social ventures australia

Senior Adviser
Financial System and Services Division
The Treasury
Langton Crescent
PARKES ACT 2600

31 March 2015

Dear Sir/Madam,

Financial System Inquiry Final Report

Please find attached Social Ventures Australia's response to the Financial System Inquiry's final report.

Do not hesitate to contact me if you wish to discuss the matter of our submission in further detail.

Kind regards,

Ian Learmonth
Executive Director, Impact Investing

Introduction

Social Ventures Australia

SVA is a not for profit organisation who over the last thirteen years has worked with over 100 social enterprises with proven track records in tackling the issues behind social disadvantage. We have also delivered over 550 projects through our strategic consulting service, many supporting social enterprises to develop and grow. By partnering with these innovative, entrepreneurial ventures we know that traditional avenues for capital raising are not meeting the market need. There are limited funding options open to the social sector to help grow proven ventures, particularly to support the building of quality organisations through the provision of appropriate infrastructure funding.

In 2009, SVA played a pivotal role in orchestrating the GoodStart syndicate comprising four non-profit organisations - SVA, Mission Australia, The Benevolent Society and The Brotherhood of St Laurence. Through the development of a new social capital model, the syndicate was able to raise $165m to successfully bid for 650 ABC Learning Centres and is now running these centres with business discipline for a social purpose.

In 2012, SVA established a social impact fund under the Commonwealth Government's SEDIF program. The fund has over $9m to lend and invest in social enterprises across Australia and to date is approximately 40% invested. SVA brought in more than 35 investors to match the Government grant of $4m to create the fund which fills a gap in the mainstream financial system.

SVA launched Australia's first social impact bond in 2013, the $7m Newpin SBB[1] which used private capital to fund a restoration program for children in foster care in NSW. This 'payment upon success' model allowed Government to evaluate the success of the program before committing to pay for the anticipated savings, as well as generating both financial and social returns for investors. The bond is now 18 months into its 7.25 year term and has reported a successful 60% Restoration Rate success which delivered investors a return of 7.5% in the first year. SVA has also advised the Western Australian, South Australian and New Zealand Governments on the implementation and development of social impact bonds in their separate jurisdictions.

SVA believes a new social capital market needs to thrive alongside traditional financial markets and we are keen to develop the new asset class of social impact investment as it becomes increasingly part of the mainstream.

Submission

SVA made an initial submission to the Financial System Inquiry on 31 March 2014 followed by a submission on 25 August 2014 in response to the Financial System Inquiry Interim Report. We welcome the inclusion of impact investment in the final report under Recommendation 32 and are pleased that the Inquiry found merit in Government facilitating

[1] Social Impact Bonds have been named Social Benefit Bonds in NSW.

the impact investment market. Our initial submission suggested that impact investment and social impact bonds fell within the terms of reference of the Inquiry and we welcome the consideration of several of our key themes in developing this market in the final report.

We note that since the original Financial System Inquiry submissions the Government-commissioned Review of Australia's Welfare System has been released and the Prime Minister's Community Business Partnership has been formed, both of which consider impact investment and innovation in social service delivery.

We also note and are pleased by the establishment of the Office of Social Impact Investment under the Department of Premier and Cabinet in New South Wales which is exploring further impact investing opportunities. The increase in attention and interest in impact investment and the sector is encouraging; however, it is clear that a Government must take a lead role in growing the market.

Our key themes to developing the market include:

- Establishment of a dedicated social 'investment bank' or fund;
- Implementation of tax concessions and incentives;
- Strengthen the roles of intermediaries in this market; and
- Review the structural barriers to appropriate investment

In this responding submission to The Treasury, we make three recommendations in line with Recommendation 32, noting the request to withhold tax based recommendations for the Tax White Paper. As part of our recommendations we have also tried to provide views on the costs, benefits, and trade-offs under some of the recommendations.

Recommendation 1 - Government undertake an active role in expanding the Australian impact investment market by establishing a social 'investment bank' or fund with assets of up to $250m. This fund would also undertake some earlier stage capacity building for social enterprises.

Government should take a leadership role in catalysing the Australian impact investment market because a larger and more robust market will realise savings and benefits to the community, Governments of all levels and taxpayers. An expanded market will result in increased capital flow to the community sector, encourage innovative social service delivery and improve data collection and reporting. SVA's experience with impact investing over five years to date highlights each of these benefits. The Australian Government can assist in the expansion of the market by establishing a dedicated wholesale social 'investment bank' or fund similar to the UK's Big Society Capital[2].

A social investment bank or fund of this nature would fund;

- loans, guarantees and investment capital to growing and dynamic social enterprises, NGOs and community organisations,

[2] http://www.bigsocietycapital.com/

- the development of the Australian social impact bond market,
- social and affordable housing development particularly in light of the discontinuation of the NRAS program,
- the working capital shortfall with NGOs across sectors such as employment and disability due to the more outcomes based contracting by Governments,
- the significant funding needs around the implementation of the NDIS, and
- social investment intermediaries.

SVA would recommend that the bank or fund is seeded with up to $200 – 250m million in the first instance to meet the capital required by the market.

