COMMONWEALTH OF AUSTRALIA

Proof Committee Hansard

SENATE

ECONOMICS REFERENCES COMMITTEE

Finance for the not-for-profit sector

(Public)

MONDAY, 1 AUGUST 2011

CANBERRA

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SENATE

ECONOMICS REFERENCES COMMITTEE

Monday, 1 August 2011

Senators in attendance: Senators Bishop, Bushby and Stephens.

Terms of reference for the inquiry:

To inquire into and report on:

Mechanisms and options for the development of a robust capital market for social economy organisations in Australia, including:

(a) the types of finance and credit options available to not-for-profit organisations, social enterprises and social businesses, the needs of the sector and international approaches;

(b) the role and current activity of financial intermediary organisations and how these can be strengthened;

(c) strengthening diversity in social business models;

(d) the development of appropriate wholesale and retail financial products and services;

(e) government actions that would support the potential for social economy organisations involved in the delivery of government services to access capital markets;

(f) incentives to support investment in the sector;

(g) making better use of the sector's own financial capacity, including practices relating to purchasing of products and services and use of reserve capital;

(h) making better use of the corpus of philanthropic foundations and trusts to make investments in Australia's social economy organisations, expand socially responsible investments and impact investments and any current barrier to their investment;

(i) policies, practices and strategies that affect the availability of capital markets for social economy organisations on social innovation, productivity, growth and workforce issues in these sectors; and

(j) any other related matters.

WITNESSES

LEWIS, Mr Evan, Group Manager, Department of Families, Housing, Community Services and Indigenous Affairs

MANCE, Ms Paula, Branch Manager, Department of Families, Housing, Community Services and Indigenous Affairs

NICOL, Ms Annemarie, Branch Manager, Department of Families, Housing, Community Services and Indigenous Affairs

OSWALD, Ms Robyn, Manager, Money Management Branch, Department of Families, Housing, Community Services and Indigenous Affairs

Committee met at 10:01

CHAIR (Senator Bushby): I declare open this first hearing of the Senate Economics References Committee's inquiry into mechanisms and options for the development of a capital market for social economy organisations. On 9 February 2011 the Senate referred this inquiry to the committee for report by 31 October 2011. To date the committee has received 23 submissions, which are available on its website. These are public proceedings, although the committee may determine or agree to a request to have evidence heard in camera. I ask photographers and cameramen to follow the instructions of the committee secretariat and ensure that senators' and witnesses' laptops and personal papers are not filmed.

I remind all witnesses that, in giving evidence to the committee they are protected by parliamentary privilege. It is unlawful for anyone to threaten or disadvantage a witness on account of evidence given to a committee and such action may be treated by the Senate as a contempt. It is also a contempt to give false or misleading evidence to a committee. If a witness objects to answering a question, the witness should state the ground upon which the objection is taken and the committee will determine whether it will insist on an answer having regard to the ground which is claimed. If the committee determines to insist on an answer, a witness may request that the answer be given in camera. Such a request may, of course, also be made at any other time.

I remind members of the committee that the Senate has resolved that departmental officers shall not be asked to give opinions on matters of policy and shall be given reasonable opportunity to refer questions to superior officers or to a minister. This resolution prohibits only asking for opinions on matters of policy and does not preclude questions asking for explanations of policies or factual questions about when and how policies were adopted. I welcome officers from the Department of Families, Housing, Community Services and Indigenous Affairs. I invite you to make an opening statement.

Ms Oswald: Thank you for the invitation to appear today. The government has funded a pilot program that explores the possibility of developing a community development financial institution, or CDFI, sector in Australia. We welcome this inquiry into finance for the not-for-profit sector. Given that many of the CDFIs involved in the FaHCSIA pilot are themselves not-for-profit organisations, the information we have gathered and learnings over the course of the pilot have the capacity to inform the work of the committee.

As you are no doubt aware, CDFIs are independent financial institutions that are defined by two characteristics: they have the primary aim of providing appropriate access to financial products and services to those who are underserved by mainstream financial institutions; however, they also have a business model that maximises financial sustainability and independence from government funding. They do this by leveraging philanthropic and private investment to cover costs and in some cases even generate a return on capital investment.

On 27 January 2010 Minister Macklin approved funding to conduct a pilot of the operation of a CDFI fund as proof of concept and to gain further information on the needs of those financially excluded in Australia. Funding for this initiative was part of an allocation under the financial management program as a response to the global financial crisis and was targeted towards helping to build the financial capacity of people on very low incomes. Around $6 million was allocated to organisations to conduct the pilot and $300,000 was set aside for an evaluation and policy scoping study. The objective of the pilot is to test the CDFI model for addressing financial exclusion by providing capital and infrastructure funding to a small number of Australian CDFIs that offer financial products and services to individuals at risk of financial exclusion.

The model essentially consists of two components: an infrastructure pool and a capital pool. The funding provided by FaHCSIA was directed into the infrastructure pool. The government does not currently provide capital funding. This is provided by financial institutions. This was one of grant funding that could be used for a number of business development purposes, including technical assistance, product development, operational support or research. FaHCSIA also invited investors, comprising the four major banks, to be part of an investment circle that was able to assess the capital investment potential of, and invest in, the retail CDFIs that applied for funding through the pilot.

