FINANCIAL SYSTEM INQUIRY

SUBMISSION
ON FINANCIAL SYSTEM REFORMS
TO SUPPORT
THE DEVELOPMENT OF SOCIAL IMPACT INVESTING AND
THE FINANCING OF SOCIAL ENTERPRISE

1. The Case for Inclusion of Social Impact Investing and the Financing of Social Enterprise in the Financial System Inquiry

We believe it is vital that impact investing and the financing of social enterprise be regarded as a mainstream consideration of the Financial System Inquiry.

The world of financial markets is changing. There is increasing recognition of the capacity and need for impact investment, as is acknowledged by the formation of the G8 Impact Investment Advisory Task Force, launched by British Prime Minister David Cameron. It is well understood that such forms of investment can provide institutional quality financial returns and deliver important social purpose outcomes.

A recent speech by Mr Cameron (attached as Appendix A), highlighted the growth of this market, the need it fulfils and the capacity for government to play a 'light touch' but constructive role in facilitating its growth. These are powerful precedents for the Inquiry to consider and from which to draw.

To facilitate and deliver these reforms, our submission proposes the following five themes for reform:

1. Access to capital
2. Consider the establishment of a dedicated social 'investment bank'
3. Implementation of tax concessions and incentives
4. Strengthen the role of financial intermediaries
5. Review the structural barriers to appropriate investment

Our submission outlines in further detail below, how best to develop these themes drawing in some cases on evidence of reforms being undertaken overseas in the area of impact investing. It is exactly the kind of reforms that the Financial System Inquiry is well placed to address

2. About Social Ventures Australia

Social Ventures Australia (SVA) invests in social change. SVA is a not for profit who over the last twelve years has worked with over 100 social enterprises with proven track records in tackling the issues behind social disadvantage. We have also delivered over 450 projects through our strategic consulting service, many supporting social enterprises to develop and grow. By partnering with these innovative, entrepreneurial ventures we know that traditional avenues for capital raising are not meeting the market need. There are limited funding options open to the social sector to help grow proven ventures, particularly to support the building of quality organisations though the provision of appropriate infrastructure funding.

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

In 2012, SVA established a social impact fund under the Commonwealth Government's SEDIF program. The fund has over $9m to lend and invest in social enterprises across Australia and to date is approximately 30% invested. SVA brought in more than 35 investors to match the Government grant of $4m to create the fund which fills a financing gap in the mainstream financial system.

SVA launched Australia's first social impact bond in 2013, the $7m Newpin SBB[1] which used private capital to fund a restoration program for children in foster care in NSW. This 'payment upon success' model allowed Government to evaluate the success of the program before committing to pay for the anticipated savings, as well as generating both financial and social returns for investors.

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

3. Social enterprise and social investment in Australia: its place in the financial system

As outlined in the November 2011 Senate Inquiry Report (Investing for Good) the non-profit sector supports industries that contribute to Australia's growth and standard of living; eg

- Housing – social and affordable
- Health – community, rural, research
- Indigenous businesses
- Aged Care
- Child care
- Disability services
- Employment services
- Justice – advocacy, rehabilitation, diversion

4. Barriers and shortcomings in current financial system

The current financial services system has been and remains inadequate for the non-profit sector most often due to the limited scope for traditional bank debt. Reasons include the following:

- Social enterprises are less attractive investments in relation to: revenue stream, available security, financial reporting and measurement, and relatively large transaction costs for banks

[1] Social benefit bond (SBB) has been the name for social impact bonds in NSW.

- The social sector is generally not well known or understood by banks and usually lending is only on the basis of mortgage security
- There are some community sector banks, eg Bendigo, MECU, but they focus on local community personal and business banking rather than social enterprise lending or investing
- Charities are generally risk averse in terms of taking on debt
- The 'sole purpose test' governing superannuation funds precludes valuing the social or community element of a business or social enterprise in making investment decisions.
- Trust law across Australia also requires all trustees including charities and private ancillary funds to act on behalf of beneficiaries without the flexibility of taking into account any social or community impact of an investment. In contrast the UK Charity Commission released guidance in 2012[2] explaining to UK trustees of charities that ethical considerations are relevant for investment decisions even if the investment might provide a lower rate of return than an alternative investment.

