Australian Government

Social Impact Investing Discussion Paper

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1 Introduction

1.1 Purpose

The purpose of this discussion paper is to explore ways the Australian Government can develop the social impact investing market. This discussion paper proposes that the Australian Government could primarily support social impact investing by creating an enabling environment for private sector-led social impact investing and by funding (or co-funding with State and Territory Governments) investments which generate savings or avoided future costs to fund reforms and deliver better outcomes for Australians.

Taking a social impact investment approach provides the Australian Government with an opportunity to fund 'what works' and reinvest spending that would otherwise not achieve beneficial outcomes.

In many policy areas relevant to social impact investing, the Australian Government is a funder or regulator. For example, the Australian Government has funded social impact investments in the Indo-Pacific region as part of a move towards innovative financing across the whole Australian aid program. The Australian Government is also responsible for financial market regulation, including the regulatory settings that affect social impact investing (see section 5).

State and Territory Governments are leading on social impact investing, consistent with their responsibility for the delivery of many services which could be delivered through social impact investing, including justice, homelessness and out of home care services. The discussion paper also seeks views on areas where the Australian Government has direct policy responsibility (see section 3).

The Australian Government could form partnerships with other levels of government to develop social impact investments. Such partnerships could involve sharing data critical to determining the outcomes of interventions. The split of roles and responsibilities between the Commonwealth, State and Territory and local governments shapes the role each level of government could effectively play in developing the social impact investing market.

Two reports have recommended the Government consider moving towards a social impact investment model for funding some social services. The 2015 review of Australia's welfare system, *A New System for Better Employment and Social Outcomes* (known as the McClure Report), recommended that the Government consider expanding outcomes based social impact investment models to target financial investments towards addressing social problems. [1]

In 2014, the final report of the Financial System Inquiry recommended that the Australian Government 'explore ways to facilitate development of the impact investment market and encourage innovation in funding social service delivery'.[2] As part of the Australian Government's response to the Financial System Inquiry, the Australian Government agreed to prepare a discussion paper to explore ways to facilitate the development of the social impact investment market in Australia.[3]

1 Department of Social Service 2015, *A New System for Better Employment and Social Outcomes*, Final Report, p. 175.

2 Australian Government 2014, *Financial System Inquiry: Final Report*, Recommendation 32, p. 261.

3 Australian Government 2015, *Government Response to the Financial System Inquiry: Improving Australia's Financial System*, p. 17.

Social impact investments are investments made with the intention of generating measurable social and/or environmental outcomes in addition to a financial return. Social impact investing is an emerging, outcomes based approach that brings together governments, service providers, investors and communities to tackle a range of social issues.

This discussion paper seeks comments on issues that are relevant to the role of the Australian Government in developing the social impact investing market in Australia.

1.2 INVITATION TO CONSULT

This discussion paper invites consultation on the Australian Government's role in developing the social impact investing market. We encourage participants from the community, charitable and private sectors, State and Territory Governments and the public to consider the issues set out in this paper and make a submission. A full list of questions posed in this discussion paper is at Appendix A.

There are three key components for consultation in this discussion paper:

1. The **role the Australian Government should play in the social impact investing market**. This discussion paper proposes that the Australian Government could primarily support social impact investing by (i) creating an enabling environment and (ii) by funding (or co-funding with State and Territory Governments) investments which would likely achieve savings to fund the intervention and deliver better outcomes for Australians.

2. The **principles for social impact investing** have been developed by looking internationally and at the State and Territory level to identify the key principles for effective social impact investments. The principles have also been informed by the Australian Government's experience in this field to date and consultation with stakeholders. We seek feedback on these principles from interested parties before they are finalised. Once the consultation closes, we will create a revised version of the principles that takes into account submissions.

3. This discussion paper also outlines **potential regulatory barriers** to the growth of the social impact investment market identified by stakeholders and research on the sector. It seeks views on potential ways that the Australian Government can act to address these barriers, with the aim of facilitating social impact investing.

We seek written submissions on the issues raised in this discussion paper by no later than 27 February 2017.

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1.3 Paper structure

Section 2 provides an overview of social impact investing including the main forms of social impact investment and the benefits and challenges of social impact investing.

Section 3 considers the role of the Australian Government, investors and service providers, and possible policy areas of opportunity for social impact investing for the Australian Government.

Section 4 sets out principles for social impact investing to guide the Australian Government's involvement in the social impact investing market.

Section 5 sets out possible regulatory barriers to the growth of the social impact investment market.

Appendix A sets out a list of all questions on which submissions are sought.

Appendix B sets out a glossary of key terms.

Appendix C provides background information on social impact investing.

Appendix D provides background information on how the Australian Government has supported the growth of the social impact market to date.

2 OVERVIEW OF SOCIAL IMPACT INVESTING

This section provides an overview of:

- the definition of social impact investing and the role of social impact investing;
- the main forms of social impact investing;
- the potential benefits and challenges associated with social impact investing.

For background material on social impact investing, including the size of the social impact investing market and where social impact investing sits in relation to philanthropy and mainstream investing, see Appendix C.

2.1 WHAT IS SOCIAL IMPACT INVESTING?

Social impact investments are investments made with the intention of generating measurable social and/or environmental outcomes in addition to a financial return.[4] Social impact investing is an innovative method of financing interventions to address intractable social or environmental problems.

The focus of social impact investing is delivering better outcomes. Measurement and evaluation is critical for investors to rigorously assess risk and financial returns, and for service providers and governments to assess outcomes and efficacy.

The Australian Government currently delivers and funds a range of services, including a welfare safety net, health services, services for Indigenous Australians and environmental sustainability measures. Social impact investing has the potential to complement (but not replace) the Australian Government's existing role and responsibilities across many portfolios. The key elements of social impact investing include:

- leveraging private capital;
- taking a 'try, test and learn' approach to trialling innovative ideas; and
- increasing the focus on outcomes and evaluation.

Social impact investing offers an opportunity to bring together governments and providers with investors who wish to see better social outcomes. Social impact investing also provides an opportunity to build a stronger culture of robust evaluation and evidence-based decision making in service delivery by learning 'what works'.

4 The environmental dimension of the social impact investing market is further developed than the market for social outcomes, which is the main focus of this paper. A 2016 report by Impact Investing Australia noted that on a dollar-weighted basis, most investment in the social impact investing market is directed to environmental outcomes. Green bonds in particular dominate the market, representing approximately $900 million: see Impact Investing Australia, *Benchmarking Impact: Australian Impact Investment Activity and Performance Report 2016*, http://impactinvestingaustralia.com/wp-content/uploads/Benchmarking-Impact.pdf. Additionally, the Clean Energy Finance Corporation provides and develops financing solutions for clean energy projects and technologies.

Service providers and philanthropic investors have an important role to play in social impact investing. Many government services funded by Government grants and competitive tenders are delivered by the not-for-profit sector and other services providers. In addition, the not-for-profit and philanthropic sectors play a crucial role in providing support for many Australians, and support for a sustainable future.

Case Study 1: The Murray-Darling Basin Balanced Water Fund (the Fund)

The Fund is Australia's first water investment fund to address environmental, agricultural, social and financial outcomes. The Fund is a collaboration between the Nature Conservancy Australia and Kilter Rural.

The Fund invests in Water Entitlements (permanent water rights) in the Southern Murray-Darling Basin and generates financial return for wholesale investors through capital appreciation and annual lease of entitlements, and trade of temporary water allocations.

The Fund also supports social and environment benefits. When water is scarce and demand is higher, more water is made available to agriculture, providing water security for farmers. When water is plentiful and agricultural demand is lower, more water is made available to wetlands, targeting areas of high ecological and Indigenous cultural significance. This has benefits for wetland restoration and supporting threatened freshwater species, and helping conserve sites of important cultural and spiritual significance to Indigenous people.

Initial capital raised in 2015 comprised $22 million in equity and $5 million in debt. The second capital raising will close in March 2017.

It is important to note that social impact investing is not suitable for funding every service. Social impact investing provides an opportunity to address problems where existing policy interventions and service delivery are not achieving the desired outcomes.[5] Determining where these opportunities are is a key step in deciding where social impact investing might be suitable for delivering better outcomes to the community (see Section 3).

This discussion paper is focused on the role for the Australian Government in the social impact investing market. As the social impact investing market is still at a nascent stage, the lessons learnt by other jurisdictions have informed the development of this discussion paper.

Social impact investing has been growing in popularity both in Australia and internationally. Many early social impact investments have been social impact bonds. The first social impact bond commenced in 2010 in the United Kingdom (UK), with many State and Territory Governments leading on social impact bonds in Australia.

Social impact investing is also increasingly being used by countries to deliver aid programs and achieve development policy outcomes like reducing poverty. The Department of Foreign Affairs and Trade's (DFAT's) InnovationXchange has been actively learning from overseas developments and considering the role of innovative financing mechanisms like social impact investing as part of Australia's aid program. More information on DFAT's initiatives is at Appendix D.

5 Organisation for Economic Co-operation and Development 2016, *Understanding Social Impact Bonds*, p. 15, http://web.archive.org/web/20161003014420/http://www.oecd.org/cfe/leed/UnderstandingSIBsLux-WorkingPaper.pdf.

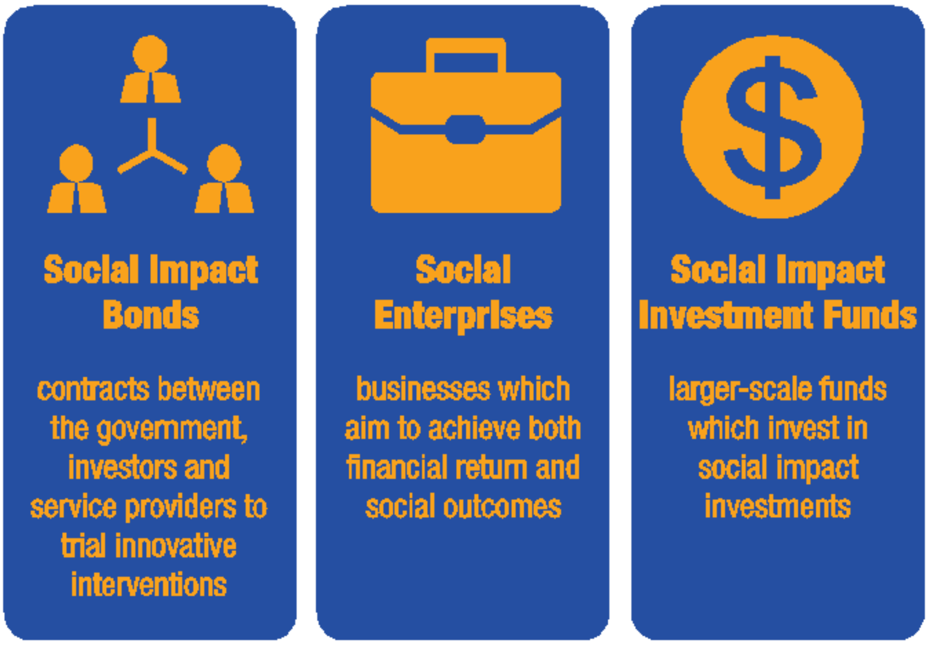
2.2 Main forms of social impact investing

The main forms of social impact investing include but are not limited to:

- social enterprises: businesses which aim to achieve both financial and social or environmental outcomes through their work, for example STREAT in Melbourne, which employs disadvantaged young people to work in a café and coffee roasting business or the Hepburn Community Wind Park Co-operative in Victoria;
- social impact bonds: contracts between the government, investors and service providers to trial innovative interventions — a form of payment-by-results contracts, wherein service providers are paid on the results they achieve;
- social impact investment funds: larger-scale funds which pool funds from investors to invest in several social or environmental impact investments.

