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The following submission is submitted for and on behalf of Foresters Community Finance Ltd (Foresters).

Foresters is Australia's leading Community Development Finance Institution (CDFI). The core of the work that Foresters undertake is to assist nonprofit organisations to build financial and social sustainability thereby making a contribution to the strength of civil society.

Foresters focus largely on channelling capital into underserved markets that typically have difficulty securing finance from mainstream financial markets. This finance or investment strategy has to date been utilised to assist with the acquisition of strategic assets that are aligned with the mission of those nonprofit organisations.

The capital required to complete these community finance projects is achieved by offering social investment products that provide sound, transparent investment choices for a growing community of Australians who are looking for both financial and social returns. Funds are invested in the Community Investment Fund which aims to preserve capital and generate a financial return through finance and investment transactions.

Foresters has also developed an extensive Social Innovation Education program to meet the growing demand for access to education and training that builds capacity in nonprofit organisations. People with the community sector want to unlock their creativity, be exposed to new ways of thinking and stretch beyond the limitations of traditional charitable approaches to socials issues.

This submission is focused almost solely on 'Principle 1 – PPFs are Philanthropic' and specifically on the investment of capital into Social Investment products as an alternative to current market investments.

Please direct any queries with regard to this submission to contact details below.

Thanks and regards,

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Principle 1 – PPFs are Philanthropic

"For PPFs to be truly philanthropic the focus must be applied as much to the invested capital base as it is to the transfer or distribution of any income that is generated."

The proposed changes relating to 'required distributions' in the new guidelines are positive in that there is a clear, equal and concise standard for all parties that would ensure increased functional efficiencies and reduced costs. The benefits for this will be immediate and sustainable and go some way to reinforcing the principle that PPFs are philanthropic.

Foresters firmly believe however that this is only part of the solution. While there is in part a positive shift to transferring a percentage of the total value of the fund at the end of each financial year there is still an omission to cast any review or assessment on where the capital is invested throughout the life of the PPF.

<u>Who profits from current capital investment</u>

The choices currently available to trustees of PPF's are limited to investments in the mainstream financial services market. In our consultation with PPF trustees and other peak bodies that work with large numbers of PPFs this view is confirmed. Most of the capital is in fact invested in cash or share equity products.

These funds are placed with and managed by banks, fund managers, broking firms and other financial institutions that in turn benefit by means of interest margins, transaction fees and other revenue generated from the management of these funds. The profits derived from the activities of these institutions are then paid to the shareholders of these companies.

We are certainly not opposing the role of these financial institutions in relation to providing services to PPF's, however, we are asserting that a more creative approach to the investment of this capital could be taken that sees the profit from investment activities remain within the community sector.

<u>Mission aligned investment of PPF Capital</u>

In the United Sates the concept of mission aligned investment is well understood among both philanthropic and community sector organisations. Essentially mission aligned investment is a direct and positive investment of capital in a way that achieves a community outcome at the same time as making the organisations or philanthropist a social return. Generally these investments are made through social investment products specially designed for community purposes.

The concept is relatively new in Australia, but even so may provide a real solution in relation to aligning the capital of a PPF to its mission. For example, if the mission of one such PPF was to ensure its funds, through sufficient annual distributions, were dedicated to making a difference to the employment of marginal individuals and these regular transfers were being made to a suitable nonprofit organisation with DGR status then it would be perceived under the proposed new guidelines as being philanthropic.

If this PPF however has heavily invested its capital directly (share ownership) or indirectly (i.e. managed fund) into a number of organisations that either don't employ any marginalised individuals or are going through significant job cuts, would the impact of the PPF's capital still be deemed to be philanthropic? Are its invested funds mission aligned if these two facts are not in alignment?

This is not a hypothetical question but one that was raised recently by an organisation who, like a PPF, have invested funds for which the purpose of those funds should be for community benefit (philanthropic).

Any such attempts to introduce, maintain and enforce the principle of social investment of the core capital would be exhaustive in terms of time and costs for all parties. It should also be acknowledged from our experience that most PPFs have been established with the right values and would not knowingly make unethical or immoral investments that would have a detrimental impact on the communities or civil society with which they are attempting to assist.

So while the 'stick' approach is neither commercial nor entirely necessary the alternate as always is done so with the 'carrot' in the form of an incentive or encouragement.

Foresters proposed addition to the new Guidelines.

On page 4 of the discussion paper in point 16 it states that "PPFs should neither be prolonged accumulators of funds, nor sparse distributors of funds". This would certainly be the case if the funds being accumulated were invested in markets that had no correlation to the philanthropic sector. If however the capital funds were invested directly into a 'social investment' product then in fact you could deem the PPF to have an increased philanthropic position.