While maintaining open communication with FaHCIA, the members of the investment circle independently assessed applications in accordance with their own criteria. They then entered into their own arrangements to provide capital to the CDFIs as appropriate. Not all applicants required a capital source provided by a member of the investment circle. Leveraging investment by the banks to work with CDFIs is a central element of the project. It is clear that the involvement of major banks is a critical component for the sustainability of CDFIs in the medium to longer term. At the same time, FaHCIA also led an interdepartmental working group, including representatives from the Department of the Prime Minister and Cabinet, Treasury and DEWR, to investigate the necessary framework and legislation required to support a CDFI sector in Australia. I understand that the committee will be speaking with DEWR later today about their Social Enterprise Development and Investment Fund model—the SEDIF model.

Calls for applications for our pilot were advertised nationally during the week of 7 July 2010. At that time, FaHCIA also ran a series of information workshops in capital cities and made available an information pack for potential applicants. In order to provide you with some background to FaHCIA's CDFI pilot, we have available a copy of the CDFI fund guidelines if you would like those. They were included in the information pack for potential applicants.

For the pilot we received 14 applications and we assessed those against three criteria—firstly, their contribution to financial inclusion; secondly, the demonstrated ability of the organisation to manage and implement its business plan and achieve quality outcomes for low-income or disadvantaged individuals; and, thirdly, the financial sustainability of the organisation. The final criterion was independently assessed by KPMG. Six of the community financial organisations were assessed as suitable. One of the organisations was not able to participate in the pilot as they were unable to secure capital funding support from the investment circle and did not have a financial services licence. However, this organisation was able to be directed into another FaHCIA funded program and they are now delivering the No Interest Loan Scheme to financially excluded individuals in the Toowoomba area. The remaining five organisations were funded to participate in the pilot. Those five organisations include Foresters Community Finance, Community Sector Banking, Many Rivers Opportunities, Fitzroy and Carlton Community Credit Cooperative, and the Fair Loans Foundation. These organisations have a presence in every state and territory, with the exception of the ACT, and one of the organisations, the Fair Loans Foundation, is providing loans nationally via the internet. We can provide more details on these organisations if you wish. Most importantly, these CDFIs are specifically designed to provide fair and appropriate access to financial products and services to individuals who are excluded from mainstream financial products and services.

The pilot was formally launched by Minister Macklin on 17 February this year. Since that time, the five organisations participating in the pilot have been working to build the capacity of their organisations to deliver the products and services detailed in their application. These include: establishing offices and shopfronts, recruiting personnel, developing marketing strategies, establishing credit control and compliance systems, and establishing financial literacy programs for their clients. Two of the organisations are currently delivering loans. As at 7 July the Fair Loans Foundation, who are providing loans via the internet, informed us that they have approved over 130 loans at a value of around $300,000. Many Rivers Microfinance, who are providing microenterprise loans and business mentoring, have approved 11 loans at a value of nearly $50,000. We expect the remaining organisations to begin delivering loans in the coming weeks. Feedback received from these organisations indicates that there is a lot of community interest and engagement in the pilot and they are expecting a very strong demand for these loan products. The pilot will formally conclude in March 2012; however, the organisations involved in the pilot are expecting to continue to deliver the products and services delivered during the pilot period.

The pilot is currently being evaluated to look at the extent to which the objectives of the pilot have been achieved, with particular reference to three key evaluation questions: firstly, how effective were the participating

CDFIs in increasing access to appropriate financial products and services for disadvantaged individuals; secondly, is the demand for financial products and services by disadvantaged individuals best met by CDFIs; and, lastly, what mechanisms and barriers do CDFIs face in gaining access to capital? That final evaluation report is expected to be delivered to FaHCSIA by about mid-2012.

There was a report commissioned by FaHCSIA, written by Social Ventures Australia in 2009, that suggested that a sustainable CDFI sector would require ongoing government financial support—for example, in the form of a CDFI fund—as well as tax concessions to encourage private sector support. As a result of this FaHCSIA has also commissioned the Centre for Social Impact to explore the legislative and regulatory environment needed to build a sustainable CDFI sector and the role the government needs to play in this development. That final report is expected to be delivered by the end of this year or early next year. So, ultimately, I think the issue of a CDFI sector does go beyond the FaHCSIA portfolio and will require a whole-of-government positioning and coordination if it is to be pursued in the longer term. Thank you.

CHAIR: I will ask a couple of questions before handing over to Senator Stephens, who might go into this in further detail. You talked in your opening statement about the desirability of reducing dependence on government. There were two aspects to the program but you focused on one-off grants rather than the other aspect. How is this, in effect, different from the government providing one-off grants directly?

Ms Oswald: I suppose the space that we are in at the moment is that we are facilitating the establishment of the sector. We are not providing any of the direct loan capital but we are supporting organisations to establish themselves as CDFIs, with assistance with staffing and shopfronts and marketing and those kinds of elements as one-off seed funding, if you like, to help the sector to establish itself and to attract capital.