There may be instances where a ‘layered investment’ is used by combining different types of social impact investments and mainstream investments in non-traditional ways, for example by providing a grant and a social impact loan to a social enterprise.

Figure 1: The main forms of social impact investing



For more information on the main forms of social impact investing and early evidence of their performance, see Appendix C.

2.3 Benefits and challenges of social impact investing

Benefits of social impact investing

Social impact investing has the potential to innovatively address social problems by leveraging private sector capital, though evidence is limited due to the nascent stage of the market. A number of benefits of social impact investing have been identified:

Potential benefits for the Commonwealth Government	Potential benefits for investors	Potential benefits for service providers
• Stimulate innovation to deliver better outcomes and achieve better value for money in service delivery. • Share financial and performance risk with investors — the Government pays for success. • Improve quality of services and policy development — provides opportunities to 'try, test and learn' which interventions are working and for whom. • Increased transparency, accountability and performance. • Collaboration — build stronger partnerships with service providers, investors and State and Territory Governments. • Possible efficiencies associated with focusing on prescribing outcomes, rather than the method of achieving those outcomes.	• Some investors wish to align their investment with their values. • Investors are looking to diversify their portfolio and maximise the risk-balanced rate of return on use of their capital. • Philanthropists and charitable foundations want to extend the value of their contribution by investing and re-investing in social impact investing, instead of always providing irrevocable donations or grants.	• Service providers may be looking to trial or scale-up an intervention but do not have adequate funding. • Social enterprises may be looking for equity or debt financing to start or scale up their operations, and social impact investing may provide an alternative funding source to mainstream lending. • Greater flexibility in the method of achieving the objective, potentially reducing red tape.

Challenges for social impact investing

There is considerable private sector interest and institutional funds available for social impact investing, but there is currently a lack of investment opportunities with market rates of return.[6] Some of the barriers to landing deals with market rates of return are likely inherent to the nature of the market. If the investments had market rates of returns and satisfied the requirements of mainstream lenders and wealth managers they would be attractive to all investors, including those who are not socially or environmentally motivated. Instead, social impact investing typically takes place in imperfect markets where existing policy interventions are not achieving the desired outcomes or where disadvantaged individuals have fallen through the cracks of the current system.

6 Impact Investing Australia 2016, *2016 Investor Report*, p. 29, http://impactinvestingaustralia.com/wp-content/uploads/Impact-Investing-Australia-2016-Investor-Report.pdf.

The social impact investing market is only at an early stage, particularly in Australia. There are a number of challenges for the growth of the social impact investing market in Australia:

- impact investments, especially at this nascent stage, are generally small scale, bespoke and illiquid;
- high due diligence costs for investors and intermediaries, due to the small scale of investment opportunities in Australia and the developing evidence base for social impact investments;
- the impact investment ecosystem is still developing: there are few mainstream advisers or wealth managers who are willing to provide advice on social impact investments;
- deals can have high transaction costs, often driven by the need to use specialist lawyers, finance professionals and intermediaries to establish the projects;
- a lack of accessible, high quality data to measure outcomes to determine the level of success (and payment) for particular social impact investment projects;
- limited capacity in the community sector to deliver projects, with many organisations still grant-focused and lacking the resources for complex contract negotiation and robust outcomes-measurement;
- the narrow application of social impact investment: as discussed earlier, not all social problems could or should be targeted through social impact investment and it takes time to identify opportunities for social impact investing;
- the difficulty in clearly articulating and agreeing to social outcome measures; and
- the time frames involved in achieving and measuring outcomes may not satisfy investors.

The costs and time it takes to develop social impact investments may fall in the future as the evidence and knowledge base for social impact investing grows and new structures for social impact investing are developed.

Consultation questions:

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

3 Role of the Australian Government in social impact investing

This section provides an overview of:

- the potential roles of the Australian Government, investors and service providers in the social impact investing market; and
- the policy areas where the Australian Government could potentially encourage social impact investing, either to deliver services or as a funder (or co-funder with State and Territory Governments).

In addition, the Australian Government has taken a number of actions over the last decade which has supported the growth of the social impact investing market. More information on these initiatives is at Appendix D.

3.1 Role of the Australian Government, investors and service providers

Role of the Australian Government

There are a number of constructive roles the Australian Government could play in developing social impact investing. This discussion proposes that the Australian Government could primarily support social impact investing by:

- creating an enabling environment for private sector-led social impact investing; and
- funding (or co-funding with State and Territory Governments) investments which would likely achieve savings to fund the intervention (including paying for returns to investors, where required) and deliver better outcomes for Australians.

The Australian Government could **participate directly** in the social impact investment market, as a convenor by setting up the investment or as a funder. Leveraging private capital and applying market-based principles through social impact investing has the potential to complement the Australian Government's existing role and responsibilities across many portfolios. While many opportunities for social impact investing exist in areas where service provision traditionally falls under state and territory responsibility, there are benefits to the Australian Government in exploring effective interventions that lead to better long-term outcomes for Australians.

The Australian Government could consider **partnerships with State and Territory Governments**, including co-funding arrangements where the benefits to the Australian Government could be demonstrated through the successful outcomes of the intervention and data sharing partnerships for new or existing social impact investments.

Such partnerships would benefit from the work undertaken by State and Territory Governments on social impact investing. The New South Wales (NSW) Government has launched two social impact bonds, with the Victorian, Queensland, Western Australian and South Australian Governments exploring social impact bonds. Beyond social impact bonds, NSW has announced a social impact investment to reduce recidivism,[7] with two health-related social impact investments under development.[8]

If these state and territory-led investments lead to better outcomes, there may also be flow-on benefits to reduced outlays or increased tax revenue for the Australian Government. For example, a State Government-led investment which improved outcomes for youth who had experienced homelessness may lead to reduced welfare spending and greater tax revenue for the Australian Government.

The Principles outlined in Section 4 aim to guide the Australian Government's involvement in the social impact investment as a participant, while recognising that:

- social impact investing will not replace the core role of the Australian Government in service delivery and the commissioning and funding of services;
- social impact investing is not an appropriate or effective vehicle for all interventions; and
- many social impact investments do not involve the government as a participant; instead, investors solely fund the service provider to deliver social outcomes, and the investor receives any financial return achieved. Investors and service providers should not consider government involvement a prerequisite for a successful social impact investment.

The Government could also play a **stewardship role** by ensuring an appropriate regulatory environment for the growth of the social impact investment market. Section 5 of this discussion paper identifies a number of potential regulatory barriers to the growth of social impact investing. The Financial System Inquiry identified that the Government could facilitate the market by coordinating interested private sector parties, providing expertise on social service delivery and performance measurement, and offering explicit public endorsement for the significant private sector interest in this market.

Role of investors

Harnessing private sector capital is one of the key features differentiating social impact investing from other forms of service delivery. Many investors want to fund an investment which aligns with their own social or environmental goals, while also achieving a financial return and diversifying their investment portfolio. There are a diverse range of investors who are interested in social impact investing, from individuals to philanthropic and family foundations to institutional funds.

Like all investments, social impact investments have their own balance of risk and reward.

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7 NSW Government 2016, *New social impact investment to reduce parolee reoffending and re-incarceration*, 12 July 2016, http://www.osii.nsw.gov.au/news/2016/07/12/new-social-impact-investment-to-reduce-parolee-reoffending-and-re-incarceration/.

8 NSW Government 2016, *Two proposals to improve health outcomes selection for joint development*, 27 May 2016, http://www.osii.nsw.gov.au/news/2016/05/27/two-proposals-to-improve-health-outcomes-selected-for-joint-development/.

Role of service providers

Service providers are the organisation or enterprise delivering the intervention and providing a service to the client group. There are many types of organisations that are service providers for social impact investments including charities, not-for-profit and for-profit service delivery organisations, social enterprises and co-operatives. Service providers can also be investors, as has happened in some social impact bonds.

Consultation questions:

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

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?

6. Are there areas where funding through a social investment framework may generate more effective and efficient policy outcomes than direct grant funding?

3.2 Potential areas of opportunity for the Australian Government

The Australian Government is considering policy areas where social impact investing could be applied.

The Department of Social Services, on behalf of the Prime Minister's Community Business Partnership, commissioned the professional services firm EY to investigate the benefits from social impact investing in Australia and overseas. The EY report identified that there is potential to realise benefits through social impact investing in the following areas which are the responsibility of the Australian Government:[9]

- to address unmet need in early education and child care, particularly for vulnerable and disadvantaged children;
- to fund innovative program delivery in employment, education and further training, particularly through the provision of working capital to social enterprises looking to address youth unemployment;
- to provide infrastructure capital to social and affordable housing;
- to address unmet need in rural and regional aged care, and to fund innovative program delivery for consumer directed aged care;

9 EY 2016, *Social impact investing research*, commissioned by the Department of Social Services for the Prime Minister's Community Business Partnership, pp. 21-40, http://www.communitybusinesspartnership.gov.au/wp-content/uploads/2016/11/social_impact_investing_research_report.pdf.

- to address unmet need for Australians experiencing financial exclusion who are unable to access mainstream financial services;
- to address unmet need for health services, including future service shortages and the lower health outcomes for disadvantaged groups; and
- innovative service delivery in disability services to complement the introduction of the National Disability Insurance Scheme.

The above policy areas are the responsibility of the Australian Government, so in these areas it is possible that the Australian Government could develop and implement a social impact investment. For policy areas that are the responsibility of State and Territory Governments, there may be opportunities for collaboration between the Commonwealth and states and territories in developing and supporting joint social impact investments. In these cases, the Australian Government would be a funder rather than service deliverer.

In areas where the Commonwealth and State and Territory Governments share responsibilities, such as health and education, joint investments may be necessary for the cost savings from better outcomes to be fully realised. Otherwise, an investment which only measured the outcomes for one level of government may not be justified on a 'value for money' basis. Such investments would also provide only a limited picture of the impact of the intervention.

Consultation questions:

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?

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

Opportunities for data sharing

There are likely to be opportunities for the Government to enter into data sharing partnerships for both existing and future social impact investments. Data sharing is integral to social impact investing as high quality data is needed to determine whether a social impact has been achieved. Sharing data and evaluations is also a key aspect of building the evidence and knowledge base for social impact investing.

The Government has taken a proactive role to improving access to public data, with a number of projects being progressed which will improve access to public data for the purposes of social impact investing (see Appendix D for more information). In addition, the Productivity Commission is undertaking an inquiry to investigate ways to improve the availability of use of public and private sector data, with the final report expected to be delivered to the Government in March 2017.

While the Government aims to optimise the use of public data, there are challenges for data sharing in the social impact investing market. In particular, the benefits or cost savings from social impact investing often cut across both multiple levels of government (Australian Government, State and Territory and local Governments) and multiple departments or portfolios within each level of government. Building partnerships to foster data sharing will be crucial to the growth of the social impact investing market in Australia.

Consultation questions:

9. What are the biggest challenges for the implementing the Australian Government's public data policy in the social impact investing market? What can do the Australian Government do to address these challenges?

10. Are there opportunities for the Australian Government to form data sharing partnerships with State and Territory Governments, intermediaries and/or service providers?

4 Australia's Social Impact Investing Principles

This section sets out, and seeks feedback on, four proposed principles which would guide the Australian Government's participation in the social impact investment market.

4.1 Purpose of Australia's Social Impact Investment Principles

The proposed Social Impact Investing Principles aim to guide actions across the Australian Government related to the development of the social impact investing market.

In addition, the Principles aim to encourage the involvement of the community and private sector. This includes the approaches taken by community organisations, philanthropists, charitable foundations, social enterprises, intermediaries and institutional investors. The efforts of these actors, along with the State and Territory Governments, have driven the growth of the Australian social impact investing market to date.

