see the Vanguard Laundry case study below), whilst other enterprises may help achieve improved environmental outcomes (see the Yume case study below)
 - Closely aligns with the Australian Government’s ‘National Innovation and Science Agenda’, which seeks to ‘harness new sources of growth to deliver the next age of economic prosperity in Australia’.⁷

There is also a precedent in terms of other business assistance and support that the Australian Government provides in many other parts of the economy.

Capacity Building Case Study 1 – Vanguard Laundry Services



Vanguard Laundry services is a start-up social enterprise laundry backed by Toowoomba Clubhouse and Philanthropy Australia Member Social Ventures Australia. It focuses on employing people living with mental health issues in Toowoomba. It received a \$71,000 Impact Investment Ready Growth Grant, which was used to assist with financial and business modelling, business planning, setting up initial customer contracts and obtaining legal services. The grant helped leverage \$2.19 million in impact investment – a **30-fold return** on the grant funding. It was opened by the Prime Minister on 16 January 2017.

Capacity Building Case Study 2 – Yume



Yume is an online platform where food producers, manufacturers, wholesalers and distributors can sell surplus produce that would otherwise go to landfill or be sold for little or no profit. It has attracted impact investment from several Philanthropy Australia Members. It received a \$100,000 Impact Investment Ready Growth Grant which allowed it to contract the services of Impact Generation Partners and other service providers, who helped Yume to become impact investment ready and raise capital. Services provided by Impact Generation Partners included financial modelling, writing an information memorandum and connecting Yume with a network of investors, including philanthropic organisations. The grant helped leverage \$2,600,000 in impact investment – a **26-fold return** on the grant funding.

⁵ For more information, including an evaluation of the fund’s performance, see: <http://www.sibgroup.org.uk/resources/in-pursuit-of-readiness>

⁶ See: <http://www.impactinvestmentready.com.au/growthgrant-about>

⁷ See: <http://www.innovation.gov.au/page/agenda>

Based on the compelling evidence of the effectiveness of capacity building funds in terms of their ability to unlock impact investment opportunities, Philanthropy Australia recommends that the Australian Government provide some funding for capacity building support for organisations seeking to become ‘impact investment ready’. This would complement the small amounts of non-government funding currently available.

Recommendation 1

That the Australian Government provides funding for capacity building support for organisations seeking to become ‘impact investment ready’.

Reflecting Federal Budget constraints, it is proposed that a relatively modest allocation of between \$2 to 3 million per year over four years be provided.

This could either be administered by the Australian Government and provided directly as grants to organisations seeking capacity building support to become ‘impact investment ready’, or could be provided to an existing intermediary as part of a competitive tender process, with the intermediary managing the distribution of the grants.

The outcomes from this funding should be evaluated at the end of the four years.

3. The Australian Government’s Participation in the Social Impact Investment Market

Social Impact Investing Principles

Philanthropy Australia welcomes the development of the draft Social Impact Investing Principles (the Principles) set out in the Discussion Paper.

We are broadly supportive of their content and focus, but note that other stakeholders such as Impact Investing Australia have provided more detailed analysis of the principles and suggested revisions.

Philanthropy Australia does however believe that currently the principles lack a focus on how impact investments should be ‘designed’ to reflect the importance of valuing people in the community as subject matter experts, as practitioners in areas that may be funded, and as the end beneficiaries of services that are delivered.

It is important to ensure that any impact investing initiatives progressed by the Australian Government are not designed in a manner which excludes community input.

Rather it is important that they are ‘co-designed’ through extensive and constructive engagement with subject matter experts and practitioners in the areas that may be funded. These may include those employed by organisations to deliver particular services in the community, academics and researchers with particular awareness of the issues that the impact investing initiatives are seeking to address, and peak body representatives.

This will ensure that any impact investing initiatives are well informed by a broad base of stakeholders with relevant expertise and experience, to improve their efficacy.