CHAIR: So the money that the CDFIs are loaning out is not the money that the government has provided to them?

Ms Oswald: No.

CHAIR: That was just to help set it up and manage it and administrate and so forth?

Ms Oswald: That is exactly right.

CHAIR: That explains that. That then answers the next question I was going to ask. In your key evaluation you were talking about barriers to CDFIs accessing capital. How will this particular program illuminate that? I guess you are funding the administration for them to be able to get out there in the market and be better equipped to seek capital to on-loan. Will that provide the information that the government needs to assess how CDFIs are going in terms of accessing capital?

Ms Oswald: It will help us, but mostly it will be, I think, through a scoping study that we are commissioning the Centre for Social Impact to do for us to specifically look at the legislative and regulatory framework that is needed to support CDFIs. I think that, as part of that, we would be able to look at some of the barriers—for example, some of the legislative barriers that there might be for social enterprise to attract capital. One of those, I guess, is mostly in the philanthropic space and is to do with whether or not organisations can get deductible gift recipient status, which helps them to attract philanthropic investment. So that is one of the barriers that we would expect our scoping study to look at in a bit more detail.

CHAIR: You also mentioned that a whole-of-government approach is required, and your focus is, to a degree, on specific areas. I think you are probably right. The 23 submissions that we have had have raised all sorts of possibilities, and the things we are going to hear about later on today range from social infrastructure bonds to arbitrage bonds—or social impact bonds; sorry—which I think could impact the ability of CDFIs to raise funds. No doubt the study you have commissioned will assist with that. I might hand over at this point to Senator Stephens.

Senator STEPHENS: Thank you very much for your submission; it is good to see you all here today. We are here because the Productivity Commission report highlighted the fact that access to capital markets for not-for-profit organisations is very problematic. You will have seen in our terms of reference that we are very interested in the broadest range of challenges associated with sector development and access to finance for not-for-profit organisations. For the committee's benefit, could you make some comment about the impact of the global financial crisis on not-for-profit organisations and the things that the government, and particularly your organisation, had to do to support very substantial service providers during the GFC. I think that it would be helpful for people to understand why they could not borrow on the open market.

Mr Lewis: Thank you for the question. In the broader context, the global financial crisis, we responded by providing additional money and emergency relief—or the government did, shall we say? That was based on discussions with the big and small end of town, who administer that money more broadly. A lot of these nongovernment organisations—the big ones particularly—have investment funds and pools, and many of them argued that their investment revenue had dropped right off. There were also particular things that went on during the global financial crisis—for example, the Victorian bushfires. For example, Red Cross, who normally do an annual fund collection, argued that because of the bushfire and other events around that, which occurred in a period that affected them, they were underfunded. So there were a range of things that happened concurrently—it was not just the global financial crisis—and organisations like Red Cross, CatholicCare and Anglicare came to government and said: 'We are hurting. Can you help us?' We helped them through additional funding for citizens—that is, through the emergency relief increase. We also listened to some of their structural issues and, where possible, referred assistance to government for consideration—without talking about specific figures.

Senator STEPHENS: Can you give us a quantum of how much additional financial support was given to organisations to keep those organisations afloat?

Mr Lewis: I could not. I do not have that with me here.

Senator STEPHENS: Could you take that one on notice for us, please. That would be great. The point that the Productivity Commission made about access to capital was that there is a big difference between the not-for-profit organisations that provide services contracted from government and those organisations that are actually working out in the not-for-profit space. Some of the submissions have proposed things like organisations being allowed to leverage—to borrow against future contracts with government if they are on a service panel. So therefore they would be recognised and treated as preferred providers, I suppose, or long-term contracted providers. Is that an issue that the department—FaHCSIA—has been considering at all?

Mr Lewis: We have not in recent times but, as you are aware, when the department was involved with a lot of the reform work, particularly the compact work, we certainly had discussions with Treasury and other agencies around similar issues. There is work going on. I think the Department of Finance are looking at the not-for-profit sector more broadly. Certainly that would be something that they may wish to consider as they go through their work. They are reviewing with us the not-for-profit sector's structure and engagement with the government. Certainly common contracts, common reporting and rules around forward estimates would need to be addressed. Every year we have to manage forward year contracts and commitments. I suspect there would need to be significant legislative changes to the capacity of departments to in effect allow those not-for-profits to draw down going forward if they were on such a panel. We are not actively involved in doing that work. I suspect Finance or Treasury would be the place to go. The new body within Prime Minister and Cabinet around the sector might be working on this.

Senator STEPHENS: Thank you for your CDFI submission. We will have a copy of the statement, so that will be good. You raised that six organisations expressed interest and five were able to take up the issue. You mentioned there that one of the critical issues was around having a financial services licence. What were the other key criteria?

Ms Oswald: It was basically the organisation's ability to secure capital funding support. As the model is just for us to provide sort of infrastructure support; the organisation had to have a source of funding for their capital to be able to provide loans. They did need to be able to secure that capital support.

Senator STEPHENS: Anything else?