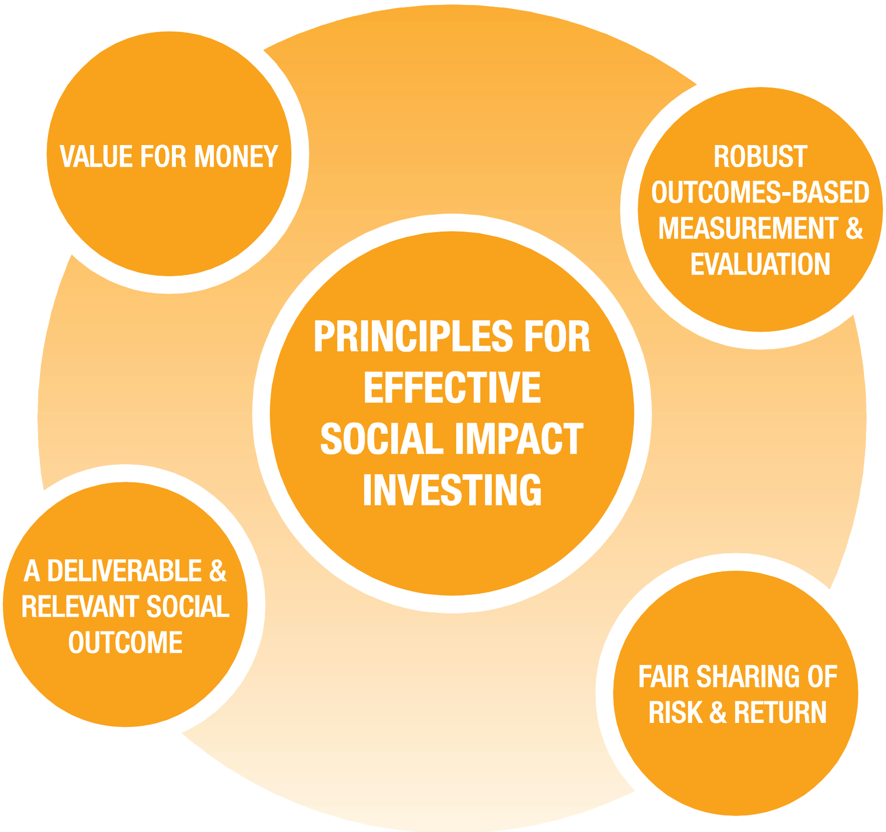
The objectives of the Principles are to:

- ensure that projects with Australian Government involvement:
  - provide value for money;
  - have a robust approach to outcomes-based measurement;
  - demonstrate fair sharing of risk and return; and
  - focus on a deliverable and relevant social outcome;
- assist Australian Government agencies in their decision-making about which social impact investment proposals would be suitable for further development;
- facilitate a consistent and streamlined approach to social impact investing across the Australian Government; and
- be sufficiently flexible to respond to changes in the social impact investing market and the Government's strategic priorities.

Innovative approaches to social impact investment projects are particularly encouraged. It is important that the forms of social impact investing and the processes for delivering a social impact investment project continue to evolve, particularly given the market's early stage of development. The Australian Government will continue to monitor developments in the social impact investing market and review and refine the Principles as required.

4.2 Principles for Social Impact Investing

Figure 2: Overview of the Principles



1. Value for money

Social impact investments should only proceed when they represent value for money: that is, when the expected benefits for the Australian Government outweigh the costs.

Having regard to the value for money of a social impact investment, Australian Government agencies could consider the following guidance:

Many measurable benefits can be used to support a proposal, including:

- measurable economic, social and/or environmental beneficial outcomes;
- cash savings to the Government from preventing the use of services, which may be able to fund investor returns;
- future costs avoided such as a reduction in future social security payments; and
- productivity gains.

Importantly, the proposal should be structured so that measurement of the social and/or environmental outcome is a prerequisite to payment. When the financial return is dependent on the social and/or environmental outcome, outcomes measurement and evaluation is an integral part of the investment.

1.1 Determining who benefits

In many cases, the benefits from social impact investing may be spread across multiple Australian Government agencies or between the Commonwealth Government and State and Territory Governments. Evidence would be required to support the likelihood of benefits and identify where the benefits will likely accrue. Evidence could be from similar interventions in Australia or overseas that may have been targeted at a different cohort or situated in a different context.

1.2 Timing of the benefit

The timing of the benefits of social impact investing can vary considerably. The savings to the Australian Government may accrue over a longer timeframe (for example, lower than expected welfare spending from increased workforce participation) which complicates measurement and paying for results. In contrast, the costs of acute services often fall directly on the State and Territory Governments (for example, the cost of out of home care services).

In addition, consideration could be given to how to continue measuring the outcome once the investment has expired. In some cases, the benefits that accrue over the following years or decades may be important evidence for future interventions or for public policy decisions. For example, measuring the long-term outcome of an intervention aimed at reducing unemployment among young people could provide useful evidence for decisions about employment services.

2. Robust outcomes-based measurement and evaluation

Social impact investments should include outcomes-based measurement to monitor the progress, risk and returns of the investment and a robust and transparent evaluation method to determine the investment's impact and efficacy.

Having regard to the robust outcomes-measurement and evaluation methods of an investment, Australian Government agencies could consider the following guidance:

The approach to measurement will vary but three key elements are:

- the structure of the investment;
- measuring the progress of the investment; and
- robust and transparent methods of evaluating the impact of the investment.

2.1 Structure of the investment

The structure of the investment will shape how the impact of the investment can be measured and evaluated.

A key element of the structure of the investment is how clients will be chosen. One issue to consider when selecting a client group is the need to reduce perverse incentives, for example where clients who are more likely to have a positive outcome are 'cherry picked' for the intervention while difficult-to-treat clients are 'parked' elsewhere.

Consideration could also be given to whether the client group reflect the demographic of those experiencing the social problem that is being targeted.

2.2 Measuring the progress of the intervention

Establishing appropriate outcomes would allow progress of the intervention to be measured throughout the life of the investment. Measuring the progress of the intervention is also important for the ongoing calculation of risk and returns for investors.

Where it is not possible to directly measure the social and/or environmental outcome during the life of the contract it may be appropriate to use proxy measures as an indicator of an outcome. For example, the overarching outcome may be to increase the participation of young people in paid employment. The outcome for the intervention could be determined by a range of proxy measures, including hours worked and retaining the job for 12 months or more.

A reasonable time frame for measuring outcomes is important. For example, evidence may suggest it takes two or three years for an intervention to have an impact, in which case measuring outcomes after only 12 months would be inconclusive.

Access to data will vary in both cost and complexity. Custom data collection can be very expensive, while using administrative (government) data could be a more cost-effective approach. Legal and privacy factors are also relevant: the processes for using government data may be more straightforward than new forms of data collection. Systems to ensure that data can reliably be collected for the duration of the investment (and possibly continue to be collected after the conclusion of the intervention) would be important.

2.3 Robust and transparent evaluation methods

Evidence of success in achieving outcomes will be important in determining the performance of an individual social impact investment, as well as to building the evidence base for social impact investing more broadly. Publishing the results of social impact investments builds a track record of evidence and increases investor awareness of social impact investing.

It is important that the evaluation is able to attribute the outcome to the intervention or to external factors in order to determine the impact of the intervention. It may be the case that a particular client group is subject to multiple interventions on the Commonwealth and state levels, which could complicate the ability to isolate the effect of the individual intervention.

When appropriate, a randomized controlled trial could be used to reduce bias in the selection of the client group in cases where a new intervention is being trialled. In a randomized controlled trial, clients are chosen at random by randomly assigning people into the client group and into a control group. With a sufficient sample size, the results can be analysed according to a range of variables in the client group to identify which types of clients benefit most from an intervention. For example, a prison through-care program may be more (or less) effective for ex-offenders who have only served one sentence. This approach can allow for analysis of how the intervention affected different demographic subgroups, including women, Indigenous Australians, people with disabilities and people from culturally and linguistically diverse backgrounds.

Ethical concerns are often raised about randomisation and denying access to interventions that are potentially effective. However, there are also ethical issues associated with continuing to deliver status quo interventions which may have no effect, or in fact be detrimental, to the client group.

However, randomized controlled trials may not be suitable for every intervention. The next best options are ‘natural’ or ‘quasi-experiments’, which share similarities with RCTs while lacking the element of randomisation. Beyond natural experiments, there are also before-after studies, which assume that if the intervention had not taken place, the outcomes in the ‘after’ period would be the same as they were before the intervention.

However, purely qualitative or anecdotal approaches — such as participant interviews — should be avoided, unless supplemented by more robust methods of evaluation.

3. Fair sharing of risk and return

The risks and returns of a social impact investment should be fairly shared between the Australian Government, investors and service providers.

Having regard to the fair sharing of risk and return, Australian Government agencies could consider the following guidance:

3.1 Financial risk

The benefits from social impact investing involve genuine collaboration between the Government, investors and service providers. Investments which shift too much of the risk to the Government could undermine the benefits of social impact investing and are less likely to represent value for money. Less government involvement means that investors take on more risk, which should be reflected in the returns available.

The risk-return profile for all of the parties involved in a social impact investment is relevant: the Government, investors and service providers. A risk analysis could include identifying:

- how the upfront cost of the service delivery will be funded;
- how the outcomes payments will align with the service delivery costs (for example, a negative or nil outcome may result in payments which do not cover the full cost of the service);
- whether the service provider will also be an investor; and
- the reliability of the client selection and referral process.

One possible model for mitigating risk is where the Government pays the investor when outcomes have been achieved by the intervention. This accords with how social impact investments have been designed internationally: all of the financial risk is typically transferred to investors and governments have only paid when outcomes have been achieved.

In contrast, some State and Territory Governments have taken on significant financial risk in the form of standing charges[10] to service providers and capital protection and minimum guaranteed interest rates to investors. This level of government support may not be sustainable for the market.

A relevant consideration is how the investment will be marketed to investors. Investor expectations about acceptable risk-return profiles vary: some investors expect market rates adjusted for perceived risk (for example, institutional investors) while other investors are comfortable with lower returns or higher risk (for example, philanthropists and charitable foundations).

It is important that relevant information around the financial risks of the investment is disclosed publicly. This ensures accountability and transparency, and allows for external scrutiny of the investment.

10 Standing charges are payments to service providers to reduce the risk associated with the investment.

3.2 Risk to the client group

Depending on the significance of any negative outcome for the client group, it may be necessary to adjust the intervention during the life of the investment. There are a number of risks to the client group which are relevant, including the actions which could be taken if:

- the intervention has a negative outcome on the client group during the life of the investment;
- the intervention is ineffective (that is, has nil effect);
- the intervention is discontinued, for example if investors can terminate a contract early; or
- the intervention has a continuing negative effect after the investment has concluded.

3.3 Other risks

Social impact investing can involve a number of moral hazards for which the Government bears the risk. It may not be possible to fully mitigate these risks. The Government will usually bear the reputational risks for unintended consequences for the client group, and will ultimately bear the costs for the long-term service delivery to the client group. For example, if an employment related intervention decreased participation, the Government would potentially bear the cost of increased welfare payments.

4. A deliverable and relevant social outcome

Social impact investments should have a strong case for being able to successfully address social and/or environmental problems which are priorities for the Government.

Having regard to the relevance and likely success of a social impact investment, Australian Government agencies could consider the following guidance:

4.1 An intervention likely to achieve social outcomes

Government agencies could consider a number of factors which may indicate a provider's ability to successfully deliver outcomes including:

- the governance arrangements;
- the capability of the management team;
- the sustainability of the business model;
- service delivery and relationship management experience;
- the ability to adjust the delivery of the intervention in response to data about performance; and
- whether the proposed intervention is supported by the existing evidence base.

