

---

**FEBRUARY**  
**2017**

---

# **SOCIAL IMPACT HUB**

## **SUBMISSION IN RESPONSE TO THE AUSTRALIAN GOVERNMENT SOCIAL IMPACT INVESTING DISCUSSION PAPER**

Written by Ellen Fulthorp and Jessica Roth



# TABLE OF CONTENTS

<b>ABOUT THE SOCIAL IMPACT HUB .....</b>	<b>3</b>
<b>RECOMMENDATIONS .....</b>	<b>4</b>
<b>INTRODUCTION .....</b>	<b>5</b>
<b>THE IMPACT INVESTING MARKET .....</b>	<b>6</b>
<b>ROLE OF THE AUSTRALIAN GOVERNMENT IN THE IMPACT INVESTING MARKET.....</b>	<b>7</b>
<b>PRINCIPLES FOR IMPACT INVESTING .....</b>	<b>9</b>
<b>REDUCING REGULATORY BARRIERS.....</b>	<b>9</b>
Private Ancillary Funds.....	9
Superannuation law .....	10
Program-related investments .....	11
Legal structures for social enterprises .....	12

## ABOUT THE SOCIAL IMPACT HUB

The Social Impact Hub (SIH) brings university students together with industry, social enterprises, not-for-profits and foundations to develop and conduct applied projects in fields of social impact under the supervision of industry experts. This innovative program aims to foster the next generation of social change agents, whilst providing not-for-profits and social enterprises access to high quality, industry-standard consulting, policy, research, advocacy and advisory services.

SIH has done a significant amount of work that is relevant to the questions raised in the Social Impact Investing Discussion Paper January 2017 (Discussion Paper) and these will be referenced at the appropriate points. These pieces of work include:

- We have written a [Field Guide to Impact Investing for Australian Charitable Trusts and Foundations](#), which was launched at Macquarie Group in October 2015. We wrote the Guide to help increase the participation of foundations in impact investing, and in turn, contribute to the strength of the Australian impact investment market, as well as increasing the impact of foundations.
- We have conducted a [Case Study of Benefit Corporations in the US and the Lessons for Australia](#), together with B Lab Australia.
- We were fortunate to receive a grant from the Impact Investment Readiness Fund (now the Impact Investment Ready Growth Grant) to support our capacity building work to help a social enterprise called RAW Impact become investment ready. We helped RAW Impact with its impact measurement framework, as rigour around impact measurement is an important part of impact investing.
- In 2014 (before the establishment of the Impact Investment Readiness Fund), we conducted a review of the UK Investment Contract Readiness Fund, together with The Different Incubator, and identified the lessons for Australia.
- We published a research report called [Impact Investing to Reduce and Prevent Youth Homelessness](#), in collaboration with the Mercy Foundation. It was launched at Ashurst in September 2016.
- We will shortly launch an Impact Investing Hub, with the support of the Impact Investment Summit and building on initial work by Impact Investing Australia. The Impact Investing Hub maps the current impact investing ecosystem in Australia and the deals so far. It will also provide a listing of current investment opportunities.

## RECOMMENDATIONS

### **Recommendation 1**

That the Australian Government use the term ‘impact investing’ rather than ‘social impact investing’.

### **Recommendation 2**

That the Australian Government establish a dedicated Office of Impact Investing.

### **Recommendation 3**

That the Australian Government consider the importance of an independent market building organisation like Impact Investing Australia and the need to provide some core funding to enable its work to continue.

### **Recommendation 4**

That the Australian Government consider other ways it can proactively develop the impact investing market, such as supporting in-person convenings like the Impact Investment Summit Asia Pacific or competitions or prizes.

### **Recommendation 5**

That the Australian Government add sustainable agriculture to the list of areas that hold the most potential for impact investing.

### **Recommendation 6**

That an ancillary fund should satisfy the meaning of ‘control’ for the ‘sophisticated’ investor test and the ‘wholesale client’ test if at least one director of the Trustee who personally satisfies the test agrees to undertake a particular investment, as proven by the minutes of the meeting. This is in addition to the existing criteria of the fund itself having net assets of at least \$2.5 million or income of at least \$250,000 in each of the past two years.