Ms Oswald: In terms of the criteria for the organisations themselves, there were the three that I mentioned really: their contribution to financial inclusion, so their ability to be able to deal with underserved markets or disadvantaged individuals who might not have an asset base or may not have a suitable credit record; their ability to manage and implement their business plan, so that is their viability as an entity; and their financial sustainability, part of which was their capacity to attract capital.

Senator STEPHENS: You said the four banks were part of the investment circle.

Ms Oswald: That is right.

Senator STEPHENS: Are each of the four major banks participating with the CDFIs?

Ms Oswald: Two of the banks are actively participating at the moment.

Senator STEPHENS: Which ones?

Ms Oswald: NAB and Westpac.

Senator STEPHENS: The focus is both on low-income and disadvantaged Australians and on not-for-profit organisations. Is a proportion of the funding expected to go to organisations as opposed to individuals?

Ms Oswald: One issue with our pilot and I guess your terms of reference as a committee is that our pilot is only for individuals. We are not providing loans to organisations. I should say that some of our CDFIs do as part of their other business provide loans to organisations but not as part of our CDFI pilot.

Senator STEPHENS: So the loans by the two organisations—130 loans up to about $300,000 and 11 loans to $50,000—were to individuals?

Ms Oswald: To individuals only, yes. That is correct.

Senator MARK BISHOP: Welcome, ladies and gentleman. At various stages in my life I have been involved in various forms of financing for the not-for-profit sector. Late last year or early this year I was heavily lobbied by a set of firms in Western Australia who were heavily engaged in the social housing market and initiatives initially under Prime Minister Rudd and then in successive terms. I had a lot to do with officers from your department—I thought it was the department of housing, but it must have been here. I have no criticism of their professionalism or the advice they gave at the time as an assistance to resolve a problem. I am not in any way critical, but during those extensive discussions with the firms lobbying me and the intermediaries—to the tune of hundreds of millions of dollars for investment in hundreds of potential social housing outlets in Western Australia, which had an impact on the rest of the country—it became clear that the regulatory regime was in the process of being established, both to suit the needs of investors from the not-for-profit side and the profit side of the industry, and the taxation regime, for investors to receive a degree of certainty. If they were going to ante up hundreds of millions of dollars and potentially billions of dollars for social housing which was at the outset non-existent, then over time there were extensive negotiations and an adequate regulatory regime was established and I suspect it has become established in the last two or three months, but what struck me from my own experience and from what those insurers said to me was the old equation of risk and return in this industry. There was clearly manifestly inadequate work done by government as part of the lead-up to getting funds for social housing. It was then and still is a major initiative of this government. We were hoping by this stage to have had tens of thousands of social housing units established right around this country. While there is some growth, it is certainly not of the magnitude we would have hoped for when we came into power. That is by way of background.

Has your department—or at IDC level—given any serious consideration to the development of an adequate regulatory regime on the taxation side which gives the appropriate guarantees to investors and providing the incentive and guarantees to investors, particularly from both the profit and not-for-profit side of the superannuation industry which has potentially billions of dollars to invest? If you have given any serious thought to that, either at the departmental or at IDC level—I know Treasury and Finance have particular points of view, legitimate points of view in this risk return equation—could your outline where that is at, what the department is doing? Secondly, are you focusing on a generic model which covers investment, the social purpose from either the profit or not-for-profit sector, or do you propose to go down the path of industry subset distinct models—that is, for example, the requirements of the social housing market may well be totally different from a different industry sector loosely within the not-for-profit or charitable sector? Can you outline that for me because in extensive negotiations with your department, officers from housing, officers from finance, officers from Treasury, officers from Minister Shorten's office, officers from Minister Plibersek's office and officers from Minister Burke's office, all of whom had different levels of engagement, I was struck by two or three glaring anomalies right through that process. Ms Oswald, if you are the appropriate person, could you bring the committee up-to-date with those issues?

Ms Oswald: I am not sure, Senator Bishop, that I will be able to give you a totally detailed answer. I will defer to my colleague, Mr Lewis, shortly. All I can really say is that we do need to do further work in this area, and that is why we have commissioned the Centre for Social Impact to look specifically at the legislative and regulatory regimes that are needed for these types of community development financial institutions to flourish in Australia. The main barrier is, as we have acknowledged, access to capital and the capacity for not-for-profit entities to have deductible gift recipient status and, therefore, attract venture capital or philanthropic capital to give them the basis from which they need to work. I would also defer to my Treasury and Finance colleagues in that space, because that is where they are expert and FaHCSIA is not in terms of the regulatory regimes that surround the charitable institutions and DGR status.

In terms of the incentives you mentioned the balance between risk and return. One of the things that we are aware of is that a lot more work has been done in this area overseas than in Australia. In the UK and the US, for example, these markets are much more developed than they are in this country currently. I think it is in the US in particular that they have an interesting model where they look at a social return on investment, have the capacity to assess the social impact of an initiative and look at what the return to government is. For example, an investment in social housing now will have a certain return on that investment in the future from the government not having to put additional funding into programs for homelessness, public housing or whatever. So, if you are sophisticated in your measurement of outcomes, you are able to attribute a return on that social investment and that can then be used as a lever to attract further capital. I think this is where that bond concept comes from.