It is also important to engage the intended end beneficiaries of impact investing initiatives. It is too often the case that policy interventions are designed without including the perspectives of end beneficiaries, meaning that they are not provided an opportunity to share their views

on what is proposed, leading to questions around the legitimacy of these policy interventions.⁸

Co-design involving all relevant stakeholders will lead to better informed decisions about the design of impact investing initiatives and also help ensure that there is broader buy-in and support for the initiatives.

Recommendation 2

That a fifth Social Impact Investment Principle be included, to broadly read as follows:

Co-design with stakeholders

Social impact investments should be designed in collaboration with a broad range of stakeholders including subject matter experts, practitioners in the areas that may be funded, and the intended end beneficiaries.

An Office for Social Impact Investment

Philanthropy Australia believes that it would be beneficial for the Australian Government to establish a small 'Office for Social Impact Investing' which would coordinate and oversee the Australian Government's participation in the impact investment market.

The New South Wales Government has established such an office, and Philanthropy Australia believes that it serves an important purpose focusing and driving a strategic approach to impact investing within the NSW Government.

Such an office could be based within the Department of the Treasury or the Prime Minister and Cabinet, and its responsibilities could include:

- Administering funding for capacity building support as described in Recommendation 1
- Monitoring the use of the Social Impact Investment Principles within the Australian Government;
- Examining Australian Government policy areas to identify the potential for impact investment approaches, including but not limited to social impact bonds, to improve outcomes and reduce costs;
- Leading the implementation of any such impact investment approaches, in collaboration with the relevant line agency; and
- Developing relationships with stakeholders within the impact investing sector, including philanthropy, financial institutions and intermediaries.

Recommendation 3

That the Australian Government establish an Office for Social Impact Investing.

⁸ For more discussion about the importance of ensuring that impact investing initiatives are regarded as legitimate, see: <https://nonprofitquarterly.org/2016/06/22/impact-investing-needs-to-be-conscious-of-its-social-license/>

4. The Regulatory Framework

Private Ancillary Funds as Sophisticated Investors

Philanthropy Australia welcomes the Australian Government's commitment to providing greater certainty for private ancillary funds (PAFs) controlled by sophisticated investors.

Philanthropy Australia's preferred approach to implementing this commitment is informed by two considerations:

- It would be beneficial to provide certainty in relation to the treatment of private ancillary funds for the purposes of both the 'sophisticated investor test' in Chapter 6D and the 'wholesale client' test in Chapter 7 of the *Corporations Act 2001*
- That even some PAFs which themselves already meet the relevant test (because of their size), on occasion have difficulty proving this, and that additional clarity in this regard would be beneficial – this can also be an issue for some public ancillary funds (PuAFs).

Therefore, we believe that the most effective approach would be to insert a new section into the *Corporations Act 2001* which provides that an ancillary fund satisfies *both* the 'sophisticated investor test' in s708 and the 'wholesale client' test in s761G of the *Corporations Act 2001*, if *either* of the following criteria are met:

- The fund has assets of at least \$2.5 million or has had income of at least \$250,000 in each of the past two years, as evidenced by its audited financial statements or a certificate from an accountant – this would apply to both PAFs and PuAFs, and would provide the additional clarity discussed in the second dot point above; or
- At least one director of the Trustee, who personally satisfies both the 'sophisticated investor test' in s708 and the 'wholesale client' test in s761G of the *Corporations Act 2001*, agrees to undertake a particular investment as evidenced by the Trustee's minutes – this would only apply to PAFs, and addresses the fact that the largest financial donor to a PAF may cease to be a trustee (for example upon death), but the PAF may still have a trustee who satisfies the relevant tests.

Philanthropy Australia would not support an approach where the majority of the directors of the trustee must satisfy the relevant tests in order for the PAF to satisfy them, as this would be unworkable and provide little benefit compared with the current situation.

In terms of the specific consultation questions asked in the Discussion Paper, Philanthropy Australia provides the following responses:

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

Response: As noted above, even some PAFs that themselves already meet the relevant tests (because of their size) on occasion have difficulty proving that they satisfy the relevant tests, and that additional clarity in this regard would be beneficial to make things easier for these PAFs – this can also be an issue for some PuAFs.