### **Recommendation 7**

That the Australian Government implement an enhanced program related investment framework that recognises the total loan for the purposes of meeting the ancillary fund’s minimum annual distribution.

### **Recommendation 8**

That the Australian Government create the benefit corporation as a distinct legal structure.

## INTRODUCTION

Impact investing has the potential to drive meaningful positive social and environmental change and thus ensure sustainable economic growth in Australia. SIH asserts that impact investing can play a critical role in positioning the financial system to best meet Australia's evolving needs and support the country's economic growth. As such, SIH is very pleased that the Australian Government is considering its role in developing the impact investing market and consulting with stakeholders.

As a preliminary matter, SIH prefers the term 'impact investing' to 'social impact investing'. The Financial Systems Inquiry used the term 'impact investment' in both their interim report and final report. SIH strongly urges the Government to replace references to 'social impact investing' with 'impact investing' as the latter term encapsulates all opportunities that offer social, as well as environmental and cultural returns (as well as of course financial returns) – instead of limiting the focus just to social returns. We use the phrase 'impact investing' throughout this paper.

### **Recommendation 1**

That the Australian Government use the term 'impact investing' rather than 'social impact investing'.

SIH notes that submissions are being processed by the Housing Unit in the Social Policy Division of Treasury. In addition, in the media release accompanying the release of the Discussion Paper, the Treasurer, the Hon Scott Morrison MP, spoke at length about the applicability of impact investing to housing. Even though affordable housing is a significant area of opportunity for impact investing, there are so many other areas where impact investing could be applied and all areas should be given equal consideration. The Government should establish a dedicated unit in Treasury (or elsewhere) to drive the adoption of impact investing across Government, rather than just using the Housing Unit to have carriage of the matter.

### **Recommendation 2**

That the Australian Government establish a dedicated Office of Impact Investing.

This balance of this submission responds to the consultation questions as set out in the Discussion Paper. SIH's comments on the Discussion Paper follow the structure of the paper in being separated into four key components: (1) impact investing market; (2) the role that the Australian government should play in the impact investing market; (3) principles for impact investing; and (4) potential regulatory barriers to the growth of the social impact. The consultations questions are answered with reference to the numbering and structure of the questions in the Discussion Paper for clarity and ease of cross-

referencing.

This submission was prepared by Ellen Fulthorp, a UNSW Law student completing the Social Impact Hub Clinic, and Jessica Roth, Director and Founder of the Social Impact Hub.

## THE IMPACT INVESTING MARKET

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?

The impact investing market in Australia is a very small proportion of the investing market at large, at an estimated \$3.7 billion out of \$633 billion in assets invested per the Responsible Investment Benchmark Report 2016.<sup>1</sup> Growth in the market is necessary to (a) maximise impact and (b) ensure the sustainability of impact investing in the investing market. The main barriers to growth include the limited access to product and the short track record of impact investing making the prospect of impact investing seem riskier than it is. The setup and due diligence costs also act as large barriers to creating impact investments.

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

In the future, we hope that impact investing will be as common and popular amongst retail investors as investing in shares, bonds, foreign exchange or housing.

Hopefully all investments will become impact investments, and considering impact will just become another dimension in assessing investments, like risk and return.

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

There are a number of barriers constraining the growth of the market and these are addressed in the regulatory section - PAFs as sophisticated investors, the lack of clarity for superannuation trustees, program-related investments and the legal structures for social enterprises.

---

<sup>1</sup> Responsible Investment Association of Australasia 2016, Responsible Investment Benchmark Report 2016, p. 10, <http://impactinvestingaustralia.com/wp-content/uploads/impact-investing-Australia-2016-Investor-Report.pdf>.

