Submission on the Social Impact Investing Discussion Paper

March 2017

About QBE

QBE Insurance Group (***QBE***) has been an integral part of the Australian business landscape since its early beginnings in Queensland in 1886, providing peace of mind to Australians during normal business and times of crisis.

Listed on the ASX and headquartered in Sydney, organic growth and strategic acquisitions have seen QBE grow to become one of the world's top 20 general insurance and reinsurance companies, with a presence in all key global insurance markets. Today, QBE is one of the few Australian-based financial institutions to be operating on a truly global landscape, with operations in and revenue flowing from 37 countries.

As a global insurer, QBE believes that Australia must continually look to refresh its financial and regulatory systems, to ensure the nation remains competitive with foreign financial markets, and attractive to investment.

QBE welcomes the opportunity to respond to the Australian Government's *Social Impact Investing Discussion Paper* (***Discussion Paper***). QBE is an active supporter of social impact investment both in Australia and around the world, and is an anchor partner of Impact Investing Australia.

Background

In 2014, QBE announced its intention to invest up to $US100 million over the next three years in suitable social impact bond opportunities across its global investment portfolio. As an institutional investor, QBE can not only provide capital but can also offer insights on how to make these bonds attractive to the investment market.

Social impact bonds, also known as social benefit bonds and pay for success bonds, are social policy-driven investments that pay a return based on the performance of a social service provider improving a specific social outcome. Unlike most bonds, they do not offer a fixed rate of return. The key participants in social impact bonds are governments, social service providers (generally not for profit organisations) and private sector investors.

Under a social impact bond, investors fund the delivery of services targeted at improving a particular social outcome. Achievement of this outcome should reduce the need for, and therefore government spending on, acute social or welfare services. Part of the resultant public sector savings are then used to repay investors' principal and make additional reward payments (the return on investment), the level of which is dependent on the degree of improvement achieved.

The global social impact bond market is still in its infancy and QBE is seeking to play an active role, as an institutional investor, in the development of this market.

Since QBE announced its intention to invest $US100 million in suitable social impact bond opportunities, we have invested in social impact bond opportunities in three of our four global divisions. We currently invest in six social impact bonds, including:

- *The Benevolent Society Social Benefit Bond* in New South Wales (NSW), which aims to keep children out of the foster care system by providing intensive support to families,
- *Sheffield Futureshapers* in the United Kingdom, a project to improve youth employment opportunities by developing the skills, attitudes and understanding of 14 to 17 year olds, and support them to make a positive transition from education to employment, and
- *The Family Stability Pay for Success Project* in Connecticut, United States, which aims to promote family stability and reduce parental substance use for families with young children at risk of being removed to out of home state care.

Like other insurers, from a prudential perspective, the vast majority of our $26 billion of assets is invested for profit, and a relatively small amount is set aside for purpose, channelled to good causes through our Foundation[1] and other important social initiatives[2]. QBE considers impact investing provides a valuable opportunity for institutional investors to combine profit with purpose, however volume and scale have proved challenging to date for institutional investors.

QBE is currently working with various parties in a number of countries to help create deals involving social impact bonds. QBE can offer insights on leading practice globally and what is needed to support the growth of social impact bonds and compress the timeframe for transaction development.

QBE continues to believe that the market will develop into a niche institutional market that has the ability to meet social objectives and provide relief to fiscally constrained governments, as well as providing a valuable source of uncorrelated financial returns for institutional investors.

Response to questions

QBE is pleased to respond as follows to the questions set out in the Discussion Paper. We have limited our responses to those questions that relate most closely to our areas of expertise as an institutional investor.

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

Availability of suitable opportunities

QBE broadly agrees with the proposition expressed in the Discussion Paper that there is currently a lack of investment opportunities which offer the potential for market rates of return.[3] Generally, institutional investors seek investments which are of a size and scale commensurate with their broader investment portfolio. At present, there are few suitable investment opportunities available which meet these criteria, with the result that current and potential demand for larger investments is outstripping available opportunities.

The 2016 Impact Investing Australia *Benchmarking Impact Report* estimated that demand for Australian social impact investments may grow to at least $18 billion between the 2015 and 2020 financial years.[4] As current projects reach fruition and governments, service providers and investors develop expertise, we consider it likely that the market will expand.

High transaction costs

Given the current ad-hoc nature of impact investing, both governments and investors can experience high set up costs relative to the size of each investment. Governments generally incur significant research and development costs, including the need to establish a baseline cost of services and desired outcomes. There is no standard framework or contractual documentation that presently exists which leads to the need for involvement of specialist professionals and complex negotiation for each impact investment opportunity.

From a purely financial perspective, social impact bonds tend to offer relatively low rates of return. This is particularly relevant considering the level of resourcing involved, the amount of risk the investor must assume, the novel nature of the investment proposal and the lack of investment liquidity.