2. Are there examples of recent situations where a PAF has considered that it is sufficiently controlled, or not sufficiently controlled, that fall outside these situations?

Response: See the discussion above.

3. Do the options canvassed provide sufficient certainty around when a PAF is controlled by a sophisticated investor? Are there better options that are not discussed?

Response: See the discussion above.

4. How could these options be best incorporated within the appropriate legislation?

Response: Philanthropy Australia believes that the most effective approach would be to insert a new section into the *Corporation Act 2001* which sets out when an ancillary fund satisfies both the ‘sophisticated investor test’ in s708 and the ‘wholesale client’ test in s761G of the *Corporations Act 2001*, using the criteria discussed above.

5. Is a written statement from the board of directors of the PAF sufficient evidence of the status of the trust as a sophisticated investor, or should a letter from an independent third-party be required?

Response: Philanthropy Australia would support either approach, however on balance we believe that requiring a letter from an independent third-party is the better option.

6. What qualifications should the independent third-party person be required to hold?

Response: They should be a qualified accountant, as defined in s88B of the *Corporations Act* as a person meeting the criteria in a class declaration made by the Australian Securities and Investments Commission. This is consistent with the current approach to certifying that a person is a sophisticated investor or wholesale client.⁹

7. Is it common for a natural person involved with a PAF to meet the professional investor test, but not the sophisticated investor test, or visa-versa?

Response: Under Philanthropy Australia’s preferred approach, this would not be an issue because the PAF would meet the requirements of s761G of the *Corporations Act 2001* if it has assets of at least \$2.5 million or has had income of at least \$250,000 in each of the past two years. So, whether the PAF is regarded as a professional investor or not would not be relevant.

8. Does this lack of control provision restrict PAFs established by professional investors from investing in impact investment products?

Response: It is not an issue which Philanthropy Australia has come across.

9. Are there any similar issues about the application of the sophisticated investor test and/or professional investor test for investment by PAFs in financial products other than securities that are structured as impact investment products?

Response: Yes, as there are many investments which are only open to sophisticated investors. Therefore, any uncertainty around this is relevant for all such investments, not just impact investments.

10. If the Government were to amend any of these definitions to provide clarity for PAFs, would there be any consequences for other activities regulated by the *Corporations Act*, or other Commonwealth legislation?

Response: Not that Philanthropy Australia is aware of.

Recommendation 4

That the *Corporations Act 2001* be amended to add a new section which provides that an ancillary fund satisfies both the ‘sophisticated investor test’ in s708 and the

⁹ See: <http://asic.gov.au/regulatory-resources/financial-services/financial-product-disclosure/certificates-issued-by-a-qualified-accountant/>

‘wholesale client’ test in s761G of the Corporations Act 2001, if either of the following criteria are met:

- **The fund has assets of at least \$2.5 million or has had income of at least \$250,000 in each of the past two years, as evidenced by its audited financial statements or a certificate from an accountant – this would apply to both PAFs and PuAFs; or**
- **At least one director of the Trustee, who personally satisfies both the ‘sophisticated investor test’ in s708 and/or the ‘wholesale client’ test in s761G of the Corporations Act 2001, agrees to undertake a particular investment as evidenced by the Trustee’s minutes – this would only apply to PAFs**

Philanthropy Australia would welcome the opportunity to provide feedback on the detailed drafting of any amendments to the *Corporations Act 2001* to give effect to this recommendation.

An Enhanced Program Related Investments Framework

Philanthropy Australia believes that amendments should be made to the *Private Ancillary Fund Guidelines 2009* and the *Public Ancillary Fund Guidelines 2011* to allow for an enhanced program related investments (PRI) framework that provides more flexibility and choice for ancillary funds and the organisations they support.

Philanthropy Australia recognises that the amendments made as part of the *Private Ancillary Fund and Public Ancillary Fund Amendment Guidelines 2016* improved the existing PRI framework for ancillary funds by:

- Providing more clarity regarding the treatment of concessional rates of return on loans made to DGRs, for the purposes of calculating an ancillary fund’s annual distribution; and
- Allowing for ancillary funds to provide loan guarantees over borrowings of DGRs, and count the market value of these towards their annual distribution.