# ROLE OF THE AUSTRALIAN GOVERNMENT IN THE IMPACT INVESTING MARKET

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

The Discussion Paper notes two types of roles that the Australian Government can play in developing the impact investing market: creating an enabling environment and funding (or co-funding with State and Territory Governments) impact investments. SIH supports both of these roles, and encourages the Government to take an even more active role in building the market.

SIH also acknowledges the important work of Impact Investing Australia as an independent market building organisation. It has achieved a significant amount in the last three years and there is more that Impact Investing Australia could do, potentially shifting to become a peak body for the sector. However, given that the market is still developing, the financial viability of this peak body model is limited. Therefore it is suggested that the Government consider the importance of the role of an independent organisation like Impact Investing Australia and alternative ways it might need to be funded.

Additionally, the Government can play an important role in educating the market about impact investment. There should be more programs to teach impact investing at a tertiary level as well as competitions or prizes that serve to encourage talented individuals to seek full-time positions in the impact investing market. The Government should also consider supporting existing market building activities, such as the Impact Investment Summit Asia Pacific.

## **Recommendation 3**

That the Australian Government consider the importance of an independent market building organisation like Impact Investing Australia and the need to provide some core funding to enable its work to continue.

## **Recommendation 4**

That the Australian Government consider other ways it can proactively develop the impact investing market, such as supporting in-person convenings like the Impact Investment Summit Asia Pacific or competitions or prizes.

Question 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?

Collaboration between different government levels is essential to maximise the growth of the impact investing market. If the Australian Government savings

could be counted in addition to the State Government savings, that could grow the size of potential transactions significantly.

For example, the Social Impact Hub conducted a report into homelessness impact investment mechanisms. Comprehensive services in the area of homelessness reduce the need for temporary accommodation, healthcare and justice costs, all State government costs. However, there may also be savings in relation to Medicare and Centrelink, Australian Government programs. It would be highly beneficial to count these savings towards the total savings generated.

As mentioned above, SIH recommends the establishment of a dedicated Office for Impact Investing in Treasury. It would be part of the responsibility of this Office to work on joint initiatives with State Governments and ensure that effective communication occurs across government levels.

**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?**

SIH supports the seven areas identified by EY as holding large potential for impact investing.

SIH also endorses Blue River's suggestion to add sustainable agriculture as a potential area of opportunity. The Government has viewed impact investing through a very narrow 'social' lens, and it would be very beneficial to broaden the lens to include investing that has a beneficial environmental impact, in addition to social impact.

#### **Recommendation 5**

That the Australian Government add sustainable agriculture to the list of areas that hold the most potential for impact investing.

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

There are significant opportunities for collaboration between the Australian Government and State and Territory Governments in the impact investing space.

Examples include joint savings as recommended in Question 5, especially in relation to health care impact investments as well as education.



## PRINCIPLES FOR IMPACT INVESTING

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

SIH broadly agrees with the four proposed Principles.

We agree with the suggestion made by a number of other organisations about a fifth principle regarding co-design with stakeholders. Community input is critical to ensure that the investment proposals are well suited to the issues they are designed to address.

SIH also encourages the Government to emphasise a streamlined approach. It is critical to minimise the bureaucracy and make the process as straightforward as possible. For example, ideally Government should accept submissions for proposals that are not in chosen priority areas, and be flexible enough to work to different timeframes if the private sector parties request this.

## REDUCING REGULATORY BARRIERS

### PRIVATE ANCILLARY FUNDS

Question 12: 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?

Question 14: 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?

Question 15: How could these options be best incorporated within the appropriate legislation?

Question 16: 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?

SIH is pleased that the Government is committed to providing greater certainty for PAFs controlled by sophisticated investors.

SIH supports the recommendation from Philanthropy Australia that control could be demonstrated if at least one director of the Trustee personally satisfies the sophisticated investor test, and they are present at the meeting that approves the particular investment (and they support it). The minutes of the meeting should be sufficient to prove this.

For example, if an investment decision maker, such as the Chief Investment Officer, is considered a sophisticated investor, the underlying PAF should similarly be classified as a sophisticated investor. This would enable the PAF to access a greater number of investment offerings.