The raising of equity has also been scarce not just due to the smaller number of significant businesses in the sector but also due to the legal structures that dominate the sector and limit the available methods of capital raising:

- Most non-profit or 'for purpose' entities are structured as companies limited by guarantee or incorporated associations which are, by virtue of their legal structure, not able to issue equity
- Deductible Gift Recipient rules also effectively mean that capital can be raised either by equity or by philanthropy but not by both
- The duty of directors to act in the "best interests of the company" effectively requires profits before philanthropic mission

In response to the scarcity of bank support or interest in the sector there has been considerable financial innovation often as a means of addressing the lack of easily accessible capital. Some examples of this include:

- The use of acquisition funding including coupon bearing subordinated 'social capital': Goodstart Early Learning 2009 (acquisition of ABC Learning Centres)
- Social benefit bonds: Newpin NSW 2013; The Benevolent Society NSW 2013
- Social investment funds established by the Commonwealth's SEDIF program: Foresters Community Finance , SVA Social Impact Fund, SEFA
- Charitable bonds: Chris O'Brien Lifehouse 2010
- Crowdfunding: Pozible, Chuffed

5. Models and initiatives in other countries

There has been significant development internationally in broadening the funding base for social enterprises and the non-profit sector, particularly in the UK and the US. Some examples which we consider worthy of mention and as initiatives inviting further consideration in Australia include:

[2] https://www.charitycommission.gov.uk/publications/cc14.aspx#c2

- Big Society Capital (UK)[3] – GBP600m wholesale lender established by unclaimed bank account monies as well as UK clearing bank and Lotteries contributions. Big Society Capital lends to community development finance institutions and other 'front line' lenders and has been a major catalyst in the on-going development of the UK social impact investment market;
- In the UK tax relief will be introduced for investors in social impact bonds and also for social enterprise funding[4] which is expected to raise GBP480m in additional social investment.
- Benefit Corporations (US); L3C (US); Community Interest Company (UK) are all vehicles that allow flexible incorporation of both social and financial outcomes in a company's decision making;
- The US Community Reinvestment Act (CRA) is a federal regulatory regime aimed at encouraging financial institutions to meet the credit and service needs of the entire community. The CRA was passed in 1977 as a result of concerns raised in the community that certain poorer neighbourhoods were being denied access to lending and services. The CRA requires that the record of agreed banks be evaluated periodically by the relevant federal agencies: lending, investment and service. As of 2010 the CRA has resulted in over 340 agreements between CDFIs and Financial Institutions to the value of US$1 trillion.
- Furthermore, in 1994 the Clinton Administration established a Community Development Financial Institute (CDFI) Fund through the Riegle Community Development and Regulatory Improvement Act, awarding over $1 billion of funding to CDFIs, to support the sector's capitalisation and capacity building.
- The US CDFI Fund provides grant funding and technical assistance and implements the following programs:
    - Technical Assistance program – provides financial assistance for product development, and client support costs.
    - Bank Enterprise Award Program (BEA). The BEA program rewards banks and thrifts which are active in community development including support of the CDFI industry, sitting on boards, assessing risk and providing flexible products.
    - New Market Tax Credit Program. This permits tax payers to receive a credit against federal income taxes for making qualified equity investments in designated CDFIs. It was designed to leverage investment and has attracted over US$16 billion to the CFI sector since 1994.
    - Native American CDFI program (NACA) established in 2002. This provides specialised advice to CDFIs serving indigenous areas within the USA.

It is SVA's belief that there is no fixed international template which Australia could or should adopt but rather there are a series of lessons which can be learned from international experience and should be applied in fashioning a home-grown approach. There is further background to this approach in the SVA Consulting report[5] commissioned by the then Department of Families, Housing,

[3] http://www.bigsocietycapital.com/
[4] https://www.gov.uk/government/publications/social-investment-roadmap/social-investment-roadmap
[5] The report which can be found at http://www.dss.gov.au/our-responsibilities/indigenous-australians/publications-articles/community-development-finance-institutions-scoping-study

Community and Indigenous Affairs (FaHCSIA) on the role a CDFI sector could play in enhancing access financial products and services by excluded organisations and individuals.

6. Themes for reform

We would urge the Inquiry to look closely at the following themes as areas of much needed reform which would lead to the development of more social investment and a greater social capital market as well as greater engagement with the Australian financial services system.

(a) **Access to capital** – to look to increase access to capital (both debt and equity) for the social sector, including the growth of social enterprises as well as capital for the construction of social and affordable housing. Leveraging private capital should be a key tenet of such an initiative.

(b) **The Inquiry should consider the establishment of a dedicated social 'investment bank'** like the UK's Big Society Capital which could be supported by the 'Big 4' and funded by unclaimed superannuation and/or bank accounts. This organisation would also look to build effective methods to measure social impact so a standard can be adopted by the mainstream financial investor community. We note the G8 Taskforce is specifically looking at work in this area.[6]

(c) Consideration of **tax concessions and incentives** for social impact investment to increase access to finance and reduce its cost over the longer term in the sector (as recently seen in the UK).