Foresters propose that any funds that are invested in markets and/or products not correlated or aligned with the philanthropic sector must abide by the proposed new guidelines and distribute the agreed percentage (15%) to suitable nonprofit organisations.

For any funds that are invested in markets and/or products that are established and directly aligned with the provision of finance or investment directly into the philanthropic sector then these funds would only be required to distribute the income that is generated from this investment.

To provide further explanation if an organisation has 50% funds in cash and equity then the total value of this portion of the PPF would be calculated at the end of the financial year and 15% of the value would be required to be distributed appropriately. If the remaining 50% is invested in Foresters Community Investment Fund then only the income generated from this fund over the same period would be required to be distributed.

These guidelines would ensure that for any funds not deemed to be philanthropic investments still maintain a distribution strategy where the 'regularity and quantity of transfers are such that the fund is characterised as philanthropic'. Any such funds that are deemed to be philanthropic investments would obviously and clearly demonstrate that the fund is indeed philanthropic.

Maintaining Social Investment Capital Value

The importance of building a large corpus of social investment funds would argue that the capital base be maintained for continued investment into the future as opposed to any attempt to erode that capital on a yearly basis.

Providing finance and/or investment to nonprofit organisations requires patient capital that is not forced to be reduced over the short to medium term. Social Investment is also very unlikely to generate returns that will match any proposed percentage (15%) for distribution of total fund value as indicated in the new guidelines. In fact to do so would be counter productive as it is the nonprofit organisations that would essentially be paying for these returns.

So it is essential that if any funds deemed obligatory for community benefit that are placed in an approved Social Investment product, the necessity to reduce any capital should be removed. Any income should be transferred appropriately and the core capital base maintained for the purpose with which it serves.

Placing a cap on Social Investment within each fund

Any such move to adopt the Foresters proposal may see a large influx of PPFs looking to place funds into Social Investment. While this would be favourable for Foresters and perhaps even the development of the social investment market more broadly we understand there may be impacts on the quantity of funds being distributed to appropriate organisations.

Rather then placing a cap on funds placed in Social Investment however it is suggested that the incentive itself cease at 50% of the total capital in the PPF. So if a PPF should choose to invest 80% of the total value in the Community Investment Fund the additional 30% would still be required to distribute in line with the proposed guidelines.

This would allow PPFs to invest as they saw necessary into Social Investment products, provide an incentive for them to do so for a portion of their portfolio and prevent them from prolonging the accumulation of funds.

<u>Social Investment organisations and products</u>
Community Development Finance Institutions (CDFIs) are plentiful and well regarded in both the UK and US and have contributed significantly to strengthening areas of the community that required additional assistance. At this point in Australia Foresters is the only organisation that offers true Social Investment products.

Foresters would welcome the development of this field in Australia and encourage the establishment of new organisations to offer similar service propositions and product offerings. Should there be a necessity to approve Foresters and other CDFIs as suitable organisations for investment by PPFs we would welcome that endeavour.

In the interim with Foresters being the only organisation that would accommodate these financial product offerings we would gladly work closely with Treasury and other necessary parties to ensure any concerns around risk, compliance, legal and regulatory issues were mitigated.

<u>Summary</u>
Foresters proposed changes to the new Guidelines are listed as follows:

1. Encourage funds that have been allocated for ‘community benefit’ to be invested in the community
2. Similarly, incentivise PPFs to invest in Social Investment (SI) products for the benefit of civil society
3. Allow 50% of total value of PPFs to be invested in SI products without diluting capital
4. Capital up to 50% invested in SI products must distribute the annual income
5. Capital above 50% invested in SI products will be treated as per non SI capital
6. Assist build an awareness of SI opportunities among the PPF arena

Foresters are confident there will be strong growth in Social Investment within Australia as has been the case in other parts of the world in recent years. The growing demand from nonprofit organisations seeking ‘fair’ finance from the community is significant and continues to grow.

In parallel there is a rumbling groundswell of people and organisations wanting to invest in areas that are improving local communities and tackling national social inequities while at the same time meeting their financial requirements.

The development and growth of the Social Investment industry will strengthen nonprofit organisations and in turn strongly benefit our local communities. Foresters are also completing some initial research and development on applying the principles of SI to tackle large scale social inequities such as affordable housing, social enterprise, early childhood education and personal fair finance.

Support from Government would simply reduce the time frames of achieving these critical outcomes.

The following supporting documents will be found in these links:
1. Foresters Community Investment Fund Product Statement
2. Information Statement for the most recent Foresters Community Finance Project
3. A paper released in Dec 2008 - ‘Possibilities for Community Development Financial Institutions’