The ‘bank’ could be funded in an efficient way for Government including consideration of the following options;

- Option 1 - Establishing a dedicated lending and investing institution funded by the Government at the Commonwealth Bond rate and managed by someone with the requisite experience and track record. By using competitive Government funding rather than a grant it would also limit the impact on the Commonwealth budget.[3]

- Option 2 - Alternatively the Government could grant fund the social investment bank matched by private investors such as superannuation funds, Private Ancillary Funds and High Net Worth individuals on a ‘dollar for dollar’ basis. Funding by way of a grant would allow the social investment bank to take greater risks than the debt funded approach under Option 1. The Government could look at accessing unclaimed superannuation and/or unclaimed bank accounts (as undertaken successfully in the UK with Big Society Capital) and use such unclaimed monies to support the grant. This grant matching model has been successful with the smaller SEDIF[4] pilot program of 2011.

A wholesale social investment bank would expand the pool of capital available for social enterprises and enable a sector to access finance that has otherwise been left behind by the mainstream financial service providers. It would allow for more appropriate financial products and services and specifically strengthen the role of financial intermediaries in the impact investing marketplace.

The vehicle could also invest in social impact bonds as well as create liquidity in that fledgling market. The social investment bank could underwrite more risky investments and provide capital protection to ‘crowd in’ other impact investors. Our first-hand experience suggests that there is market appetite amongst impact investors to invest in such a vehicle and the experience, resources and infrastructure required could be easily accessed.

[3] The proposed ‘social investment bank’ is similar to the $100m ‘Social Transition Fund’ which SVA proposed to the Prime Minister earlier this month. This initiative was in response to the growing impact investor appetite for new and larger investment opportunities. The proposed Social Transition Fund could also be match-funded by impact investors.

[4] SEDIF - http://employment.gov.au/social-enterprise-development-and-investment-funds

Research into the equivalent UK market suggests that it can be expected to grow at 38% per year, much of which can be attributed to the involvement of government in establishing a bank which allows for greater capital flow, higher-risk models of payment, payment by success contracts and social procurement policies.[5]

The US National Advisory Board on Impact Investing comments that for the impact investing market to reach its full potential, 'it will require a more intentional and proactive partnership between government and the private sector'[6]. A state based impact investment bank has also been recommended for the US context.

A 'social investment bank' or fund that also had deductible gift recipient status could also attract grants from philanthropic funds and other grant making entities. These funds could then be used to meet the demand for capacity building grants and early stage social enterprise funding. International experience, particularly in the UK and US, provide specific examples of the positive and proactive involvement of government in expanding the impact investing market in this way.

A more proactive government involvement in the development of the market through the establishment of an impact investment 'bank' or fund would encourage innovation in funding social service delivery.

Recommendation 2 - Classify a private ancillary fund as a sophisticated or professional investor for the purposes of the exemption from the prospectus regime where the sponsor or ultimate controller of the fund meets either of these thresholds.

The final report identifies that some uncertainty remains under the *Corporations Act 2001 (Cth)* as to whether certain PAFs technically meet the sophisticated or professional investor test under the Corporations Act exemptions from the prospectus regime. This uncertainty presents an unnecessary barrier to participating in the market given that the individuals that control these vehicles are invariably sophisticated investors.

There is an increasing number and size of PAFs being established in Australia. With a corpus of over $3.5 billion, these entities have significant impact investing potential. This was demonstrated by those looking to participate in the NSW social impact bond trials and the recent SEDIF funds. Clarifying their classification as sophisticated or professional investors based on an analysis of their ultimate funder or controller will in turn unlock and increase capital flow to the sector.

SVA believes that this is an area of unnecessary uncertainty, which presents a barrier to PAFs investing in social impact bonds and potentially other impact investing products.

Recommendation 3 - Provide guidance to superannuation, charitable and philanthropic trustees which allows them to take into account social, ethical and environment considerations in determining the correct return in making impact investments.

[5] Boston Consulting Group, 'The First Billion', 2012 (https://www.bcg.com/documents/file115598.pdf)
[6] US National Advisory Board on Impact Investing, 'Private Capital, Public Good', 2014 http://static.squarespace.com/static/539e71d9e4b0ccf778116f69/t/53aa1681e4b04a6c515fac31/1403655809489/Private_Capital_Public_Good.pdf

We note the FSI interim report noted *'Superannuation funds and philanthropic trustees have indicated willingness to engage in the market, however, uncertainty remains whether the relevant regulations preclude their participation in the market'.*

The only real uncertainty as seen by SVA is that trustees of a superannuation fund may feel the sole purpose test[7] could be compromised in making such an investment. The sole purpose test includes the principle that requires trustees to invest purely on financial merit and they should not incorporate any social, environmental or ethical elements into the risk/reward equation of any decision making.

In summary, we would propose that it is beneficial to the development of the impact investment market to allow the trustees and/or directors of superannuation funds, charities, endowments, PAFs and Public Ancillary Funds to also take into account social, environmental and ethical considerations when making an investment. This has been acknowledged in the UK[8] to relieve directors and trustees of charities of any risk when making such a decision. Increasingly the relevance of the underlying social merit of an investment features in the decision making across the broader investment community.

Next Steps

SVA would recommend establishing a targeted working group with representatives from the impact investing sector and Treasury to look at the practical measures to implement the recommendations as suggested above. SVA has undertaken a significant amount of background work across all the suggestions above and would be happy to share our experiences with Government.

Further information

We would be pleased to discuss any aspect of this submission with Treasury at a convenient time.

Please contact **Ian Learmonth** at Social Ventures on 02 80046729 or
ilearmonth@socialventures.com.au

7 http://www.superguide.com.au/superannuation-topics/sole-purpose-test
8 http://www.charitycommission.gov.uk/detailed-guidance/money-and-accounts/charities-and-investment-matters-a-guide-for-trustees-cc14/#b