(d) **Ensuring a renewed corporate bond market is sufficiently flexible to accommodate funding for social infrastructure** (including social and affordable housing) and facilitating joint "for profit" and "for purpose" projects.

(e) Strengthen **the role of financial intermediaries** in the social investment marketplace and the infrastructure to develop and support such new markets; This is a critical role in the 'for profit' sector, but relatively unknown in the non-profit or 'for purpose' sector where expertise and institutional capability to bring together funders and organisations in need of innovative forms of capital is much needed, and

(f) **Review the structural barriers to appropriate investment** including regulations, corporate entity legislation and standard definitions that restrict new investment.

7. Further information

We would be pleased to discuss any aspect of this submission with the Inquiry. In particular, there are several specific reforms that we have considered within the framework of the themes for reform outlined above. We would be pleased to develop those further with the Inquiry.

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

8. Other Proponents of this Submission

As well as SVA this submission is supported by, and made on behalf of:

[6] https://www.gov.uk/government/policy-advisory-groups/social-impact-investment-taskforce

- **Ashurst Australia**. Ashurst is a leading international law firm advising corporates, financial institutions and governments. It has offices across Asia, Australia, Europe, the Middle East and the Americas. Ashurst has an active pro bono practice across all of its offices and is active in advising on social enterprise and social investment projects. *Contact*: Michael Ryland, Partner, 02 9258 5627, michael.ryland@ashurst.com
- **Chris Cuffe –** Chris was former CEO of Colonial Mutual and is now involved in a portfolio of activities including directorships, managing public and private investments, and in various roles assisting the not-for-profit sector.

  This includes:

  - Chairman of UniSuper (the $38 billion superannuation scheme servicing the staff of universities and related institutions across Australia);
  - Non executive director of Fitzpatrick Private Wealth (a national advisory and wealth management firm);
  - Founding director and portfolio manager of Third Link Growth Fund (a managed investment scheme investing in Australian shares where the management fees received are donated to charity)

Appendix 1 – Prime Minister David Cameron's speech at the Social Impact Investment Forum in London on 6 June 2013.

It's great to welcome so many of the world's top social entrepreneurs and investors to London. As Prime Minister I am frequently asked to speak at conferences. But this is a conference I actually asked to speak at. In fact, I asked to set the whole thing up. Today I want to tell you why.

We've got a great idea here that can transform our societies, by using the power of finance to tackle the most difficult social problems. Problems that have frustrated government after government, country after country, generation after generation. Issues like drug abuse, youth unemployment, homelessness and even global poverty. The potential for social investment is that big. So I want to make it a success in Britain and I want to sell it all over the world.

So how does it work? Businesses need finance to grow and make profit. Governments need finance to fund big infrastructure projects. That's why we have banks, bonds, investment markets and all the rest. The idea here is just as simple and just as powerful. Social enterprises, charities and voluntary bodies have the knowledge, human touch and personal commitment to succeed where governments often fail. But they need finance too. They can get it from socially minded investors. So we need social investment markets, social investment bonds and social investment banks. And here government needs to help. Government needs to be more creative and innovative – saying to social entrepreneurs: "if you can solve the problem we'll give you money." As soon as government says that, social entrepreneurs can go out and raise capital. So that is exactly what the British government has been saying. And I am proud that Britain has led the way from the outset. We have created the first social impact bond – with more of these bonds in the UK today than in the rest of the world put together. We had the first charity bond too. And last year, I think our proudest creation yet, the first ever wholesale social investment bank - Big Society Capital.

I knew we had to be bold here to make this work. A few million pounds was never going to be enough. So we took - not just some but - all the dormant funds from banks, together with further contributions, to provide a pot of £600 million to invest in our society. And we asked Sir Ronnie Cohen – the grandfather of social investment – to chair it. In just its first year, Big Society Capital has already committed £56 million to 20 different intermediaries, already supporting 23 frontline organisations and creating 13 new social investment intermediaries. That sounds quite technical. So let me put it simply. Big Society Capital matters because it is giving brilliant social entrepreneurs with dreams bigger than their budgets, the means to prove themselves, scale up and do more.