We advocated for these amendments and were pleased that they were implemented by the Australian Government.

Whilst these amendments were a positive development, they are not sufficient in and of themselves.

An Enhanced Program Related Investments Framework

As noted in the Discussion Paper, In the second half of 2015, Philanthropy Australia was commissioned by the Department of Social Services to undertake a project examining PRIs to inform the work of the Prime Minister’s Community Business Partnership.

The project involved examining the PRI framework in the United States, developing options for how such a framework could be implemented in Australia, seeking to ascertain demand for such a framework in Australia within the philanthropic sector, and recommending a model for introducing PRIs in Australia. The output of the project was a report, ‘Program Related Investments – An Opportunity for Australia’ (the report).¹⁰

To inform the development of this report, a consultation process was undertaken as part of the project. Consultation involved two facilitated workshops as well as one-on-one consultation. Stakeholders consulted included the management and trustees of various

¹⁰ See: <http://www.communitybusinesspartnership.gov.au/program-related-investments-research-report/>

Australian trusts and foundations, with a focus on PAFs and PuAFs, both large and small, as well as other advisers and experts.

During the consultation process, it was emphasised that there are ways that concessional loans made by PAFs and PuAFs to DGRs can still be counted, at least in part, towards the minimum annual distribution – whilst this was helpfully clarified by the *Private Ancillary Fund and Public Ancillary Fund Amendment Guidelines 2016* at Philanthropy Australia’s request, it was still commonly understood that this was previously permitted. Allowing for ancillary funds to provide loan guarantees over borrowings of DGRs was not yet permitted, so this was not consulted on.

Findings from the Consultation Process

A key finding from the consultation process was that there was little interest in using the current approach available to PAFs and PuAFs in Australia to make concessional loans to DGRs.

One explanation for this appeared to be the fact that such a concessional investment involves allocating part of the investment to the ancillary fund’s assets and part of the investment to the ancillary fund’s granting. There was a general view that this approach was somewhat confusing, with the cautious approach taken by many trustees in relation to investments being made using assets also being relevant.

This view has been further reinforced by feedback received by Philanthropy Australia as part of consulting our Members when preparing this submission.

In addition, the current approach requires valuing the difference between the market rate of interest and the concessional rate of interest charged on the loans to the DGR. This can be a complicated process.

Another key finding from the consultation process was there was very strong support from a broad range of stakeholders for the introduction of an enhanced PRI framework in Australia.

Implementing an Enhanced Program Related Investments Framework

Therefore, in Philanthropy Australia’s submission in response to the Exposure Draft of the *Private Ancillary Fund and Public Ancillary Fund Amendment Guidelines 2016*, we advocated for the introduction of an enhanced PRI framework.¹¹

This enhanced PRI framework would:

- Allow ancillary funds to make concessional (below market interest rate) loans to DGRs and count the *full amount* of the loans as part of their minimum annual distribution; and
- Provide that repaid principal from the loan be added to the minimum annual distribution in the year of repayment or the following year.

Although the report recommended allowing PRIs to be made in both DGRs, and certain organisations which are not DGRs, we realise that this would require legislative change.

Philanthropy Australia is of the view that an enhanced PRI framework could be introduced that would, at this stage, be limited to DGRs. Such a change would only require relatively simple amendments to the PAF and PuAF Guidelines.

¹¹ See: http://www.philanthropy.org.au/images/site/publications/Philanthropy_Australia_Submission_-_Draft_Amendments_to_AF_Guidelines.pdf – at p.22.

These amendments could be drafted broadly enough to allow for PRIs to be extended to other eligible entities once their operation in relation to DGRs can be evaluated and demand for a broader approach can be assessed.

An enhanced PRI framework will not mean that the existing PRI framework will be abolished – rather, ancillary funds and the organisations they support will be provided with more flexibility and choice regarding how they engage with one another.

Some may still prefer to use the existing PRI framework, but based on the consultations we have undertaken, we expect a larger number to be attracted to the enhanced PRI framework, given that it addresses some of the deficiencies of the existing framework outlined above.