We are at the very early stages of looking at those kinds of models in Australia and being able to quantify a social return on investment, but I think that kind of approach is fairly fundamental to being able to attract capital. Again, it is just being able to demonstrate a return on that investment, particularly to government.

Senator MARK BISHOP: Ms Oswald, I was not talking about a return to government and I was not talking about social investment, and I noted that in the submissions. I was talking about the adequacy of the regulatory regime as an impediment or an incentive to investors from both the profit and not-for-profit sector. That is what I am talking about and that is what I want a response on, not the social cost of investment. I understand that concept. Let me give you a tip. If I am running a multibillion dollar superannuation fund and the government is going to get a 2½ per cent social investment and, hence, a reduction on its cost of investment, that does not affect me one iota when I am on the investment committee of a superannuation fund. That is a matter for government. I am talking about not-for-profit sector investors and the regulatory regime. Will you address that please.

Ms Oswald: The scoping study that we are having done by the Centre for Social Impact, which is looking at that taxation and regulatory regime, will give us more information by the end of the year.

Senator MARK BISHOP: More information by the end of the year.

Ms Oswald: That is right.

Senator MARK BISHOP: What about now?

Mr Lewis: Senator, perhaps just to assist my colleague: our scope and our focus do not come to your broader question, which really is probably better channelled to the department of finance or to Treasury. Our work, as Ms Oswald has outlined, is particularly around the CDFI work, which is quite right. The broader issues around government's engagement with the sector and regulatory reform are not within our remit; they are broader, whole-of-government issues that the department of finance or Treasury or maybe even Prime Minister and Cabinet in their new role of looking at not-for-profit right across the board might be more responsible. That is not really something that we can answer you today.

Senator MARK BISHOP: So you do not have a view on that.

Mr Lewis: It is not our place to have a view on that.

Senator MARK BISHOP: Why is it not your place to have a view on that?

Mr Lewis: Because they go to the views of government.

Senator MARK BISHOP: So what are the views you are expressing? What are they?

Mr Lewis: In relation to what, Senator?

Senator MARK BISHOP: The questions I am asking.

Mr Lewis: You are asking about whether we should have a regulatory reform change—

Senator MARK BISHOP: I am asking about the impact of regulation as an incentive or a cost to the providers of capital to social needs. You see the problem you have got is this: you can have all these wonderful ideas and go down that path that some of these submissions are suggesting, but if the capital is not available and it is not attractive to investors in the superannuation industry or the finance industry and if the taxation regime is not industry subsector appropriate, it will fall every time at the first hurdle. That was the major problem in the initiatives of the government in the social housing sector and it took three years to resolve.

Mr Lewis: This part of the department is not responsible for the social housing work. Secondly, the whole-of-government view on regulatory reform and impediments to that would sit appropriately with the Department of Finance or Prime Minister and Cabinet.

Senator MARK BISHOP: So has the issue I raised been referred to the Centre for Social Impact? Has that issue been referred at all?

Mr Lewis: In the context of the CDFI or more broadly?

Senator MARK BISHOP: Both.

Ms Oswald: As far as I understand it, they have been commissioned to look at the legislative and regulatory regime around CDFIs.

Senator MARK BISHOP: Did your department commission that or is it done by another department?

Ms Oswald: We commissioned that work.

Mr Lewis: But specifically in relation to the CDFI that we are responsible for.

Ms Oswald: We have commissioned the Centre for Social Impact to undertake a policy scoping study into the legislative and regulatory context in which the CDFIs currently operate, make comparisons internationally and describe key issues that would need to be taken into account in developing a framework supportive of a CDFI sector.

Senator MARK BISHOP: So it is an argument about the CDFI sector and regulatory regimes that would prohibit or prevent it growing.

Ms Oswald: That is right.

Senator MARK BISHOP: Has the department done any up-to-date analysis or a case study on developments with respect to the government's social housing policy and its success or failures, growth or otherwise?

Mr Lewis: We can refer that to our colleagues in social housing.

Senator MARK BISHOP: Are they a separate department or are they within your department?

Mr Lewis: They are within our department but the officers who are responsible for social housing are not at this table.

Senator MARK BISHOP: Senator Stephens suggests we try to get them into Melbourne. Meanwhile, could you refer them to this discussion and take on notice to provide a briefing to the committee in due course on the developments to date, the growth to date, the impact to date, the impediments to date and the potential solutions to the ongoing growth of the government's social housing model. That would be much appreciated. We will give consideration to calling them to get more pertinent information. Thank you, Ms Oswald and Mr Lewis.

CHAIR: You mentioned that the pilot program concludes in March next year but you anticipate that some of the participants will be ongoing. Is it likely that the pilot program will be extended at all or will the participants be continuing because of the impetus that the pilot program has provided?

Ms Oswald: It will be a decision for government as to whether the pilot continues.

CHAIR: At this stage you are not aware of any decision?

Ms Oswald: At this stage it is concluding in March 2012.

