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Dear David

Social Impact Investing Discussion Paper

CPA Australia welcomes the opportunity to respond to the above Consultation. CPA Australia represents the diverse interests of more than 160,000 members in 118 countries. Our vision is to make CPA Australia the global accountancy designation for strategic business leaders. We make this submission on behalf of our members and in the broader public interest.

CPA Australia welcomes this timely discussion paper that explores the emerging area of social impact investing – where an investment seeks to achieve both positive social outcomes and generate a financial return - and some of the opportunities and challenges associated with it.

The public sector, the private not-for-profit (NFP) sector and the private for-profit sector each occupy and operate in a distinct space in Australia. Whilst there is some overlap between these sectors, the regulatory frameworks and governance structures that are in place for each of these sectors reflect their respective objectives, and are designed to protect their respective stakeholder interests.

Growth in social impact investing is likely to give rise to a sector that whilst not necessarily distinct, possesses attributes of the public sector, private NFP sector and private for-profit sector. Nurturing the growth of this relatively new approach to serving societal needs in Australia will require some careful thought in ensuring the appropriate governance structures and regulatory frameworks are developed to protect the interests of stakeholders in social impact investing.

In addition to generating savings/avoiding future costs for the Australian government, an enabling environment will also need to ensure the interests of private investors, service providers and recipients are adequately protected. With this in mind we provide our responses to the questions in the discussion paper in the Attachment.

If you require further information on any of our views expressed in this submission, please contact Ram Subramanian, CPA Australia by email at ram.subramanian@cpaustralia.com.au or 03 9606 9755.

Yours sincerely

A handwritten signature in black ink, appearing to be 'Stuart Dignam', written over a horizontal line.

Stuart Dignam
General Manager – Policy and Corporate Affairs

- 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?**

Although there have been some government led initiatives and there are a few non-governmental organisations committed to developing social impact investing in Australia, this is a relatively new proposition compared to other jurisdictions like the United Kingdom. Further growth in this nascent area will require a collaborative effort from federal and state/territory governments, the NFP sector and the investor community.

We highlight below some of the challenges that we foresee as barriers to the growth of social impact investing in Australia:

- Social impact investment funded initiatives may encounter a conflict between the objective of maximising social outcomes, the objective of minimising public spending and the objective of maximising financial return for investors. To ensure any such conflict is minimised, it is essential that all stakeholders involved in such initiatives are fully aware of the purpose and nature of such initiatives.
- An environment that seeks to nurture social impact investment needs to attract organisations and individuals with the right mindset and awareness of the unique characteristics of social impact investing. Not all investors may be willing or able to invest in initiatives with only social purpose. Similarly, social purpose initiatives should also have the capacity to generate a financial return in addition to achieving social outcomes.
- There is currently limited awareness of social impact investing and the opportunities and risks associated with it. The development of tools and resources that raise awareness and educate interested parties about social impact investing will be essential to ensure further growth of this area.
- Expertise on financial matters is a skillset that has been identified as an area for improvement at board level within the NFP sector. Assuming the NFP sector will play a significant role in service delivery funded by social impact investing, board level financial expertise will be essential, particularly as generating a financial return will be a prerequisite in many cases for such initiatives.
- The legal structures that currently exist in Australia do not readily provide a perfect fit for an entity with all the attributes envisaged for a social enterprise. Section 5.4 of the discussion paper considers this issue and we provide our views on this matter in response to questions raised in that section.
- Multiple references are made throughout the discussion paper about the importance of the measurement and evaluation of outcomes and other non-financial measures of entities engaged in social impact activities. We agree that reporting of the social impact achieved by entities will be a critical measure of success. There is a well-established financial reporting framework in Australia that enables the measurement and reporting of financial performance. However there is no similar well-established framework for the measurement and reporting of non-financial performance measures that represent an equally important yardstick of success. The Australian Accounting Standards Board (AASB) published Exposure Draft 270 *Reporting Service Performance Information* in August 2015 setting out proposals for the reporting of non-financial performance measures by public and private NFP entities. Following feedback to this consultation, the AASB is currently reconsidering its original proposals. We suggest pursuing the establishment of a service performance reporting framework with the assistance of the AASB and other constituents.

There are other well developed reporting frameworks that may provide suitable solutions for the reporting envisaged for social impact investing. The Integrated Reporting <IR> Framework though primarily written in the context of private sector for-profit companies, and thus with a provider of financial capital audience in mind, is nevertheless readily adaptable to different structures and organisational purposes of existence. Centred as it is on ideas of integrated thinking, explanation of the organisation's business model and value creation, <IR> seems potentially well suited to social impact investing affording providers of this class of capital a basis of holistic assessment of performance and outcomes. CPA Australia's Chief Executive Alex Malley is a member of the International Integrated Reporting Council (IIRC) and both the organisation and our CEO remain staunch supporters of this holistic and value based reporting methodology.