Government agencies should ensure they have the internal capability to manage a social impact investment, including:

- management capability;
- contract and relationship management skills; and
- access to the required data.

Social impact investments often focus on innovative interventions to intractable social and/or environmental problems. There are many ways in which an intervention may be innovative: innovation can involve a new approach which has never been implemented or a more effective approach which has not previously been implemented in the same way.

4.2 A focus on outcomes that align with the Australian Government's agenda

Social impact investing can complement the Government's substantial role in the delivery and funding of services by creating successful partnerships to address intractable social and/or environmental problems in alignment with the Government's policy and service delivery agenda.

Government agencies may periodically identify opportunities for social impact investments, and provide additional information as part of any formal process seeking proposals.

Consultation - the Principles

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

5 Reducing regulatory barriers

As discussed earlier, one way for the Australian Government to develop social impact investing is to create an enabling environment. This section outlines possible regulatory barriers to the growth of the social impact investing market raised by stakeholders and in research on social impact investing, including:

- the treatment of private ancillary funds as 'sophisticated' or 'professional' investors;
- the interaction between superannuation law and social impact investing;
- the treatment of program-related investment in the tax system; and
- legal structures for social enterprises.

Submissions are sought from a wide range of participants and potential entrants in the social impact investing market as to the extent these issues are barriers to the growth of the social impact investing market and, if they are a barrier, what the Australian Government could do to address them.

5.1 Private Ancillary Funds as sophisticated investors

The Financial System Inquiry (FSI) final report identified private ancillary funds (PAFs)[11] as a potentially important investor class for social impact investment products. However, the philanthropy community has raised the issue that some PAFs controlled by sophisticated investors may be excluded from purchasing many of these products.

Under the *Corporations Act 2001* (the Corporations Act) an offer of securities (including impact bonds) needs to be accompanied by disclosure that is appropriate to the type of investment product and investor. To lower costs, many social impact investment products in Australia are accompanied by limited disclosure and are offered to sophisticated and professional investors under a disclosure exemption. Therefore, to issue social impact investment products to a PAF, the PAF would need to meet the test of a sophisticated or professional investor.

The FSI noted that some PAFs do not meet these sophisticated or professional investor tests for this disclosure exemption, despite high net worth individuals or organisations (who themselves may meet these tests) having established them. This can be a barrier to PAFs investing in these impact investment products.

Under the current Corporations Act and accompanying regulations, a PAF would satisfy the sophisticated investor test if the PAF *itself* had net assets of at least $2.5 million, gross income of at least $250,000 for each of the last two financial years or paid at least $500,000 to accept an offer of securities. Sophisticated investors hold a certificate from a qualified accountant certifying they have the prescribed net asset or gross income level. Stakeholders have not raised concerns over the sophisticated investor test for the PAF itself.

11 Please note this section only relates to private ancillary funds, not public ancillary funds.

Alternatively, if the PAF itself did not meet the sophisticated investor test because of an insufficient level of assets or income, the PAF could satisfy the test if it was controlled by a sophisticated investor. Stakeholder feedback to date has suggested that uncertainty over the meaning of 'control' under s708(8) and s50AA of the Corporations Act is a key barrier to these PAFs investing in social impact investment products. In particular, more certainty is required as to whether a PAF can be considered a sophisticated investor when at least one of its directors satisfies those definitions.

The Government has committed to providing greater certainty for PAFs controlled by sophisticated investors, building on the recommendations of the FSI.[12] The Government would appreciate feedback on options to clarify when a PAF is sufficiently controlled, and options on how this can be demonstrated to third parties. Options being considered as a specific provision relating to PAFs include, but are not limited to:

Control of a PAF for the purposes of s708(8) of the Corporations Act could be demonstrated if either of these conditions is met:

- a director of the trustee is both the largest financial donor to the PAF and satisfies the sophisticated investor test; or

- the majority of the directors of the trustee themselves satisfy the sophisticated investor test.

Control of a PAF for the purposes of s708(8) of the Corporations Act could be evidenced in writing either by:

- an independent and qualified accountant (or alternative suitable person) having provided a certificate within the preceding six months stating that the PAF meets one of these conditions; or

- the board of directors of the trustee providing a letter stating that the PAF meets one of these conditions.

12 Australian Government 2015, *Government Response to the Financial System Inquiry: Improving Australia's Financial System*, p. 17.

Consultation questions:

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?

13. 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?

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?

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

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?

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

While the definition of a sophisticated investor includes a trust controlled by a sophisticated investor, there is no similar corresponding test for a PAF controlled by a professional investor under s708(11) of the Corporations Act. While it is likely that a professional investor would also meet the sophisticated investor tests, this may not always be the case. In these cases, it is unclear if a PAF would be able to satisfy the professional investor test if it was controlled by a professional investor, who was not also a sophisticated investor.

Consultation questions:

18. 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?

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

20. 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?

The definitions of control and sophisticated and professional investors are relevant to a number of provisions in the Corporations Act.

Consultation questions:

21. 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?

The Government would appreciate views on whether there are any other significant barriers to facilitating this type of social impact investment for PAFs.

Consultation questions:

22. Are there relevant parts of the Corporations law, or other Commonwealth legislation and guidelines, which represent a barrier to PAFs investing in impact investment products?

5.2 Superannuation law and social impact investment

Superannuation fund trustees have a fiduciary duty to make decisions in the best interests of members under both the general trust law and section 52 of the *Superannuation Industry (Supervision) Act 1993* (the 'SIS Act'). This duty is imposed because trustees are given the responsibility to manage others' retirement savings on their behalf. The best interest duty is generally construed as the best financial interest; which is not inconsistent with ethical or socially responsible investing, such as social impact investing.

The SIS Act requires a trustee, when formulating an investment strategy, to give regard to the risk and the likely return from the investments, diversification, liquidity, valuation and other relevant factors. A trustee may take additional factors into account where there is no conflict with the requirements in the law. A trustee is required to have a reasoned basis for determining that the investment strategy formulated for such an investment option is in the best interests of beneficiaries, and that the investment strategy satisfies the requirements of section 52 of the SIS Act. Therefore social 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.

A number of super funds currently offer choice products for members who want to invest responsibly, with a steady stream of new products being released on a regular basis. For example, Australian Ethical applies positive and negative screens in their investment strategy and has invested in social impact investments, including one of the NSW Government's social impact bonds. Similarly, Christian Super applies positive and negative screens to investments and has invested in a range of social impact investments, both in Australia and overseas. It is also common for superannuation fund trustees to make social impact investments through externally managed pooled vehicles.

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 current prudential practice guidance on investment governance (SPG 530)[13] states that trustees can offer ethical investments (which includes social impact investing), provided trustees comply with the legal requirements described above and that a trustee can demonstrate appropriate analysis and a reasoned basis to support the formulation of an investment strategy that has environmental, social and governance issue (ESG) considerations. It states that trustees should be mindful of exposing the interests of beneficiaries to undue risk stemming from matters such as a lack of diversification, where investments in some industries are excluded or a positive weighting is placed on certain non-financial considerations.

13 APRA 2013, *Prudential Practice Guide: SPG 530 — Investment Governance*, http://www.apra.gov.au/Super/Documents/Prudential-Practice-Guide-SPG-530-Investment-Governance.pdf.

Some stakeholders have suggested that APRA provide clearer guidance on the appropriateness of impact investment for superannuation trustees. Given trustees' fiduciary duties mean that they have to exercise care and skills when making decisions about investments, trustees would need to look at the impact of each investment on a case by case basis, recognising the diversity of possible investments that might fall into this category. This means it would be difficult to provide very specific guidance. Therefore this paper seeks views on what guidance in particular would be useful to trustees in making decisions about impact investments.

In proposing any changes to APRA's prudential practice guidance, submitters should take into consideration:

- the objective the Government has chosen for superannuation, which will be enshrined in legislation: 'to provide income in retirement to substitute or supplement the Age Pension';[14] and
- the status of APRA's guidance: APRA's prudential practice guides (such as SPG 530 on Investment Governance) provide guidance on APRA's view of sound practice and the legal requirements in particular areas but do not themselves create enforceable requirements. APRA's guidance therefore only interprets the law, and any suggested changes to the guidance must be in accordance with superannuation law.

Consultation questions:

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

5.3 PROGRAM-RELATED INVESTMENTS

Program-related investments (PRIs) are investments generally made for the primary purpose of accomplishing a charitable purpose rather than for financial gain. PRIs can take many forms, including loans, equity investments, bank deposits and guarantees. PRIs are not the typical distributions made by funds but they represent an alternative to gifting money through donations or grants.

PRIs have been in existence for some time, with the concept originating in the US, through the US Tax Reform Act of 1969. In the US, PRIs are generally made by private foundations (which are akin to income tax exempt entities here in Australia) and the recipients can either be a non-profit or a for-profit organisation.

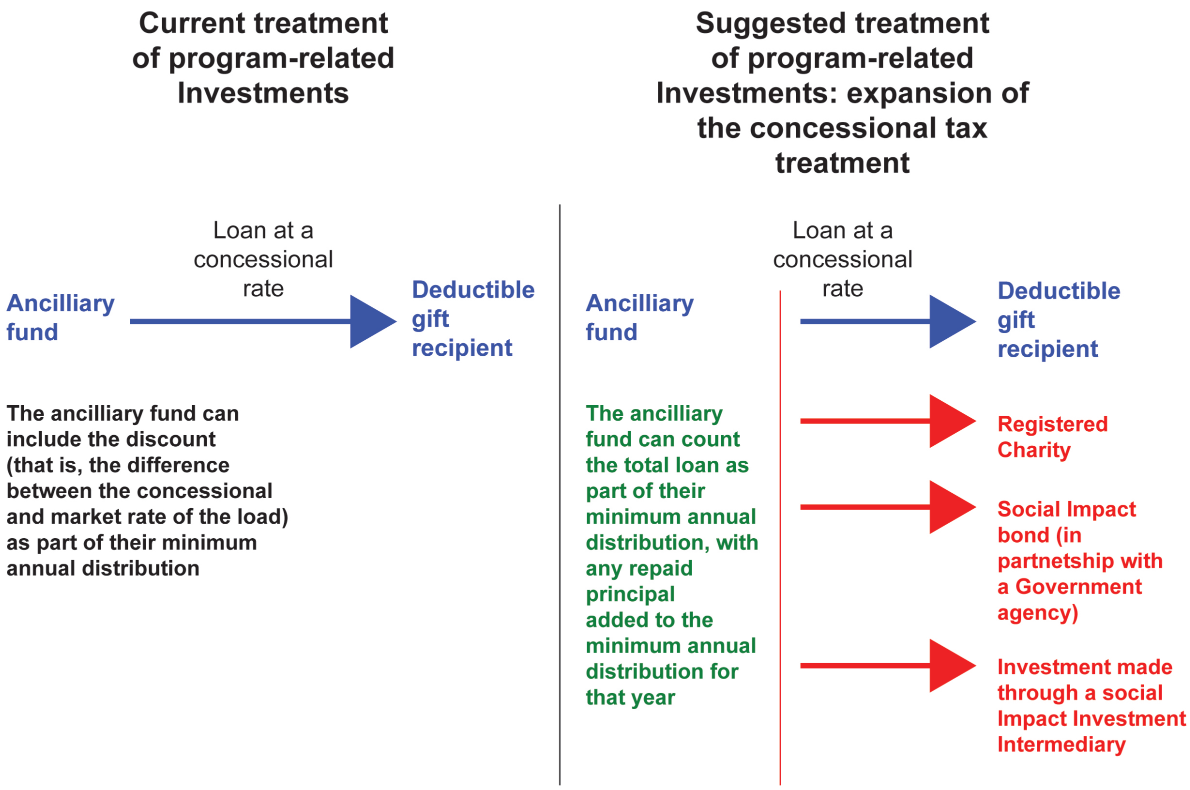
In cases where PRIs are made as loans or equity stakes, with some hope of regaining the initial investment plus a rate of return, these types of PRIs requires expertise beyond just investment decisions and distributions. They encompass effective identification and execution, due diligence, legal and financial analysis, monitoring and evaluation skills. This can be very resource intensive, and in some cases, may require assembling an internal team (who have subject matter expertise) that is devoted to working towards successfully meeting the objectives of the PRI. For this reason, it is not surprising that the take up of PRIs in the US has been small, despite being established in the late 1960s, with estimates suggesting less than 1 per cent of US foundations make PRIs.