CHAIR: Has the department provided advice to the government in terms of what might happen after that date?

Ms Oswald: Not at this stage.

CHAIR: It has been suggested that not-for-profit organisations often lack the expertise and the resources to tender successfully for government grants. As part of the process for this did you see any evidence of organisations that might have been viable but just did not really have the expertise, the skills or the resources to put together a tender document that ticked all the boxes?

Ms Oswald: Not from our perspective. The organisations that participated in the tender process managed it successfully, although I do note that there are, I think, around 10 CDFIs in Australia altogether.

CHAIR: And some of those did not tender?

Ms Oswald: And some of those did not tender.

CHAIR: Did you liaise with any of those CDFIs as to why they did not?

Ms Oswald: No, I do not think we have received any feedback on that.

CHAIR: Looking beyond the CDFI pilot, as I mentioned earlier, there are a broad range of ideas floating around that will be put before us over the coming days of hearings as to how we might assist the third and fourth sectors, as they can be called, in terms of finding finance to be able to do what they do. Some of those relate to things like social impact bonds. Are you aware of whether the department is looking at alternative ways of raising funds to assist some of those, either for new services that government may be looking to assist or, alternatively, for existing services as an alternative way of funding them?

Ms Oswald: As part of our CDFI pilot, we have not specifically looked at that aspect, because that goes much more broadly than our specific pilot.

CHAIR: Obviously your department delivers an awful lot of services. It is one of the largest departments there is in terms of government moneys. Are you aware of whether the department is looking at other ways of funding not-for-profit organisations to deliver services, some of which already occur now, and also in terms of potential services that are not being delivered by government now but which could be with assistance, maybe through something innovative, along the lines of a social impact bond?

Ms Oswald: Not in our particular area of the department. I would suggest that that might be a question that you could direct to the Department of Prime Minister and Cabinet, who now have that overarching view of the not-for-profit sector.

CHAIR: I will certainly be asking them. But I was wondering whether, given the large number of services of your department, you were aware that that is something that is being looked at or that any work is being done at the moment to look at alternative ways of funding those types of services.

Ms Oswald: Not centrally that I am aware of in the department, no.

CHAIR: Thank you very much.

Proceedings suspended from 10:42 to 10:57

McINERNEY, Mr Dallas, Group Manager, Government Affairs and Public Policy, Group Corporate Affairs, National Australia Bank

THORN, Mr Christopher, Executive Director, Philanthropic Services, JBWere

CHAIR: Welcome. Thank you for your submission. I invite you to make an opening statement.

Mr McInerney: Firstly, I thank the committee and the committee staff for their forbearance in accommodating our change to the schedule. Some factors out of our control with the fog and Qantas flights meant we could not meet the original commitments we gave you, so thank you. You have our submission. We are happy to assist you in any way. We do not have an opening statement at this stage; we would rather let the submission speak for itself. The majority of the questions should be directed to my colleague Mr Thorn, who has internal carriage of this matter.

CHAIR: Mr Thorn has a long history of working in the area with JBWere in particular. It is quite clearly encapsulated in your submission that there is an opportunity for not-for-profits to access new sources of funding and there is a role to be played by intermediaries such as you but that at the moment there are probably not the confidence levels required from investors to make it happen. Would you summarise what you see as the solution to the confidence issues. That seems to be the big problem: if there is insufficient appetite by investors to invest in socially beneficial investment options, how do we address that lack of appetite?

Mr Thorn: I think the first thing is that in this new area there are a lot of people not knowing what they do not know, so it comes back to providing information around what the opportunity is, both for a not-for-profit who is looking for funding or finance and for an investor, whether that be an individual or an institution. One of the reasons we make such a big statement around the intermediary issue in the submission is that the intermediaries are required, if you like, to educate the market and bring both the providers and the suppliers of the capital together to have those conversations. If they fully appreciate and understand the issues on both sides, they can then look to build appropriate opportunities whether they be initially discussions leading through to investment opportunities or executing transactions. As we pointed out in the submission, there is nothing unusual about that. In the history of capital markets over time the role of the intermediary to do that has been quite fundamental.

CHAIR: I noted that in your submission. Are you saying that most emerging markets, if not all, have had intermediaries play a significant role in getting them from their initial stage up to a point where they are up and running? Can you give some examples of how that has worked in other markets?

Mr Thorn: It has obviously worked in commercial markets, whether it be an equity market, a private equity market or venture capital. Relevant to this inquiry, and again as we touched on in our submission, microfinance is a very good example where it started as an exercise with philanthropists understanding the need to grow the access of capital to some of the most underprivileged seekers of capital, particularly in developing countries. As that grew and people appreciated the commercial scale that it could be taken to, we have seen institutions and commercial intermediaries come to that market and grow it to be a very significant area of commerce. That has led to other developments on the back of it.

CHAIR: And in general those intermediaries have become involved for commercial reasons, for social reasons or for a mixture of both?