Although the *Private Ancillary Fund and Public Ancillary Fund Amendment Guidelines 2016* did not implement an enhanced PRI framework as proposed by Philanthropy Australia, we recognise that the Treasury wanted to undertake further consideration of this matter and consult more broadly.

We believe that now is the opportunity to implement this proposal, as one of the outcomes of the current consultation process and ideally as part of a package of other initiatives designed to support the growth of impact investing in Australia. In addition to the benefits associated with providing more flexibility and choice regarding how ancillary funds and the organisations they support engage with one another, the proposal is attractive for two other reasons:

- It will help support impact investment by improving the regulatory framework for ancillary funds **at no cost to the Federal Budget** – a consideration which is important in a context where the Australian Government wants to support impact investing, but faces budget constraints that limit the range of initiatives it can progress; and
- It **does not require legislative change** – only relatively simple amendments to the *Private Ancillary Fund Guidelines 2009* and *Public Ancillary Fund Guidelines 2011* are required, and Philanthropy Australia has already suggested possible drafting of these amendments.¹²

In terms of the specific consultation questions asked in the Discussion Paper, Philanthropy Australia provides the following responses:

24. To what extent are the current arrangements for program related investments appropriate?

Response: This is addressed above.

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

Response: Yes, for the reasons provided above – it would increase the availability of alternate sources of finance for DGRs from ancillary funds.

24.2. allow ancillary funds to make program related investments to non-DGR organisations?

Response: Not at this stage, but this is something that could be considered further in the future.

¹² See No.11 above, at pp.23-24

25. What is the level of demand from both DGR and non-DGR organisations who could be recipients of program related investments?

Response: Consultation undertaken with intermediaries such as Social Traders has indicated that an enhanced PRI framework as proposed above would be a useful tool for the social enterprises it works with (most of which are DGRs). Consultation with other DGRs has also indicated that there is interest in an enhanced PRI framework.

26. What are the costs of administration for organisations receiving program related investments compared with receiving irrevocable donations?

Response: The costs of administration for organisations receiving program related investments are unlikely to be too different compared with receiving many forms of grants. Often grants are provided pursuant to a grant agreement, and there is reporting required under such agreements. It is expected that this would be little different under an enhanced PRI framework, other than that the funds would be provided pursuant to a loan agreement. However, an ancillary fund providing support through an PRI could require some additional reporting given that it would expect the funds to be repaid, although it would be aware that even if the funds are not repaid, it can then fully 'write off' the loan against its minimum distribution. The costs of administration for organisations receiving program related investments under the current framework compared with the enhanced framework would be identical, given that they both relate to providing loans to DGRs.

27. Given the recent changes to the ancillary fund guidelines regarding program related investments, and noting the issues associated with making further changes, are there alternative mechanisms for promoting program related investments outside of ancillary funds?

Response: Further changes to implement an enhanced PRI framework can be made relatively easily and without legislative change, as discussed above. The fact that other changes may have been made to the ancillary fund guidelines within the last year should not be a barrier to making further changes if they provide more flexibility and choice. Philanthropy Australia therefore does not see any issues associated with making further changes. If the changes are implemented, it would be beneficial for the Australian Taxation Office to provide guidance on the use of different PRIs, covering concessional loans under the existing and enhanced PRI framework which is proposed, as well as loan guarantees.

Recommendation 5

That the Private Ancillary Fund Guidelines 2009 and the Public Ancillary Fund Guidelines 2011 be amended to introduce an enhanced Program Related Investments framework which would:

- ***Allow ancillary funds to make concessional (below market interest rate) loans to DGRs and count the full amount of the loans as part of their minimum annual distribution; and***
- ***Require that repaid principal from the loan be added to the minimum annual distribution in the year of repayment or the following year.***

Suggested drafting of the necessary amendments is included in the Appendix to this submission.

Legal Structures for Social Enterprises

Philanthropy Australia supports the view that the current range of legal structures and options are not sufficient to meet the needs of a broad range organisations (including among others, social enterprises), seeking to achieve social change as well as make a financial return.