- The cost of raising funding for social impact investments may differ from other mainstream funding methods such as donations and government grants. If the initial and ongoing costs of raising finance via social impact investing is significantly higher than other forms of funding, then this will constitute a barrier for social impact investing's growth
 - Individuals wishing to provide finance to charities may prefer to make tax deductible donations rather than providing funding via social impact investing - where any investment the returns may form part of their taxable income.
 - It is likely that the dual purpose of social impact investing may lead to lower financial returns for investors. Returns that are less than 'traditional' investments may affect investor interest in social impact investment products.
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?**

CPA Australia supports the proposal that the Australian Government should assist with the creation of an enabling environment for private sector-led social impact investing. The Australian Government should play a lead role in bringing together all relevant stakeholders to design and develop such an environment. We also support the proposal that the Australian Government should play a stewardship role in ensuring an appropriate regulatory framework is established to oversee the growth of the social impact investment market. An appropriate regulatory framework is crucial for the Australian Government to offer explicit public endorsement of this market to encourage significant private investor interest in it (while not necessarily endorsing particular investment products).

Collaboration between federal and state/territory governments is necessary for the success of social impact investing. Collaboration between the two levels of Australian government should extend beyond co-funding arrangements to developing a seamless regulatory framework that applies uniformly across the country. It will be counterproductive for separate frameworks to be established by the federal and state/territory governments independent of each other.

We also note that some of the submissions to the Financial System Inquiry (FSI) review proposed a more proactive role for government(s) in developing social impact investment markets. These suggestions included governments providing risk capital to attract initial investments, developing a dedicated social investment bank and introducing tax concessions.¹

We understand that currently in NSW there are a number of financial instruments or social benefit bonds on offer.² We are also aware that in the UK products of a similar nature have been available for some years also. A number of other countries have also been actively involved in social impact investing. Notably a Social Impact Investment Taskforce formed under the auspices of the Group of 8 (G8) countries in 2013 has been exploring the prospects for growth in global social investment markets. Countries including Israel, South Africa, Portugal, Mexico, Brazil, India, China, Finland, South Korea and Argentina have all been involved in creating social impact investment markets within their respective jurisdictions as part of this initiative. We encourage the review to take these initiatives into consideration in its deliberations.

We note also that the Final FSI report stated 'The Inquiry sees merit in Government facilitating the impact investment market. Government's involvement should include 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 emerging market.'³

¹ <http://fsi.gov.au/publications/interim-report/03-funding/impact-investment/>

² <http://www.osii.nsw.gov.au/initiatives/social-benefit-bonds/>

³ P262, http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf

There is also an argument for a concessional tax treatment for income derived from qualifying social impact investments. In this regard we note that the UK's social venture capital schemes (VCTs) are to have the tax advantages that VCTs currently have⁴, including tax free dividends and capital gains amongst other things.⁵

However such an approach should be adopted in Australia is a moot point. The questions are whether such a model ultimately delivers better social outcomes overall, and whether it is affordable to the public purse. This will depend on many factors, for example the ultimate design features should a social impact investing regime be developed, and also investor uptake.

We encourage this review to consider the costs and benefits of similar tax policy options and initiatives especially since the tax reform white paper process is now defunct.

- 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?**

The succession of Intergeneration Reports, as well as the various federal, state and territory annual budgets lay bare the competing priorities of health, aged care and funding the NDIS amongst others as challenges Governments at all levels need to address.

CPA Australia sees all of these areas as holding fertile ground for social impact investing.

As well as the abovementioned broad areas there are two more specific areas of concern to us, these being – not necessarily in order – youth unemployment, and mental health.

Besides the social issues associated with both of these issues, they are also both a significant economic drag on the public purse and the economy. In this regard we encourage governments to continue to develop policies and execute plans that may ameliorate these challenges with the objective in mind of assisting in providing support to enable these people to become active and productive members of society.

For completeness we also advise that as a professional member association with a focus on the public interest our organisation has recently invested in putting the public spotlight and raising funds to address on the pressing need to find a cure for motor neurone disease.

- 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?**

One of the biggest challenges in implementing the public data policy will be the cost of accessing data held by Government agencies and regulators. The Australian Securities and Investments Commission (ASIC) is required under law to levy a fee (e.g. \$38 for a copy of a financial report) for anyone to access company information held on the ASIC database. Similar fees are charged by other regulators for access to information, for example Consumer Affairs Victoria charges different fee amounts for access to information relating to a Victorian incorporated association.

Another challenge that will arise is the existence of multiple databases that hold information on social enterprises or other entities involved in delivering social impact, depending on the legal structure they take. For example, information on a company which is not a charity will be available from ASIC and information on a Victorian incorporated association will be available from Consumer Affairs Victoria.

To address the above challenges the Governments will need to consider reviewing and revising its own data access policies, and secondly, engage with other government regulators on the potential for sharing data publicly and freely, possibly through a common portal. The "report once use often" approach adopted by the Australian

⁴https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/467531/150930_OS_VCT_Intro_Note_draft_v0.2.pdf

⁵ <https://www.ft.com/content/88c9252a-cd78-11e4-a15a-00144feab7de>

Charities and Not-for-profits Commission (ACNC) for registered charities may be a model worth considering for this initiative.