Current challenges for investors in this context include the need to invest substantial upfront resources appraising the benefits, liabilities and commercial potential of new opportunities in addition to high transactional costs. Due to the unique social challenges underlying many social investing

[1] The QBE Foundation supports local communities through charity partnerships, donations and volunteering in Australia. Our 2017 charity partners are Assistance Dogs Australia, Brainwave, Camp Quality, Foodbank, The Big Issue and The Kids' Cancer Project

[2] In conjunction with our investment in social impact bonds, QBE is also raising awareness of social investment through our global Premiums4Good initiative. This is a commercial initiative which allows selected customers to elect to commit a portion of their insurance premium to investments with an additional social or environmental objective. .

[3] Australian Government Treasury, *Social Impact Investing Discussion Paper*, page 11.

[4] Impact Investing Australia, *Benchmarking Impact*, 2016, page 8 https://impactinvestingaustralia.com/wp-content/uploads/Benchmarking-Impact.pdf.

opportunities, due diligence can be resource intensive, and may involve skill sets which are outside of the core business of the investor.

From a QBE perspective, while this can be resource intensive, given our commitment in this space, we recognise that it does present the opportunity to grow broader expertise in outcomes-based procurement and social programs. QBE agrees with the Discussion Paper that these costs may fall as expertise and investment structures develop and we consider this would be an important factor in the longer term development of a sustainable national and global market.

Availability of quality data
Additionally, QBE believes improvements in the quality and availability of data will be essential for the growth of the social investment market to enable all participants to be able to appropriately assess opportunities and develop and measure outcomes. At present, both governments and investors have limited visibility of the full cost of social issues, and the potential benefits flowing from social investments, in part due to the federal nature of Australia's political system. QBE believes that given the inherent complexities involved, cost savings to all levels of government are not being fully quantified and recognised.

Questions 4 and 5 – What do you see as the role of the Australian Government in developing the social impact investing market? Do you see different roles for different levels of government in the Australian social impact investing market?

QBE believes that the Australian Government is most appropriately placed to provide coordination and leadership of the development of this market and also direct facilitation and incentivisation of social impact investing.

We also refer to the submission of Impact Investing Australia, which comprehensively addresses the enabling role of government in developing the social investment market in Australia. To maximise the effectiveness of this work, we strongly encourage all governments to continue to consult closely with investors, intermediaries and service providers.

Coordination and leadership
The Australian Government is well-placed to provide a leadership and coordination role with state & territory governments to develop a consistent framework and approach to impact investing. Currently, some states are more advanced and have gained expertise in this area faster than others, for example, developing sample financing documentation. It is important, however. to leverage those learnings and for a national approach and framework to be developed. This will assist to reduce transactional costs which will make impact investing more viable for institutional investors in the longer term. For example:

- ***Consistent language*** – At present, social impact investments are not described using a common form of language which is accessible to investors. For example, social impact bonds may be referred to as social benefit bonds, pay for success bonds, payment for outcomes, and outcomes based contracting. Australian governments could leverage work that has occurred overseas, including in the United States and the United Kingdom, to standardise the language used in prospectus documents. As noted in the *Benchmarking Impact* report there are opportunities for alignment of the local Australian market and global benchmarking in impact measurement and standards which will support the market and better connect the Australian social investment sector with sources of capital[5].
- ***Consistent documents and processes*** – State governments have already taken steps to develop common sample financing documents for social impact bonds. This is a welcome development, and based on overseas observations, we consider it highly likely that this standardisation will make financing a more attractive proposition for investors. QBE agrees with the Discussion Paper's proposals regarding standard corporate forms for social enterprises.

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[5] Impact Investing Australia, *Benchmarking Impact*, 2016, page 40
https://impactinvestingaustralia.com/wp-content/uploads/Benchmarking-Impact.pdf.

- ***Cross sector collaboration*** – Social impact investment stimulates innovation and solutions to entrenched social issues. Cross sector forums provide an opportunity to share lessons learnt from early initiatives, some of which could be applied to outcomes-based government contracting more broadly.
- ***Improving and harmonising data*** – As outlined previously, QBE believes improvements to data availability and quality are critical for market development. Many initiatives remain constrained due to a lack of information about the true cost of social issues, especially where more than one agency or level of government has overlapping policy responsibility. This could be addressed through the development of mechanisms to support the sharing of information about, and responsibility for, social investment initiatives. While the market develops, governments could also consider lowering barriers to entry by providing some data to potential investors for free or for a reduced price, instead of on a full cost-recovery basis.