Requiring the majority of the directors of the trustee to themselves satisfy the sophisticated investor test and each provide an accountant certificate would be burdensome. It is acknowledged it would be less burdensome if the board of directors could just provide a letter stating that the majority of the directors themselves satisfy the sophisticated investor test, which is one option proposed.

The Australian Securities and Investments Commission (ASIC) acknowledged the legal uncertainty in relation to control of superannuation funds and provided clarity that the law can see the trustees in their personal capacities as a wholesale investor, rather than trustees needing to meet the \$10 million threshold of net assets in their superannuation fund. ASIC could potentially issue similar guidance in relation to PAFs.

In summary, there would be benefit in ASIC providing regulatory guidance specifically directed at PAFs which clarifies the operation of the relevant provisions of the *Corporations Act 2001 (Cth)*. This would clearly allow the corpus of PAFs to promote positive change through impact investments that are limited to sophisticated or professional investors.

#### **Recommendation 6**

That an ancillary fund should satisfy the meaning of ‘control’ for the ‘sophisticated’ investor test and the ‘wholesale client’ test if at least one director of the Trustee who personally satisfies the test agrees to undertake a particular investment, as proven by the minutes of the meeting. This is in addition to the existing criteria of the fund itself having net assets of at least \$2.5 million or income of at least \$250,000 in each of the past two years.

#### **SUPERANNUATION LAW**

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

As noted in the Discussion Paper, the Financial System Inquiry recommended that the Australian Prudential Regulation Authority (APRA) provide guidance to trustees on the appropriateness of impact investment for superannuation trustees.

APRA’s prudential practice guidance on investment governance was last updated in 2013 and this does not reflect the growth of the impact investing industry and the growing number of superannuation fund members who would like their managers to invest with an impact lens. There are a growing number of impact investment products across asset classes, so impact investments should not limit diversification. Impact investments should not be seen as a ‘category’ or a specific asset class.

The Discussion Paper states that impact investing can form part of a balanced investment strategy where it satisfies the section 52 requirements and is in the best interests of members. It could be said that it is in the best interests of all members of all superannuation funds to have their investments generate positive social or environmental impact as well as financial return (assuming the financial return is not compromised).

In addition, there is no legal reason why this could not be their complete investment strategy (rather than just part). It is possible to have a fully diversified impact investment portfolio across asset classes with market-rate returns.

If members were to ‘choose’ an impact investment strategy, there should be no doubt that it is possible for trustees to implement this.

Nevertheless, trustees are very cautious and so further guidance in relation to impact investing would be beneficial, especially given the guarded approach in the current guidance regarding diversification.

#### PROGRAM-RELATED INVESTMENTS

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

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

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

SIH supports the submission of Philanthropy Australia in advocating for an enhanced program related investments framework that recognises the total loan.

As previously noted, in 2015 we wrote a Field Guide to Impact Investing for Charitable Trusts and Foundations and we have been engaging with a number of ancillary funds in relation to this issue, so we also have feedback to draw upon from the sector.

SIH supports the view that valuing the difference between the market rate of interest and the concessional rate can be complex and if it is possible to implement a simpler framework, that would be preferable (even considering the recent changes to the ancillary fund guidelines and the issues noted with making further changes).

It makes sense to allow ancillary funds to make concessional loans and count the full amount of the loans as part of their minimum annual distribution and then add the repaid principal to the minimum annual distribution in the year it is repaid or the following year.

Ideally, this framework **would** apply to certain non-DGR organisations. However, given that this requires legislative change, perhaps the simplest first step is to just amend the Guidelines and then embark on legislative change.

SIH works with both DGR and non-DGR organisations and there is interest in an enhanced PRI framework from both types of organisations. SIH supports the criteria suggested in the Discussion Paper (and Option 2 of the Community Business Partnership report) that loans could be made to registered charities, organisations issuing social impact bonds in partnership with a government agency, or investments made through suitable impact investment intermediaries. As the Discussion Paper notes, PRIs in the US can be made to either a non-profit or a for-profit organisation.