14 See Australian Government 2016, *Objective of Superannuation*, Discussion Paper, p. 2, http://www.treasury.gov.au/~/media/Treasury/Consultations%20and%20Reviews/Consultations/2016/Objective%20of%20superannuation/Key%20Documents/PDF/objective_super_DP.ashx.

Some forms of PRIs, such as loan guarantees and providing discounted loans, are permitted to be made by ancillary funds in Australia, provided the recipients have deductible gift recipient (DGR) status. The ability for ancillary funds to provide loan guarantees over borrowings of DGRs was facilitated by amendments to the ancillary fund guidelines in May this year (see Appendix D).

There have been two further suggestions relating to PRIs (see Figure 3).[15] The first is whether the total, rather than the discount, should be recognised for the purposes of meeting the minimum distribution rate.[16] The second is whether, in addition to recognising the total loan as part of the minimum distribution, ancillary funds should also be allowed to provide PRIs to non-DGRs that are registered charities, organisations issuing social impact bonds in partnership with a government agency, or investments made through suitable impact investment intermediaries.[17]

Figure 3: Comparison of the current and suggested treatment for program-related investments made by ancillary funds



In regards to recognising the total loan as part of the minimum distribution, recognising the full value of the PRI would mark a departure from the traditional tenet of only recognising the full value of irrevocable donations. Further, it does not appear that the current minimum distribution rules applying to ancillary funds are acting as a barrier to PRIs, given that the average distribution rate from ancillary funds is well in excess of the minimum mandated requirement.

15 See Philanthropy Australia 2015, *Program-Related Investments for all Australians*, commissioned by the Department of Social Services on behalf of the Prime Minister's Community Business Partnership, http://www.communitybusinesspartnership.gov.au/wp-content/uploads/2016/01/program_related_investments_report.pdf.

16 Ibid, p. 15 — described as 'Option 1'.

17 Ibid, p. 16 — described as 'Option 2'.

Ancillary funds were set up to act as conduits between donors and DGRs. The DGR categories are intended to reflect the policy priorities of the Government in terms of the types of activities that deserve tax deductible support. These categories deliberately restrict DGR status to a closely targeted set of organisations reflecting areas of Government policy priorities. Allowing ancillary funds to provide PRIs to non-DGRs would be inconsistent with this intent.

Consultation questions:

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?

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

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

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?

5.4 Legal structures for social enterprises

Social enterprises have some advantages over not-for-profit organisations as they are able to take on equity investments, in addition to the sources of finance used by not-for-profits: fundraising, grants and debt finance. When establishing a new social enterprise, the founders of the enterprise are faced with a number of significant decisions, including what legal structure should the enterprise adopt.

While some international jurisdictions have developed distinct legal entities to accommodate the desires of some social enterprises (for example, Community Interest Companies in the UK and Limited Liability Companies in the US), there is no purpose built legal entity for social enterprises (enterprises which are for-profit and social purpose-driven) in Australia. Founders of social enterprises therefore need to choose which corporate structure best suits their enterprise. Founders of social enterprises need to investigate which legal structure best reflects and supports their mission and objectives.

The legal structure that a social enterprise adopts will affect the types of funding the enterprise can access, eligibility for tax concessions, ongoing reporting requirements, as well as the legal obligations placed on enterprise officers. Currently a social enterprise may structure itself as a:

- a proprietary company, public company or company limited by guarantee registered with the Australian Securities and Investments Commission (ASIC);

- an Indigenous corporation, registered with the Office of the Registrar of Indigenous Corporations;
- a cooperative, registered in the state or territory in which it is operating;
- an incorporated association, registered in the state or territory in which it is operating; or
- a trust.

Social enterprises are indicating that they are finding it difficult to access the capital necessary to grow their entity.[18] Reflecting these concerns, the Prime Minister's Community Business Partnership (the Partnership) has received feedback that the current suite of legal structures may be acting as a barrier to social enterprises sourcing capital, particularly equity capital.

Two particular concerns, based on anecdotal evidence, have been raised with the Partnership:

- putting in place the legal structures necessary to establish a NFP entity that can raise equity capital, or to transition a growing entity from a NFP to for-profit structure, is unreasonably expensive; and
- directors of social enterprises may breach their legal obligations if they do not act to maximise profits, even if this is contrary to the mission of the entity.

High establishment costs

There have been calls from some stakeholders, including the Prime Minister's Community Business Partnership, for the establishment of a purpose-built social enterprise legal structure, with proponents pointing to the experience of both a number of states in the US and the UK. The effectiveness of these new structures in promoting investment without specific tax advantages is not clear.[19]

The diversity of social enterprise makes it unlikely that there will be any one structure that would be suitable for a majority of for-profit/ not-for-profit/ charitable entities. Social enterprises use a variety of structures for tax and non-tax reasons. As a result, even if a new entity were easier to administer than the existing company structure, the addition of any new structure is likely to add to complexity as social enterprises adopt the new structure in addition to already existing structures.

Many of the benefits of the internationally adopted social enterprise legal structures are already available in the current structures present in Australia. For example, it appears that both a 'mission lock' and 'asset lock' may be obtained by providing for these things in the company's constitution or quarantining assets in a trust.

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18 Centre for Social Impact and Social Policy Research Centre 2016, SEDIF Evaluation Report, commissioned by the Department of Employment, pp. 29-30.

19 For example, research suggests the main benefit of the United Kingdom community interest company or CIC has essentially been a branding exercise, as the required locks on assets and profit distribution hindered investment relative to mainstream companies, see Heaney V., 2010, Investing in Social Enterprises: the Role of Tax Incentives, NESTA and the Centre for the Study of Financial Innovation, p 14. The authors were of the view that the CIC could become a focus for investment into social enterprises if tax advantages were applied to CICs. See also Canadian Task Force on Social Finance, Rec 5, p 3.

A mission lock often involves a requirement that changing a company's purpose requires a 100 per cent shareholder vote, making it difficult to change the company's purpose without full support of shareholders. Similarly, asset locks are established to protect the social purpose of a company: for example, a requirement in a governing document may state that upon dissolution of the company the residual assets can only be passed on to a company with similar objectives. While some social enterprises in Australia are interested in exploring mission and assets locks, other social enterprises do not believe that mission and asset locks are appropriate for their company.

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. This a role that an expanding range of intermediary organisations such as the School for Social Entrepreneurs, Social Traders, Social Ventures Australia, Business Enterprise Centres Australia, PilchConnect and Justice Connect are already playing.

These organisations and many more are providing standard templates for governance documents, including model constitutional provisions, which are reducing costs for social enterprises. This is an area where there would also appear to be opportunities for commercial shelf-company providers (who already create standard companies for various functions, including not-for-profit companies) to expand the standard products on offer to cover a wider range of social enterprise structures.

Director liability

There remains a perception that directors of socially minded for-profit organisations are required to maximise profits, over the social mission of the entity. This is despite a lack of evidence (beyond anecdotal concerns) that directors of a social enterprise have been found liable for acting in a manner that furthers the mission outlined in a company's constitution rather than acting to purely maximise profit.

A socially minded corporation can restrict or prohibit the company directors exercising their powers in a manner contravening the intent of the entity through the inclusion of restrictions in the company's constitution. As highlighted by the Corporations and Markets Advisory Committee,[20] which considered some of these issues in 2006, shareholders can already resolve to

> 'include a "social responsibility" charter in the company's constitution requiring the board to take into account various environmental or social factors or goals … Directors have a duty to act in accordance with a company's constitution.'

Concerns have also been raised that directors of a social enterprise would be required to favour the highest bidder for shares at a change of control event regardless of both the purpose of the organisation and the content of the entities' constitution.

It is well established that companies when issuing shares can make strategic choices regarding their shareholders, rather than just accept the highest offers. There does appear, however, to be uncertainty on the part of social enterprises as to what would be considered to be 'in the company's interests' at the point of a change of control event, though this is informed by a company's constitution.

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20 The Corporations and Markets Advisory Committee 2006, *Report into the Social Responsibility of Corporations*, p. 83, http://www.camac.gov.au/camac/camac.nsf/byheadline/pdffinal+reports+2006/$file/csr_report.pdf.

Consultation questions:

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?

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?

APPENDIX A: LIST OF CONSULTATION QUESTIONS

CONSULTATION QUESTIONS IN THIS DISCUSSION PAPER:

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?
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?
3. Are there any Australian Government legislative or regulatory barriers constraining the growth of the social impact investing market?
4. What do you see as the role of the Australian Government in developing the social impact investing market?
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?
6. Are there areas where funding through a social investment framework may generate more effective and efficient policy outcomes than direct grant funding?
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?
8. Are there opportunities for the Australian Government to collaborate with State and Territory Governments to develop or support joint social impact investments?
9. What are the biggest challenges for the implementing the Australian Government's public data policy in the social impact investing market? What can do the Australian Government do to address these challenges?
10. Are there opportunities for the Australian Government to form data sharing partnerships with State and Territory Governments, intermediaries and/or service providers?
11. We are seeking your feedback on the four proposed Principles for social impact investing.
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?
13. 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?
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?
15. How could these options be best incorporated within the appropriate legislation?
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?

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

18. 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?

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

20. 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?

21. 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?

22. Are there relevant parts of the Corporations law, or other Commonwealth legislation and guidelines, which represent a barrier to PAFs investing in impact investment products?

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

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?

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

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

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?

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?

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?

Appendix B: Glossary

Term	Definition
Client group	The individuals who are selected to receive the intervention as part of a social impact investment.
Deductible gift recipient (DGR) organisations	DGRs are a fund or organisation that can receive tax deductible gifts. DGR endorsements are managed by the Australian Taxation Office. Some charities are not DGRs, and therefore cannot take tax deductible gifts.
Donation or grant	A gift made by an individual or organisation to a charity. Donations or grants are irrevocable, that is they are not expected to be paid back.
Institutional investors	Large organisations which have considerable money to invest, whether for themselves or on behalf of their clients: for example, superannuation funds, banks, investment companies and insurance companies.
Liquidity	Liquidity refers to the degree to which an asset or security can be quickly brought or sold in the market without affecting the asset's price. For example, cash is liquid as it can be quickly used to purchase a good, while an investment in a social impact bond is illiquid as it is usually three to five years before the bond has ended and an investor has a chance to get their capital back.
Principal	In the context of social impact investing, principal is the value of the investment made in a social impact investment. For example, a superannuation fund may make a $1 million investment in a social impact bond with the aim of getting their principal (that is, $1 million) back along with a return on their investment.
Priority Investment Approach to Welfare	Actuarial analysis of the welfare system to identify cohorts at risk of long-term welfare dependency. The Government funded the Investment Approach in the 2015-16 Budget, modelled on an approach implemented by the New Zealand Government in 2011.
Private ancillary funds	Private ancillary funds are philanthropic trusts established by businesses, families and high net-worth individuals to structure their charitable giving. Donors receive an upfront, immediate tax deduction for their donation, and the fund then makes charitable contributions to deductible gift recipient organisations over a number of years. Private ancillary funds are private in nature.