The nature and content of data that will potentially be made publicly available will need to be determined. As stated in our above response, whilst there is an established framework for financial reporting, a reporting framework for other non-financial performance measures is still being developed.

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

The four proposed principles and their objectives have been developed to guide the Australian Government's participation in the social impact investment market. This leads to a presumption that the Australian Government will always have some form of involvement in all social impact investment activities.

Whilst we broadly agree with the four principles, application of the principles as currently drafted to social impact initiatives that have no Australian Government involvement may not be entirely appropriate. We recommend the principles be redrafted to ensure they remain applicable to social impact investment initiatives regardless of whether the Australian Government has a direct involvement in such initiatives.

For example, under principle 4 it is stated that "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". We suggest removing the words "...which are priorities for the Government".

- 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?**

We agree with the proposals to reference section 708(8) Sophisticated Investors of the Corporations Act 2001 when seeking to demonstrate control by sophisticated investor(s).

In considering the issue of sophisticated investors, we note that Private Ancillary Funds (PAFs) have been singled out because the FSI identified PAFs as a potentially important investor class for social impact investment products. The sophisticated investor issue could however equally apply to other investor classes interested in social impact investment too. We therefore recommend any consideration of how this issue is addressed should take into account the existence or non-existence of sophisticated investors in all other investor classes that may seek to invest in social impact investments.

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

We note the FSI's final report recommendation 32 that 'the Australian Prudential Regulatory Authority (APRA) should provide clearer guidance to superannuation trustees on the appropriateness of impact investment, as current guidance is limited⁶. The primary objective of superannuation is long term retirement savings, that is, growing and maximising members' retirement savings. CPA Australia is of the view that investment decisions by superannuation trustees should not be externally restricted or mandated in any way. Restricting investments could result in significant distortions in Australian markets by artificially increasing the demand for certain asset classes and taking investments away from alternative and potentially better-performing, asset classes.

The discussion paper refers to APRA's prudential practice guidance SPG 530 which states that trustees can offer ethical investments provided they act in accordance with their fiduciary duty to act in the best interests of the members under relevant legislation. We do not however agree with the assertion made in the discussion paper that ethical investments also include social impact investments, in our view there are subtle differences between the two.

For example the primary focus of an ethical investment is likely to be on maximising financial return to investors, but with an added focus of investing ethically. Social impact investments however are investments made with the intention of measurable social outcomes in addition to a financial return.

Superannuation trustees must always make investment decisions aimed at protecting the interests of members and a social investment vehicle that has a "dual" purpose that also includes achieving social impact may result in a breach of superannuation trustees' fiduciary duties. Unless it can be unequivocally demonstrated that social impact investments will not impede the primary purpose of superannuation, we would recommend against any guidance or suggestions that such investments are appropriate for consideration by superannuation trustees.

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?

Please see our earlier commentary on the potential tax barriers to the growth of social impact investing and our suggestion that the review consider the costs and benefits of introducing concessional tax treatment for income derived from qualifying social impact investments.

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?

We suggest that the conflict alluded to may be overstated. The maximisation of financial return is not a specific requirement within Australian corporate law, rather that directors exercise their powers in good faith and in the best

⁶ P261, http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf

interest of the company as a whole. Nevertheless, potential for confusion could to a substantial degree be alleviated through appropriate wording of the social enterprise's objects within its constitution.

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?

We acknowledge the arguments in the discussion paper for and against establishing a distinct legal structure (similar to the UK Community Interest Company) to engage in social impact activities in Australia. The proposal that the attributes necessary for a social enterprise can be provided for in a company's constitution or through quarantining assets in a trust may provide an alternative, but expensive solution. Model constitutions and other template mechanisms may reduce the costs involved, however there remains the risk that such checks and measures can be modified or altered by the entity's owners.

In either circumstance of making available model constitutions or allowing the parties to develop and adopt their own, sufficient statutory recognition will need to be given to the contractual effect such that issues of privity and presumed knowledge of terms and conditions will be made clear.

In order to find answers to some of the questions around appropriate legal structures, this initiative may benefit from a fact-finding exercise that seeks to identify:

- the legal structures chosen for social impact vehicles currently and the reasons for such choices
- the level of investor protection available under different legal structures, and
- ongoing operating costs dependent on the legal structure used.

We appreciate that a new legal structure will add to the number of legal structures that currently exist, potentially increasing regulatory burden both for the Australian Government, and for other stakeholders. An alternative solution could be to consider an approach loosely based on the registered charity model under the ACNC provisions.

Under this alternative, entities that wish to be social enterprises will register with a Commonwealth regulator and commit to the rules and requirements stipulated by the relevant laws or other regulations. This would allow social enterprises to choose from a variety of legal structures but commit to an overlay of rules and principles applicable to a social enterprise.

A common data portal could also be established under this alternative for entities involved in social impact activities to make relevant information available to investors, the public and regulators.