### Recommendation 7

That the Australian Government implement an enhanced PRI framework that recognises the total loan for the purposes of meeting the ancillary fund's minimum annual distribution.

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

The cost of administration should not be too different for PRIs than grants. In theory, grants should require just as much rigour in the administration process to ensure effectiveness and measure impact.

Question 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?

As noted above, SIH does not believe there are issues with making further changes. Official guidance from the Australian Tax Office would be helpful in the transition.

We can also update our Field Guide to Impact Investing and help educate the sector about the changes.

### LEGAL STRUCTURES FOR SOCIAL ENTERPRISES

Question 28: Have you faced a legal impediment as a director of a social enterprise from making a decision in accordance with the mission of the enterprise, rather than maximising financial returns, that only a change in the legal structure could resolve? If so, what amendment to Commonwealth legislation, regulation or ASIC guidance would you consider is needed to address this problem?

Although SIH has not itself faced a legal impediment from making a decision in accordance with the mission of the enterprise, feedback from the enterprises we support view it as an issue. Regardless of whether or not it is a *real* issue, it is definitely a *perceived* issue. We believe that it would be highly beneficial to create a benefit company legal structure in Australia.

In 2014, the SIH conducted an analysis of the US benefit corporation and identified the lessons from Australia. The full report is available [here](#). The full report will not be extracted here, but we draw your attention to pages 32-36 specifically.

The benefit corporation legal structure would remove the reluctance of directors to consider the interests of non-financial stakeholders by creating a new statutory entity that requires companies to provide a public social benefit. In other words, the directors are required to consider the impact of decisions on all stakeholders, rather than shareholders alone, as assessed against a third-party standard. The

benefit corporation differs from other forms of hybrid companies. It is more rigid than a Low-Profit Limited Liability Company (L3C) and is subject to greater review.

The Discussion Paper states that there is a lack of evidence (beyond anecdotal concerns) that directors of a social enterprise have been found liable for acting in ways other than purely maximise profit. There is also a lack of evidence or precedent to reassure directors about their liability if they take public benefit into account. This lack of evidence on both sides gives rise to caution amongst directors.

Without legislative change, it is highly unlikely that directors will be comfortable in considering public benefit as part of their core business. In addition, a change of control event brings the issue into sharp focus and as the Discussion Paper notes, there is particular uncertainty for directors at this point in time. Benefit corporation legislation would provide directors with the comfort required.

A similar situation existed in the United States and 31 separate states have now understood the case for the benefit corporation and passed the relevant legislation. A further 8 states are working on the passage of the legislation.

There are also a number of other compelling reasons to create a distinct legal structure, many of which have been outlined by Impact Seed in detail. We also refer you to the submission made by B Lab Australia and New Zealand, as well as the Prime Minister's Community Business Partnership.

#### **Recommendation 8**

That the Australian Government create the benefit corporation as a distinct legal structure.

**Question 29: Would making a model constitution for a social enterprise assist in reducing the costs for individuals intending to establish a new entity? What other standard products or other industry-led solutions would assist in reducing the costs for individuals intending to establish a social enterprise?**

SIH submits that a model constitution for a social enterprise would assist in reducing the costs for individuals intending to establish a new entity.

The Discussion Paper states that it is important that emerging social enterprises have access to advice and assistance on the most appropriate legal form and business structure to support their ventures and an expanding range of intermediary organisations are playing this role. The School for Social Entrepreneurs is mentioned in this context, but it should be noted that the School for Social Entrepreneurs Australia has now closed down. It was not financially viable for them to be providing these services to social enterprises.

Just as it was suggested earlier that the Government contribute to supporting enterprises to become impact investment ready, the social enterprise sector would also benefit from broader support to accelerate the growth of social enterprises. For example, perhaps enterprises could apply to a fund to have their establishment legal costs covered.



The intermediaries supporting the sector, including SIH, would potentially be able to scale our services and support the establishment and growth of more social enterprises with Government funding.