Term	Definition
Program-related investment	Program-related investments are investments made by public and private ancillary funds to deductible gift recipients with the aim of regaining the investment plus a reasonable rate of return. PRIs can take many forms, including loans, equity investments, bank deposits and guarantees.
Public ancillary funds	Public ancillary funds are public philanthropic trusts established by community and fundraising foundations to structure their charitable giving. Donors receive an upfront, immediate tax deduction for their donation, and the fund then makes charitable contributions to deductible gift recipient organisations over a number of years.
Scale	Refers to the size of an investment. For example, social impact bonds typically are small scale at around $7 to $15 million.
Service providers	In the context of social impact investing, service providers are the organisation or social enterprise delivering the intervention to the client group.
Social Enterprise Development and Investment Funds	An Australian Government social impact investment fund to provide finance to social enterprises which commenced in 2011.
Social enterprises	Business which aim to achieve both financial return and social outcomes.
Social impact bonds	Contracts between the government, investors and service providers to trial innovative intervention to address social and/or environmental problems.
Social impact investment funds	Larger-scale funds which invest in several social impact investments.
Social impact investments	Investments made with the intention of generating measurable social and/or environmental outcomes in addition to a financial return.
Socially responsible investing	Investing using a negative screen, by avoiding unethical investments that harm the society or the environment like tobacco and gambling.
Sustainable investing	Investing using a positive screen, by seeking out investments that support social and environmental objectives.

Term	Definition
Target population	The individuals or areas affected by a social or environmental problem. For example, the target group for an intervention addressing youth unemployment might be all people aged between 18 and 25 who are unemployed and who reside in a particular city. The target population gives an idea of the scale an intervention could achieve if it proves successful at the trial stage.

APPENDIX C: BACKGROUND INFORMATION ON SOCIAL IMPACT INVESTING

This section provides background information on social impact investing including on:

- the main forms of social impact investing;
- the motivation of social impact investors; and
- the size of the Australian social impact investing market.

THE MAIN FORMS OF SOCIAL IMPACT INVESTING

Social enterprises

Social enterprises are businesses which aim to achieve both financial and social outcomes through their work. Direct investment in social enterprises is another form of social impact investing.

Examples of social enterprises include:

- STREAT in Melbourne, which hires disadvantaged and unemployed young people to learn hospitality skills in a café and coffee roasting business; and
- Goodstart Early Learning, a childcare social enterprise formed when a consortium of businesses and charities purchased most of the ABC Learning childcare centres when they entered receivership in 2008. Goodstart measures their social impact in a number of ways, including developing new models of reaching disadvantaged children and delivering evidence-based early learning programs to all the children in their care.
- The Hepburn Community Wind Park Co-operative, which built and operates the first wind farm in Australia to be owned by the community.

Social enterprises aim to tackle a variety of social and environmental problems, including unemployment, social exclusion, homelessness and environmental sustainability. Employment-based social enterprises focus on employing people in a commercial setting, particularly those who are at-risk of long-term unemployment: people with disabilities, Indigenous Australians, disadvantaged young people and refugees.

There is limited information on Australia's social enterprise sector. A report in 2010 estimated that there were 20,000 social enterprises in Australia, with the number increasing by 7 per cent per annum over the previous five years.[21]

Most social enterprises are small and, when looking to expand operations through loans, have a limited capacity to satisfy the requirements of mainstream lenders. Social enterprises may be attracted to social impact investments which can provide greater flexibility than mainstream loans in funding expansions or ongoing operations.

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21 Queensland University of Technology and Social Traders 2010, Finding Australia's Social Enterprise Sector 2010, p. 7, http://www.socialtraders.com.au/sites/PDF/FASES_full_final_report_July_2010.pdf.

Early evidence

The EY report on social impact investing found that there is limited evidence on benefits for social impact investment in social enterprises in Australia.[22] There is, however, substantive evidence from the UK where social enterprises outperform small and medium sized enterprises in terms of start-ups, growth in revenue, job creation, innovation, diversity in leadership, and business optimism.[23] The EY report considered that, comparing the Australian and UK social enterprise sectors, there is considerable potential for direct investment in Australian social enterprises.[24]

Social Ventures Australia (SVA) reviewed the impact of three employment-based social enterprise initiatives: the Australian Government's Supporting Social Enterprise Project, and the Queensland Government's Inclusive Social Enterprise Project and Youth Enterprises Partnership. SVA found that the three initiatives created 261 jobs and 122 employment pathways (work experience and internship), which provided value of money to the Governments who funded the initiatives.[25]

Social Impact Bonds

Under a **payment-by-results contract**, the government (or another commissioning body or investors) pays a provider to deliver a service based on the results achieved.

However, not all payment-by-results contracting is a social impact investment, as there needs to be a focus on achieving social and/or environmental outcomes when the contract is negotiated. Additionally, payment-by-results contracts between governments and service providers may not leverage private capital, a key element of social impact investing.

Social impact bonds are a subset of payment-by-results financing methods — a form which has received the most attention from the media and from policymakers. One key feature which differentiates social impact bonds from other forms of payment-by-results contracts is the involvement of private investors who provide the up-front investment in the intervention.

In social impact bonds, private investors provide the initial capital to fund an innovative policy intervention to a cohort agreed by government (see Figure 4). If the intervention is successful, the government saves on current and future spending on service delivery and it is these savings that fund the cost of the social impact bond. If the intervention is successful in achieving the agreed outcomes, a proportion of the saving to the government is used to repay the investor's principal investment and provide an additional financial return in the form of a dividend.

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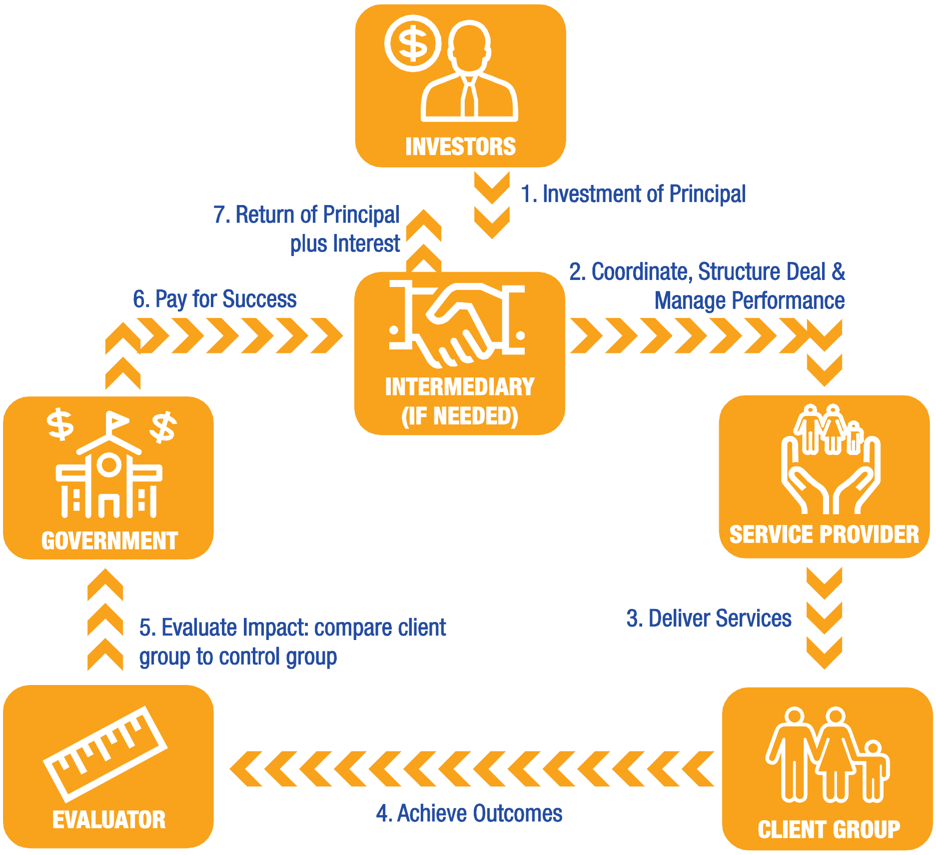
22 EY 2016, *Social impact investing research*, commissioned by the Department of Social Services for the Prime Minister's Community Business Partnership, p. 18, http://www.communitybusinesspartnership.gov.au/wp-content/uploads/2016/11/social_impact_investing_research_report.pdf.

23 Ibid, p. 19.

24 Ibid.

25 Social Ventures Australia 2012, *Solving Employment Exclusion Using Social Enterprises*, p. 3, http://socialventures.com.au/assets/Solving-Employment-Exclusion-using-Social-Enterprises.pdf.

Figure 4:[26] Social impact bond mechanics



26 Adapted from Brookings Institute 2015, *The Potential and Limitations of Impact Bonds: Lessons from the First Five Years of Experience Worldwide*, p. 6, https://www.brookings.edu/wp-content/uploads/2016/07/Impact-Bondsweb.pdf.

Case Study 2: NSW Government Newpin social impact bond

The NSW Government's first social impact bond (known as the Newpin bond) is a $7 million bond to fund Uniting services that work with vulnerable families to safely reunite children in out-of-home care with their parents. All family restorations are independently decided by the NSW Children's Court. The bond commenced in 2013 and will conclude in 2020, with a target financial return of 10 to 12 per cent per annum. The financial return is calculated based on the restoration rate of children who enter the program.

The savings to governments from a reduction in the number of children in out-of-home care has the potential to outweigh the costs of running social impact bonds. The NSW Government has estimated that the average annual cost of out-of-home care is between $30,000 and $45,000 per child.[27]

This estimate does not include the long term or indirect financial cost associated with poor lifetime outcomes for children in out-of-home care, including increased health, justice, family services, housing support and welfare spending. A 2006 study estimated that the average annual net cost to governments (that is, the difference between spending on a person who has left out-of-home care and a person in the general community) for a person who has left out-of-home care is $37,000 per annum across their life from ages 16 to 60.[28] Reuniting a child with their family will save the immediate costs of the child protection system but it may not raise a child's lifetime outcomes (and reduce spending on services) to be the same as a child who has never had contact with the child protection system.

The NSW Government provided substantial support to investors, with a minimum interest rate of 5 per cent for the first three annual payments and a guarantee that a minimum of 50 per cent of the principal will be repaid at the end of the bond. Based on the performance of the bond, investors received a 7.5 per cent return in the first year, 8.9 per cent in the second year and 12.2 per cent in the third year.[29]

Early evidence

Social impact bond development requires detailed knowledge of financing instruments as well as social policy and implementation. While social impact bonds are a promising form of funding, there is limited evidence of their efficacy and some early international programs have not demonstrated positive outcomes. On the performance of social impact bonds, the EY report on the benefits of social impact investing found:

> For SIBs [social impact bonds] we found examples of positive performance and savings to government however overall evidence of realised financial benefits for government is limited as most SIBs have only been in operation for 1-2 years, which is insufficient time to measure long term outcomes. There may also be selection bias in public reporting.

27 NSW Government 2016, *2016 Statement of Opportunities*, p. 6, http://www.osii.nsw.gov.au/assets/office-of-social-impact-investment/files/Statement-of-Opportunities-2016.pdf.

28 Morgan Disney and Associates and Applied Economics 2006, *Transition from Care: Avoidable costs to governments of alternative pathways of young people exiting the formal child protection care system in Australia*, Volume 1: Summary Report, p. 26.