Mr Thorn: In this debate we are discussing a spectrum rather than one particular point. Generally in the notion of social investment the motive of the provider of capital needs to be taken into consideration. With microfinance initially the motive was a social one using the technology, the capital and the resources of the for-profit sector to get a social return. We are seeing the same thing again in some of the other instruments we have talked about whether they be impact bonds or some of the social infrastructure bonds. The motive of the investor initially is to make a social impact and that then brings in the commercial piece to drive that social impact to the next end. When it becomes purely commercial, you are really taking it out of the realm of this discussion.

CHAIR: Are you talking about the investor there as opposed to the intermediary? If you take your submission as red, the role intermediaries play is vital in terms of developing a future social investment market at a sufficient scale to deliver lots of benefits. I understand social investors come to it looking for a return on investment that will be partially social and not fully commercial, but if the intermediaries are so important I would like to understand what would motivate their involvement and whether that is partially social as well, purely commercial all might start off as social and then become commercial, what might be their motivation in becoming involved.

Mr Thorn: I can speak about the JBWere experience. I have been running this practice for about 10 years. We have a team of between six and eight people who are firmly focused on this area of philanthropy and social investment. The reason I have been here for 10 years is that we are delivering commercial outcomes. Therefore, to be sustainable and get the investment of resources, skills and people we need to be able to demonstrate a return to our shareholders. That having been said, any returns that are made are generally turned back into the sector to support and build the sector. Since our alliance with National Australia Bank in 2009 the bank has had a very clear focus in this area for a spectrum of reasons again from commercial through to supporting the community and that is really aligned with the experience we have had at JBWere that to survive and get access to resources on an ongoing basis we had to be delivering a return.

CHAIR: I do not want my question to be misinterpreted. I am not suggesting there is anything wrong with intermediaries having a commercial purpose. In fact, if an organisation like JBWere has a particular skill and expertise in matching the expectations and desires of social investors with products that meet those expectations and desires, in a way that addresses the challenges you talk about in your submission, you have an entitlement to sell that expertise for a reasonable commercial amount. If that is what gets intermediaries involved to make that possible and to work, ultimately that will be a win-win for everybody, if you are matching and meeting those expectations and desires.

Mr Thorn: To answer your question, all of this activity would not happen if there was not an intent by the organisation originally to do something for the benefit of the community. What follows is a rational allocation of capital to that exercise, depending on the spectrum of outcomes—whether it be the benefit to the community, the benefit to the organisation or the benefit to the not-for-profit organisation that you are working with. Again, these are circles within circles in the sense that you only get good people and good resources working—and I am not just talking about our organisation but in the sector—if you can drive the outcomes that will drive the investment.

CHAIR: We talked about the fact that there are not a lot of intermediaries. You talk in your submission about the need for there to be a greater number of them working to match up investments with investors. Where do they come from? Is the expertise out there to be able to do that now or is that something that needs to be developed over time? JBWere obviously holds itself out as an organisation that has that expertise. Are there other organisations currently? How are they fostered? If they are so vital to developing the overall social investment markets, how do we actually promote the intervention of more intermediaries?

Mr Thorn: One of the big challenges is helping the intermediaries make the business case for the opportunity. The reason we are having this conversation at this point in time is that the not-for-profit sector has greater awareness in the community for what it does, what investment is required, and what the commercial opportunities are in terms of bringing commercial capital to social impact investments, or social investments. Therefore, to build that capacity, there needs to be greater knowledge around the challenges and the opportunities in terms of both people and capital. One of the roles of the intermediary is to educate the market and try and encourage other players in.

CHAIR: I am conscious that there will be other questions, so I will move on to something slightly different. In your submission you talk about three types of social or impact bonds: the infrastructure bonds, the social impact bonds and the arbitrage bonds. To some extent I understand what they all relate to but, for the benefit of the committee and for the record, can you quickly summarise each of those three different types of bonds and how they work?

Mr Thorn: Sure. The infrastructure bonds are probably the purest and simplest model. That is where capital is requested for a particular program or piece of infrastructure, but the coupon or the price for that capital might be discounted for a component of social return. Normally there is a rate for which a commercial provider would provide capital. It may be that a social investor would provide that capital at a discount to that return, and that discount will basically be set based on the implied or assumed value of the social return that is being delivered or, often, the relationship between the provider of that capital and the project. There might be someone who in the past has been asked to give money to a capital campaign who might be asked to lend money at a lower rate, or in some cases no rate of interest—it might be a larger amount of capital—rather than demand a full rate of return. There are other submissions to the inquiry that highlight that type of product.

The social impact bond, in its purest form, is where the social benefit of a particular program is recognised and understood. Normally the government, understanding what the cost is of their intervention to offset the cost of dealing with that social issue, are attracted to bringing in private capital that might fund that program and are willing to provide some form of return to attract that capital into being a replacement form of capital to government. Again, the attractor for a social investor is their ability to make a social difference and the value that social impact. And, again, that will be reflected in the discount, if there is one—sometimes there is not—if that is required to deliver that capital. In Australia there has only been—as I think the committees is aware—one organised attempt, in terms of delivering a social impact bond, but we have certainly seen that offshore.