This is a barrier to impact investing, in large part because uncertainty around how particular organisations will preserve their social and environmental mission (including the ability of directors to view social and environmental benefits in the same way as financial returns) may mean that investors, including philanthropic organisations, are less inclined to make an impact investment. This view is informed by feedback from Philanthropy Australia Members.

We do not believe that merely providing for these and other relevant matters within a company's constitution is sufficient, nor in some cases feasible.

Therefore, we believe that reform is needed in this area, particularly with regards to:

- *Establishing a Benefit Company Legal Structure* – we refer the Treasury to the submission made by BLab Australia and New Zealand for more detail.
- *Establishing a Hybrid Legal Structure based on the Community Interest Company* – we refer the Treasury to the submission made by the Legal Models Working Group for more detail.

Ideally, these two reforms could be achieved together and we refer the Treasury to the submission made by the Prime Minister's Community Business Partnership given they have done considerable thinking about how this could be achieved.

However, in terms of priorities, we do believe that the establishment of a Benefit Company legal structure should be progressed as soon as possible.

Recommendation 6

That amendments to the Corporations Act 2001 be made to introduce:

- ***A Benefit Company Structure; and***
- ***A Hybrid Legal Structure based on the Community Interest Company***

Appendix

Suggested drafting of amendments to the *Private Ancillary Fund Guidelines 2009* and the *Public Ancillary Fund Guidelines 2011* to provide for an enhanced PRI framework.

PROGRAM RELATED INVESTMENTS

19A. A Program Related Investment is a loan, the giving of a guarantee or indemnity, or any other investment which meets the following conditions:

19A.1. The primary purpose of the investment must be to further the charitable purposes or activities of a deductible gift recipient or other eligible entity

19A.2. The production of income or the appreciation of property may not be a significant purpose of the investment.

*Example 1: A *private ancillary fund provides a zero interest loan to an eligible deductible gift recipient which is used to further the deductible gift recipient's charitable purposes. The loan would be considered a program related investment.*

*Example 2: A *private ancillary fund provides a loan to an eligible deductible gift recipient which has been unable to secure a loan from a financial institution on terms acceptable to the deductible gift recipient. The loan is used to further the deductible gift recipient's charitable purposes. The interest rate on the loan is 2%, and if the *private ancillary fund had not made the loan it could have invested those funds in a term deposit with an interest rate of 3%. The loan would be considered a program related investment.*

19B. In the year in which a program related investment is made, the amount of the program related investment can be treated as if it were a distribution by *private ancillary fund

19B.1. The value of a program related investment of a *private ancillary fund is excluded from its net assets for the purposes of calculating the minimum annual distribution

19B.2. Upon repayment of the principal of a program related investment, the amount repaid must be distributed in the current or following financial year in addition to the *private ancillary fund's minimum annual distribution as required by Guideline 19

19B.3. Any income received from a program related investment forms part of the *private ancillary fund's net assets

19B.4. Guideline 19.3 does not apply to a Program Related Investment

*Example 1: In year 1, a *private ancillary fund provides a zero interest loan of \$100,000 to a deductible gift recipient which is used to further the deductible gift recipient's charitable purposes. In year 1, \$100,000, representing the value of the loan, is treated as a distribution by the *private ancillary fund. In year 4, the loan is repaid. Therefore, in year 4 or 5, the *private ancillary fund must distribute \$100,000 in addition to its minimum annual distribution.*

*Example 2: In year 1, a *private ancillary fund provides a loan of \$100,000 to a deductible gift recipient which is used to further the deductible gift recipient's charitable purposes. In year 1, \$100,000, representing the value of the loan, is treated as a distribution by the *private ancillary fund. In year 2, \$12,000 is repaid consisting of a repayment of \$10,000 of the principal and \$2,000 in interest. \$2,000 is included in the *private ancillary fund's net assets as at the end of year 2, and in year 2 or 3, the *private ancillary fund must distribute \$10,000 in addition to its minimum annual distribution.*