29 NSW Government 2016, *Media release: Third year results show Newpin continues to help families stay together*, http://osii.nsw.gov.au/news/2016/08/15/third-year-results-show-newpin-continues-to-help-families-stay-together/.

> It is unclear as to whether PbR [payment by results] and outcomes-based contracting schemes offer value for money overall compared to other mechanisms, as results varied considerably between providers, programs and sectors.[30]

Social impact bonds are usually targeted at trialling innovative policy interventions where there is limited evidence that the social outcomes will be achieved. Once an intervention has been shown to be successful through a social impact bond, it should be scaled up using an alternative funding arrangement. For example, the government may directly fund the service or the service could be funded by investors.

Social impact bonds can be costly and complex to implement. Governments who have launched social impact bonds have found that they typically have high set-up costs and can take years to implement. Once they have launched, social impact bonds have mostly attracted philanthropic investors. Institutional investors, such as superannuation funds, prefer to invest in large-scale liquid investments and the scale and liquidity of social impact bonds are generally very limited (most bonds have been under $10 million).

As noted in Section 1, the McClure Report recommended that the Government consider expanding social impact investment models, including social impact bonds, to target financial investments towards addressing social problems. The McClure Report identified the following principles for successful social impact bonds based on the evidence to date:

- Quantified saving to the government—the savings associated with the outcomes (for example, reduction in number of individuals re incarcerated) must be higher than the ongoing cost of delivering the outcome (for example reduction of recidivism) through traditional government measures.
- Clearly defined outcome metrics—an objective mechanism for assessing the degree to which social outcomes are achieved is required to meet the results focused approach of SIBs.
- Controls to mitigate external factors—the specific outcomes must be attributable to the SIB initiative and not dependent on external factors.
- Structured rewards that avoid perverse incentives—outcome metrics and subsequent rewards should adequately address the issue in its entirety, and not just easy quick measurable results.[31]

These principles are incorporated in Section 4.

30 EY 2016, *Social impact investing research*, commissioned by the Department of Social Services for the Prime Minister's Community Business Partnership, p. 2, http://www.communitybusinesspartnership.gov.au/wp-content/uploads/2016/11/social_impact_investing_research_report.pdf.

31 Department of Social Service 2015, *A New System for Better Employment and Social Outcomes*, Final Report, p. 171.

Social impact investment funds

Social impact investment funds pool funds from many investors to invest in several social impact investments. Social impact investment funds are typically larger in scale than social impact bonds or direct investment in individual social enterprises. Social impact investment funds offer a number of advantages over bespoke social impact bonds or social enterprise financing deals:

- allow for pooling of funds from smaller investors;
- can fund wholesale investment opportunities requiring larger amounts of capital, such as the construction of affordable housing;
- increase diversification for investors, which lowers the risks of investing;
- reduce the research and resources required by investors, as funds conduct due diligence on behalf of investors; and
- may be better suited to funding an expansion of existing programs rather than trialling new interventions: funds often screen potential investments to ensure they are likely to be successful and meet the fund's internal return targets.

One example of a Commonwealth supported social impact investment fund is the *Social Enterprise and Development Investment Funds* (SEDIF), which has made around 80 investments in social enterprises since 2011. The Commonwealth Government provided $20 million to SEDIF, which as managed by private fund managers. SEDIF provides an avenue for finance and support to help social enterprises develop, grow and sustain their work and impact (see Appendix D for further details). The Commonwealth Government's contribution was matched by investors, expanding the reach of the fund and increasing the capital available to social enterprises.

Early evidence

The EY report on social impact investing found multiple examples of positive short-term results from social impact investment funds, but little information on longer-term impact.[32] Financial returns to the fund are often not disclosed, making it difficult to determine how the fund is performing financially. Social impact investment funds have achieved capability development in the social enterprise sector and offered access to capital that social enterprises would have found difficult to access otherwise.[33]

There are very few social impact investment funds in Australia, and the lack of this vehicle for investment partly explains the lack of scale in the Australian social impact investing market. As such, there are opportunities for intermediaries to establish and coordinate social impact investment funds, which will be accessible to a greater number of investors who do not have the time or resources to conduct due diligence on small, bespoke deals.

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32 EY 2016, *Social impact investing research*, commissioned by the Department of Social Services for the Prime Minister's Community Business Partnership, p. 15, http://www.communitybusinesspartnership.gov.au/wp-content/uploads/2016/11/social_impact_investing_research_report.pdf.

33 Ibid, p. 16.

WHO INVESTS IN SOCIAL IMPACT INVESTING?

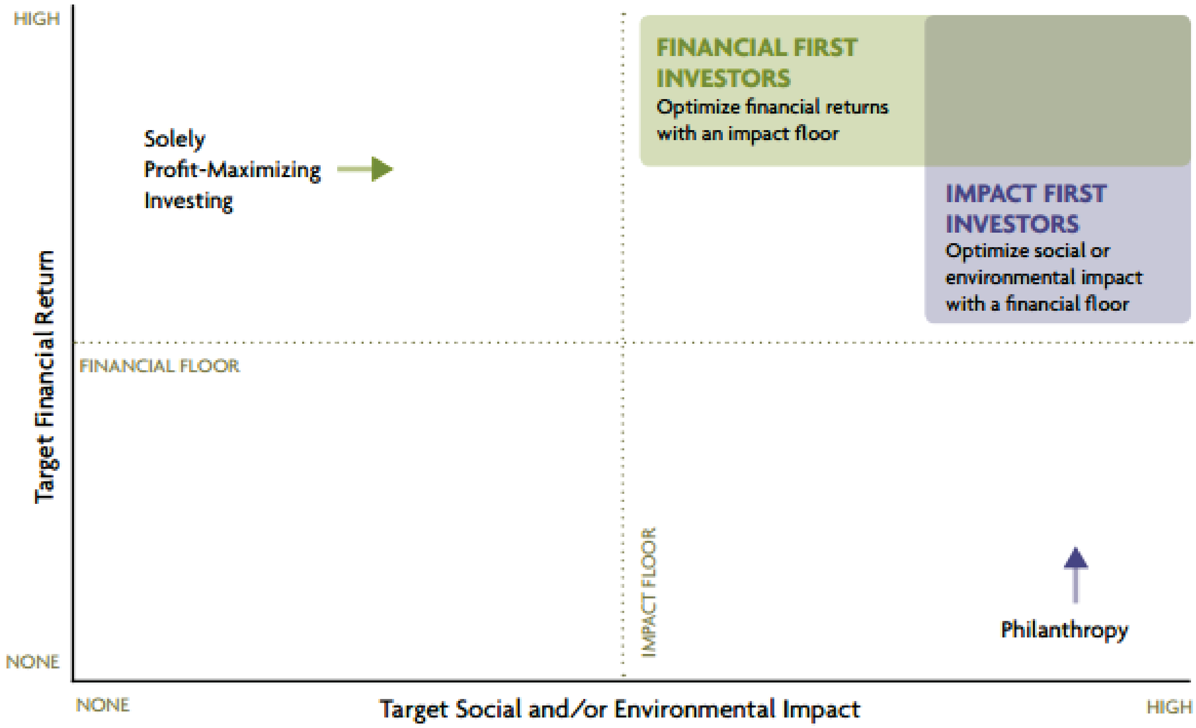
Social impact investing is on a spectrum of investments, which range from philanthropy (typically irrevocable gifts) to mainstream investments (see Figure 5).

Figure 5: Spectrum of investing

Social impact investments are attractive to a variety of investors. There appear to be two broad types of socially motivated investors who are interested in social impact investment: financial first investors and impact first investors (see Figure 6). Financial first investors (typically institutional investors including superannuation funds) expect appropriate risk adjusted financial returns for social impact projects comparable to mainstream investments.

In contrast, impact first investors (typically from the philanthropic sector and charitable foundations) are willing to accept below-market financial rates of return or greater risk to achieve social goals. There is anecdotal evidence that social impact investors in Australia expect higher returns than their overseas counterparts but it is unclear why this is the case.

Figure 6:[34] Segment of investors according to motivation for investing



SIZE OF THE AUSTRALIAN SOCIAL IMPACT INVESTING MARKET

It is difficult to accurately determine the size of the social impact investing market in Australia, as there are limited data on assets under management.

The *Responsible Investment Benchmark Report 2016* estimated that there were $3.7 billion assets under management for a broad category of impacting investing (including community finance and responsible banking products) in Australia in 2015, a 75 per cent increase since 2014.[35] One of the major growth areas was green bonds which operate in the same way as traditional bonds except they raise funds specifically for environmentally-friendly projects. The total figure of assets under management for responsible investing in Australia was $633 billion.[36]

34 Source: Monitor Institute 2009, *Investing for Social and Environmental Impact: A Design for Catalyzing an Emerging Industry*, p. 32, http://monitorinstitute.com/downloads/what-we-think/impact-investing/Impact_Investing.pdf.

35 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.

36 Ibid.

Impact Investing Australia's *Benchmarking Impact* report surveyed social impact investments active in Australia at 30 June 2015 and found that the aggregate value of the 15 products surveyed is $1.2 billion.[37] The market was dominated by green bonds ($900 million total).[38] Earlier in 2016, Impact Investing Australia released its inaugural investor report which identified at least $18 billion of demand among local investors for social impact investing over the next five years.[39]

37 Impact Investing Australia 2016, *Benchmarking Impact: Australian Impact Investment Activity and Performance Report 2016*, p. 8, http://impactinvestingaustralia.com/wp-content/uploads/Benchmarking-Impact.pdf. The report notes that this figure is not exhaustive of the market of impact investments in Australia or in which Australian investors have placed capital (as foreign domiciled investments are excluded).

38 Ibid, p. 9.

39 Impact Investing Australia 2016, *2016 Investor Report*, p. 30, http://impactinvestingaustralia.com/wp-content/uploads/Impact-Investing-Australia-2016-Investor-Report.pdf. This was calculated by multiplying the ideal allocation to impact investments in five years with the investable assets of each survey respondent.

Appendix D: Background information on Australian Government support for social impact investing

Over the last decade, the Australian Government has taken a number of actions which have supported the growth of the social impact investing market. Given the nascent stage of the market, many of these steps have been focused on building the evidence base for social impact investment and improving access to data for the development of social impact investments. This includes:

- support for social enterprises through the Social Enterprise Development and Investment Funds;
- efforts to improve access to public data;
- work by the Prime Minister's Community Business Partnership on innovative investment models;
- greater certainty for Private Ancillary Funds and Public Ancillary Funds investing in social impact investments
- the Priority Investment Approach to Welfare; and
- the application of social impact investing in Australia's aid program by the Department of Foreign Affairs and Trade.

In addition to these initiatives, the Government indirectly supports the social impact investing market in a number of ways. Many investors in Australian social impact investments have been philanthropists who often give through charitable foundations such as private and public ancillary funds. Individuals can make tax deductible donations to private ancillary funds. In 2016-17, the revenue forgone to the Australian Government due to tax deductibility for gifts to private ancillary funds is estimated to be $280 million.[40]

More broadly, the Government provides significant support to the not-for-profit sector through the tax deductibility of gifts. A number of not-for-profit organisations invest in social impact investments, such as funding social enterprises which align with their mission. Some not-for-profit organisations, such as Uniting and the Benevolent Society, have been service providers and investors for social impact bonds. In 2016-17, the revenue forgone to the Australian Government due to the tax deductibility of gifts is estimated to be $1.2 billion.[41]

Social Enterprise Development and Investment Funds

Since 2011, the Government has supported the development of social enterprises through the Social Enterprise Development and Investment Funds (SEDIF). SEDIF offers finance and support to social enterprises to help them grow their business and increase the impact of their work in their communities.