Take the story of Jim Clifford and his wife Sue who have nine adopted children. They are at the centre of the first social impact bond for adoptionbeing created today. How does it work? Every child who remains in the care system costs the taxpayer around three quarters of a million pounds. The fact is that government has never been that good at finding homes for them. This government is changing the rules, promoting adoption doing everything we can to give children the chance of a loving home and one of the ways we can do that is by using *voluntary groups and social enterprises to find homes for the hardest to place children. So Jim has created a social impact bond that will help them access that finance from socially minded investors. The way a social impact bond works is simple. When it succeeds, investors are paid from the savings to the taxpayer, but if it doesn't work, the taxpayer doesn't pay a penny. By scaling up Jim's programme nationwide over the next decade, it's not just investors who could get a return. 2,000 children who would otherwise have been overlooked could get loving homes and the taxpayer could save as much as £1.5 billion in fostering fees. That's the power of social investment. And it's why I want to work with our international partners – and the new Social Impact Investment Taskforce to grow a bigger global market in social investment that can change more lives here in Britain and right across the world.*

Growing a bigger global market, starts at home. And today we are announcing three major new steps. Tax breaks for social investments. A Social Stock Exchange to measure how successful those social investments are. And most importantly, new help for our communities to buy local assets. I want to take the third of those first. Some people will say – "social investment, all very interesting but how will it affect my life? What could it mean for my community? Of course, we all benefit from tackling deep social problems, but social investment can help transform every community. Here's how: everyone knows how vital institutions in our towns and villages are, like village halls, playing fields, local pubs. And everyone knows how - despite the best efforts of parish and local councils - these can face closure. I want our social investment funds to give people the opportunity to take them over and run them. This isn't some pipe dream. Already there are 311 community-owned shops,18 community-owned pubs, as well as community owned bookshops, cafes, swimming pools, bakers, famers markets, even community owned broadband networks.

But people need finance to make this happen. And here is the answer. TodayBig Society Capital and the Big Lottery Fund are making a long term commitment to provide a quarter of a billion pounds over the rest of this decade to help communities with ambitions to own local assets like pubs, shops, community centres and affordable housing. Now, of course, some assets are never going to be viable in commercial terms and will always need grants and so part of the money from the Big Lottery Fund will go to help with that. But what is really exciting and innovative is that many assets can be run on a commercial basis given the right mix of upfront funding. So as part of their longer-term commitment, Big Society Capital and the Big Lottery Fund are developing a £50 million Community Assets Fund that will provide a blend of grants and loans to help communities through the phases of local ownership. This will start making payments from next year. It will mean that community groups will be able to explore the feasibility of projects without incurring major debts if they decide not to proceed. At the same time, long term loans will be available to those that do go ahead - attracting further funding from local authorities, philanthropists and Local Enterprise Partnerships.

Take Fenham Swimming pool in Newcastle, for example. First opened in 1938, it was closed by Newcastle City Council in 2003 despite opposition from local residents. So a group from the Community representing schools, residents and health providers came together and saved it. But as they went along, they found they had to meet significant capital costs and the whole project was coming under pressure again. But then with investment from Big

Society Capital they were able to install solar panels to heat the pool, reduce their running costs and make it financially viable as a community centre. Thanks to Big Society Capital and the Big Lottery Fund this new Community Assets Fund - another British world first will mean that projects like this will be possible not in just in one community – but in every community across the country.

Let me turn to two other important developments. First, I've said before that I want to make Britain one of the best places in the world in which to invest and do business and as a government we are working tirelessly to create the best possible environment for business investment. But if we are serious about social investment – the same test applies. How do we create the best possible environment for social investments in Britain? One key part of that is the tax system. If we want people to take on the risk of an investment, we need to reward them and help their investment to become self-sustaining. We've done that for venture capital, it is time to do the same for social capital too.

That is why in the Budget, the Chancellor said that we would consult on a Social Investment Tax Relief. We are launching that Consultation today and we welcome your input. Social investment can no longer be the poor relation. I want you to help us shape an effective tax incentive that mirrors many of the features of the successful tax advantaged venture capital schemes.Big Society Capital tell us that tax reliefs could generate an extra half a billion pounds in social investments over the next five years. And I am determined that we should see the benefits of that.

Second, it is not enough just to incentivise social investments. We need a robust way of measuring their value and in doing so connecting businesses that deliver social and environmental value with investors seeking both a social and a financial return. So I am absolutely delighted that today the London Stock Exchange is supporting the launch of the world's first Social Stock Exchange, an online portal that will become the first information platform on the planet to showcase publicly listed social impact businesses. The market capitalisation of the first 12 Social impact businesses launching on the Social Stock Exchange today is already £500 million. The next 13 businesses set to join in October will add another £700 million. And this is just the beginning. For years the London Stock Exchange has made London the home for private finance, today London can cement its place as the home for social finance too.

Let me finish by saying this. Some people have asked whether I still believe in building a bigger, stronger society? I say to them - look around this room. See how social investment can help to change lives. See how social investment is bringing communities together. See how social investment is making our societies and therefore our countries stronger. Am I prepared to fight for that? You bet I am. Social investment can be a great force for social change on the planet. It can help us to build bigger and stronger societies. That power is in our hands. And together we will use it to build a better future for ourselves, for our children and for generations to come.