Direct facilitation and incentivisation
QBE believes there is also a role for the Australian and state governments to directly facilitate and incentivise social impact investments in the following ways:

- ***Co-funding*** – As noted above, investments often benefit more than one level of government or government agency. For example, state initiatives focused on supporting education and training, or to reduce homelessness and social exclusion, may also lessen the number of recipients of federal welfare benefits. Where projects involve a potential benefit at the federal level, or across multiple agencies, the Australian Government could provide set-up, top-up or outcomes-based funding support. For example, the United Kingdom Government's social outcomes funds support social investments that may accrue benefits for multiple government agencies. In this respect, the Youth Engagement Fund has stimulated central and local government co-funding of outcomes contracts. QBE believes a federal fund of this nature would encourage market innovation and support development of an investment pipeline.
- ***Incentives* –** The Australian Government could partner with state governments to offer incentives for private sector investment in social initiatives. This could be done while the market is in its infancy, recognising rates of return are generally below market value, and most offerings are not of a scale that appeal to larger institutional investors.
- ***Set-up support*** – Recognising the very high transaction and set up costs involved in social investments at present, the Australian Government could provide technical assistance and feasibility development. For example, the United States Social Innovation Fund and the Pay for Success program, support local and state government agencies looking to identify suitable opportunities, or to undertake cost-benefit analyses to link service delivery to the achievement of measurable outcomes. This has increased the number of medium to long term investment opportunities available.
- ***Specialist intermediaries*** – Specialist intermediaries can assist governments to bring different sector participants together and develop viable social investments. For example, Impact Investing Australia has developed a blueprint for an organisation called Impact Capital Australia, that would operate to accelerate the growth of the market by supporting investors and mobilising capital and other resources.[6]

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

A key benefit of social impact investing is that it can be applied to a broad range of social issues. QBE notes and broadly supports the future investment suggestions raised in the Discussion Paper, including early childhood care, education and employment, disability and aged care, and recidivism. Other options suitable for an outcomes-based approach could include environmental bonds

[6] Impact Investing Australia, *Blueprint to Market: Impact Capital Australia*, 2015, https://impactinvestingaustralia.com/wp-content/uploads/Blueprint-to-Market-Impact-Capital-Australia.pdf.

supporting green infrastructure developments, and health services including chronic disease prevention.

Given our general support for the development of the social impact investment market, QBE is presently open to investing in a broad range of opportunities, even where they are not directly aligned with our core business interests. As the market develops, however, we see potential benefit in aligning with investments that could also draw on our insurance expertise. By way of example, as one of two major providers of lenders' mortgage insurance, QBE is very interested in supporting affordable housing and homelessness initiatives. Similarly, given our significant presence in motor vehicle insurance, including state compulsory third party schemes, QBE is very interested in providing support and leveraging our expertise for road safety initiatives.

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

Value for money
QBE supports this principle and believes value for money – for governments, service providers and investors – will be fundamental for the successful development of the social investment market. Cross-sector collaboration and service innovation improve outcomes for all stakeholders. While social investments tend to involve high transaction costs, they also improve capacity and encourage innovation in government and the social sector more broadly. QBE also recognises that these benefits can be measured in different ways and notes that the degree of innovation involved in individual projects is another lens through which benefits can be measured.

Robust outcomes measurement and evaluation
Credible, scalable development of the social impact investment market will need to be supported by clear outcomes measurement and evaluation. As noted earlier, we consider there is an important role for the Australian Government by improving data accessibility and quality and standardising outcomes metrics.

Fair sharing of risk and reward
QBE strongly agrees with this principle. Institutional investors are unlikely to be attracted to most of the bond opportunities presently on the market. Some of the reasons for this have been canvassed above, but another key factor is the need for public and private sector partnerships to involve a fair and equitable allocation of risk between the parties. To date, the level of government risk sharing seen in state social benefit bonds has supported the development of the market. The use for example, of a standing charge covering a minimum level of service delivery payments as performance, outcomes data and returns become established is valued at this early stage of market development and can be important in attracting investor interest.

Globally, a number of governments have shown interest in transferring risk to private sector investors in order to test innovations by purchasing outcomes, instead of outputs. This area is still evolving, and perspectives vary as to the degree to which risk should be transferred to the private sector, and the level of return appropriate for that risk. QBE believes that positive social outcomes are more likely to be achieved when all participants have some 'skin in the game'.

A deliverable and relevant social outcome
QBE agrees that social impact investments should be directed towards social and/or environmental outcomes which are key priorities for the relevant government.

Further information

QBE appreciates the opportunity to respond to the Discussion Paper and reiterates our interest in lending our expertise and taking an active role, as an institutional investor, in the development of the social impact investment market.

Please do not hesitate to contact Kate O'Loughlin at kate.oloughlin@qbe.com or on (02) 8275 9089 if you would like to discuss any aspect of this submission, or if you require any further information.