40 Australian Government 2016, Tax Expenditure Statement 2015, p. 27, http://www.treasury.gov.au/~/media/Treasury/Publications%20and%20Media/Publications/2016/Tax%20Expenditures%20Statement%202015/Downloads/PDF/2015_TES.ashx.

41 Ibid.

The Government established SEDIF with a $20 million grant to seed the establishment of three investment funds which were managed by Social Enterprise Finance Australia, Foresters Community Finance and Social Ventures Australia. The $20 million Government grant was then matched by private investment.

As of the end of March 2016, 64 social enterprises received access to around $21.3 million of SEDIF finance through 80 investments.[42] A recent independent evaluation found that SEDIF has been successful in providing direct and indirect support for business development of 424 social enterprises and contributed to positive outcomes for 9051 people, including employment and employment readiness for more than 650 people.[43]

The immediate aim of SEDIF was to improve access to finance for social enterprises, with the broader aim of growing the social impact investing market in Australia. The evaluation found that SEDIF the expansion of some SEDIF-financed social enterprises but there is limited evidence that SEDIF played a direct role in growing the total number of social enterprises in Australia.[44]

SEDIF has been implemented though the Department of Employment, with the three investment funds operating at arms' length from the Government. While the funding agreements between the Department of Employment and the fund managers have expired, SEDIF will continue to finance social enterprises.

IMPROVING ACCESS TO PUBLIC DATA

Social impact investing is dependent on the availability of high quality data to determine whether a social impact has been achieved. The Government has taken a proactive role in improving access to public data, with a number of projects being progressed which will improve access to public data for the purposes of social impact investing. Improved access and use of public data will also inform policy design in areas across the Government.

- Data.gov.au is the central point of access to data from across the Australian Government. It provides an easy way to find, access and reuse public data. To date, the Government has published over 20,000 records on data.gov.au, which includes nearly 10,000 datasets and other related resources. Requests for access to public data can be made via data.gov.au or directly with the Government entity that holds the data.

- On 7 December 2015, the Government released its Public Data Policy Statement as part of the National Innovation and Science Agenda.[45] The Statement aims to transform the attitudes of Australian Government entities to the use and accessibility of public data, and improve the quality of public data made available. The Statement provides a clear mandate for Australian Government entities to optimise the use and reuse of public data; to release non-sensitive data as open by default; and to collaborate with the private and research sectors to extend the value of public data for the benefit of the Australian public.

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42 Centre for Social Impact and Social Policy Research Centre 2016, SEDIF Evaluation Report, commissioned by the Department of Employment, p. 22.

43 Ibid, p. 47.

44 Ibid, pp. 21-22.

45 Australian Government 2015, *Public Data Policy Statement*, https://www.dpmc.gov.au/sites/default/files/publications/aust_govt_public_data_policy_statement_1.pdf.

- Data61, Australia's largest data innovation group, received $75 million in funding under the National Innovation and Science Agenda.[46] Data61 brings together the Digital Productivity team from the former National ICT Australia (NICTA) with the CSIRO.

- Several high-value data sharing projects focused on key policy questions have been launched by Australian Government agencies, to build confidence in improving public sector data management and policy innovation.[47]

- The Productivity Commission is currently undertaking an inquiry to investigate ways to improve the availability of use of public and private sector data. The Commission is scheduled to provide its final report to the Government in March 2017.

Prime Minister's Community Business Partnership

The Prime Minister's Community Business Partnership (the Partnership) was established in 2014 to provide advice on strategies for promoting philanthropic giving, volunteering and investment in Australia in order to strengthen communities. The Partnership brings together leaders from the business and community sectors to promote philanthropic giving and investment. The Partnership is chaired by the Prime Minister and the Deputy Chair is the Minister for Social Services.

The Partnership has been investigating opportunities for growing innovative investment models and promoting collaborative cross-sector partnerships. A focus of this work has been investigating opportunities for growing social impact investing. The Partnership has consulted with community and business organisations on the following ideas:

- legal structures to facilitate social impact investment;

- program related investments for charitable foundations;

- social procurement; and

- guidance for private ancillary funds and public ancillary funds investing in social impact investments.

A number of these ideas are discussed in further detail in section 5.

46 Australian Government 2015, *Australian Government Public Data Policy Statement*, https://www.dpmc.gov.au/sites/default/files/publications/aust_govt_public_data_policy_statement_1.pdf.

47 Australian Government 2015, *Public Sector Data Management Report*, Appendix 4, https://www.dpmc.gov.au/sites/default/files/publications/public_sector_data_mgt_project.pdf.

CHARITABLE GIVING: GREATER CERTAINTY FOR PRIVATE ANCILLARY FUNDS AND PUBLIC ANCILLARY FUNDS INVESTING IN SOCIAL IMPACT INVESTMENTS

Ancillary funds are charitable trusts structures that provide a link between people who want to give (donors) and organisations that are deductible gift recipients (DGRs).[48] Established as a vehicle to encourage philanthropy, donations to ancillary funds are deductible at the time of donation, although the funds are only applied to their DGR purpose once distributed. They can either be a private ancillary fund (PAF) or a public ancillary fund (PuAF). PAFs are private in nature and established by business, families and individuals, while PuAFs are public structures for community and fundraising foundations.

Ancillary funds are required to make distributions to DGRs and must distribute a minimum percentage of their net assets to DGRs every year: for example, PAFs must generally distribute a minimum of 5 per cent of their net assets every financial year.

Ancillary funds can invest in social impact investments in two main ways:

- by giving a loan to DGRs at a lower than commercial rate and counting this discount as part of their minimum annual distribution; or
- by investing part of their corpus[49] in a social impact investment; the corpus is normally invested in traditional investments like shares and managed investments.

In May 2016, the Government made amendments to the *Private Ancillary Fund Guidelines 2009* and the *Public Ancillary Fund Guidelines 2011*, which set minimum standards for the governance and conduct of ancillary funds and their trustees.

Among the changes, the guideline's investment limitations were amended to allow ancillary funds to provide loan guarantees over borrowings of DGRs.

In addition, further guidance on calculating the distribution in relation to social impact investments was provided. This was achieved by adding further examples to the guidelines to assist trustees with calculating their distributions for a financial year where the fund has made social impact investments. The examples cover investing in lending money to DGRs at a discount to market rates and providing guarantees over loans provided to DGRs.

These changes had been advocated, most notably by Philanthropy Australia and the Prime Minister's Community Business Partnership. The changes that are now in the guidelines will allow ancillary funds to provide greater assistance to those DGRs that they were established to support.

48 DGRs are a fund or organisation that can receive tax deductible gifts. DGR endorsements are managed by the Australian Taxation Office. Some charities are not DGRs, and the donor cannot claim a tax deduction for gifts to non-DGR charities.

49 The corpus is the original gift made to the fund and any subsequent gifts which is used to make distributions to DGRs, invested to make returns and pay for the fund's ongoing costs.

AUSTRALIAN PRIORITY INVESTMENT APPROACH TO WELFARE

The Australian Priority Investment Approach to Welfare (the Investment Approach) uses actuarial data to estimate the future costs of the welfare system and identify specific cohorts who are at risk of long-term welfare dependence. It is similar to the Investment Approach initially developed and implemented by the New Zealand Government in 2011. In 2015, the McClure Report recommended that the Government develop and implement an Investment Approach in Australia.

The baseline valuation report for the Investment Approach was released on 20 September 2016. The report found that the future lifetime cost of Australia's welfare system for the current population is estimated to be $4.8 trillion as at 30 June 2015.[50]

The Government intends to provide controlled public access to a subset of the underlying Priority Investment Approach dataset from 2017, through three data access projects. These projects will accommodate the varying needs and expertise of a wide range of users, and encourage further analysis and co-creation of innovative solutions to welfare dependency.

A central component of the Government's implementation of the Investment Approach is the $96 million Try, Test and Learn Fund (the Fund) announced in the 2016-17 Budget. The Fund is intended to assist in the development and testing of innovative welfare interventions that will target groups who may have the capacity to work and are at risk of long-term welfare dependency. On 20 September 2016, it was announced that the priority group for the first round of interventions are young parents, young carers and young students who are at risk of transitioning to working age payments.

The first cycle of the Fund opened on 9 December 2016 and will close on 24 February 2017. The Fund will employ a similar approach to social impact investment models including:

- rigorous measurement: actuarial data will be used to identify specific cohorts who are at risk of long-term welfare dependence and who may have the capacity to work, and to evaluate the effectiveness of interventions along with other evaluation activities;
- the focus on reducing the risk of long-term welfare dependency; and
- redirecting resources to the most effective interventions: actuarial evaluations and other evaluation activities will be used to determine whether an intervention should be scaled up, continued or concluded.

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50 Department of Social Services 2016, *Valuation Report 30 June 2015 Baseline Valuation*, p. v, https://www.dss.gov.au/baseline-valuation-report-0.

DEPARTMENT OF FOREIGN AFFAIRS AND TRADE INITIATIVES

The Department of Foreign Affairs and Trade (DFAT) is actively identifying opportunities to build impact investment markets in the Indo-Pacific region. DFAT is working across markets, from business incubation support to establishing partnerships to invest in social enterprises and SMEs. Examples include:

- The **Investing in Women Initiative** is a new four year program in the South East Asia region which will promote economic growth, business development and gender equality. The program will work with impact investors to increase investment in women-led small and medium enterprises (SME), leverage investments to build knowledge regarding the women's SME market segment, promote the business case for investing in women, and build an impact investment market that brings a gender lens to its products and services.

- The **Impact Investment Exchange Asia (IIX) Women's Livelihood Bond**, funded in partnership with USAID, will mobilise up to $15.9 million in private capital providing loans for social enterprises and micro finance institutions to empower women to achieve sustainable livelihoods in Cambodia, the Philippines and Vietnam.

- The **Emerging Markets Impact Investment Fund** is in the early stages of design. The fund would allow DFAT to make non-grant investments in businesses and investment funds achieving development returns in the Indo-Pacific. The primary objective is to pilot new approaches to development financing for the Australian Government, catalysing additional private investment for development in the region. It will initially focus on improving access to finance for SMEs in Asia by investing in impact investment funds.

- The **Global Innovation Fund**, in which DFAT's innovationXchange is an investor, utilises a mix of grant, debt and equity to fund social innovation. The Global Innovation Fund supports breakthrough social innovations to global development challenges, from social enterprises, for-profit firms, non-profit organisations, researchers and government agencies.

- The **Social Entrepreneurship and Impact Initiative (SEIII)** is in the early stages of design. The initiative, led by DFAT's innovationXchange, will deliver a series of targeted market interventions in the regional impact investing marketplace. These interventions will make it easier for social entrepreneurs across the Asia-Pacific region to connect with impact investors and drive innovation to scale.

- The **Pacific Investment Readiness Pilot** commenced in July 2015 as a pilot partnership with The Difference Incubator, a social enterprise incubator linked to private impact investors. The pilot tested whether Australian models of social enterprise development could be applied in the Pacific islands, and whether investments could be catalysed under the right conditions. The pilot worked in Samoa, Tonga and Vanuatu, resulting in the establishment of the Genesis Impact Fund, a $3 million fund created by private investors.

- **Pacific Readiness for Investing in Social Enterprises (Pac RISE)** is a grant facility that will fund technical assistance for social enterprises based in or serving Pacific island countries to make them investment ready. The facility will go beyond the distribution of finance to 'crowd in' investment by working closely with impact investors to bring promising enterprises to their attention and encourage a focus on the Pacific. We will set a target for 50 per cent of assisted enterprises to be female-led, and all enterprises assisted will need to demonstrate a strong gender framework. We will also work with impact investors to encourage 'gender-lens' investing.