The arbitrage bond is a fairly straightforward financial instrument that tries to use an arbitrage between two markets to create a return that can then be used for a social purpose. Where it has been suggested in the past has been where there might be a demand for capital and that a user of capital, often a commercial organisation, cannot get access to that capital. The government, understanding that, raises money at a different rate, on-lends it through a special purpose vehicle and the arbitrage is used to fund that program. The benefit of that is that, firstly, there is no ongoing call, if you like, on the taxpayer to refund the capital because it gets unwound at the end; secondly, it can provide a form of term capital that is quite stable and predictable; and, finally, and I think this is an issue going forward in terms of the current economic conditions for these sorts of instruments where we have increased competition for global capital and a lack of confidence.

As we outlined in the submission, the view is that there is actually growing demand for Australian government paper, both by individual investors and foreign investors. If the government intends to go back to surplus, , as stated in the budget papers, it understands the need to maintain a deep bond market for investment purposes. This type of bond could form that liquidity, with a social narrative around it, if you like, that would also help the government in terms of its maintenance of a stable market and in a capital constrained world provide capital for the economy where it may not be sourced in other ways. So it is a bit of a win-win. Again, one of the objectives in the social investment space is to try and align interests so it is actually attracting capital from a potentially unsourced form to solve another need and, at the same time, generating quite a significant social benefit.

CHAIR: In the case of the arbitrage, but presumably in the case of the other two, the difference between a philanthropy where somebody may donate money is that they do not ever expect it back, but if they invest it in this sort of sense they would be expecting their principal back as well. So, presumably, the benefit to the not-for-profit organisation is the money it makes off the principal.

Mr Thorn: Or the discounted cost of the capital.

CHAIR: The capital they invest in actually has a commercial return, which enables them to repay the principal.

Mr Thorn: Yes, or access to capital at a discounted rate. So, again, it depends on the motivation of the investor. That is what I was saying at the start: the role of the intermediary is really to try and assess not just the need of the not-for-profit but also what the capacity and desire of the investor is to make that investment. Now some investors may be giving capital anyway, so they are willing to take a return not just on their coupon but also on the capital return, and it is a question of working out where, along that spectrum, the investor sits.

CHAIR: There are a whole host of combinations and permutations of what people might be looking to achieve as an investor, and how they match that up.

Mr Thorn: Sure. At the end of the day, the further you go towards the commercial end of the sphere, the greater access to capital there is by definition, because otherwise you just step into a commercial market.

CHAIR: A final question before I hand over to somebody else is on the role of government. Do you see that there are impediments in the way that government regulation and practices currently exist and, alternatively but related, things that government is not doing that it could be, which would help promote social markets?

Mr Thorn: Again, we highlighted in the submission several areas where we feel the government can make a significant contribution. Primarily, as the principle funder to the sector already, it is obviously in a very strong position to understand the funding needs and potentially consider how other funders might be brought in to replace their funding. So I think the notion of issuing social debt to replace a traditional government funding mechanism is attractive. Likewise, where there may be existing government funding, replacing that with some form of guarantee to bring in one of these capital instruments is certainly something that is quite feasible. I think from a government perspective, they are actually releasing the taxpayer from some obligation, albeit using a guarantee. It is really about building market confidence and demonstrating to intermediaries and investors that the government still has an ongoing interest. In the final area there is, of course, the regulation around that. Absolutely, there are some issues and the government is already looking at this in other places in terms of a reform agenda for the governance of the non-profit space.

I think one of the key messages, though, is that this is not about putting a lot more debt into the not-for-profit sector. That would be a terrible outcome, and it needs to be understood and worked through. Secondly, with the existing philanthropic capital that is being used to invest to generate an income stream to provide social benefit, it is important that it does not get diverted into products or investments that might take it away from funding the reason it was set up.

CHAIR: It needs to be delicately managed.

Mr Thorn: Yes. The key point, I suppose, that I would make is that it is really the government understanding the motives and interests of all of the players and working in an informed manner to bring about the change that is required. Certainly, as I said before, to date in some of the other inquiries that the government has put in place that discussion is happening.

CHAIR: Are there any specific regulatory problems? Are there any ASIC regulatory guidelines or anything like that which actually interfere with the ability of this market to develop?

Mr Thorn: There probably are a number, but for me to at this point in time pick out one over any other is difficult. I think really the first part is around building the market and building the understanding of what is required, and then following through the process to get that change. To pick out one and say it is any more significant than the others would be difficult.

Senator MARK BISHOP: Thank you, Mr Thorn, for your comments. In your submission you referred to a number of government social debt instruments as a means of providing capital in one way or another to the marketplace. There is of course an opportunity cost to doing that. If government is going to be allocating funds or guarantees to those various instruments, it is not going to be spending it elsewhere. Secondly, there are many thousands of worthwhile social causes that seek to attract government support of one kind or another.

Identified areas of social need—and I will instance some off the top of my head: social housing, aged care, hospitals and healthcare—all require large licks of capital on an ongoing basis. What is your view on government seeking to develop industry specific subsector sets of regulations that provide the guarantees that investors require if they are going to be providing large licks of capital to worthwhile social causes and what sorts of incentives are adequate? If you offer me three per cent less than the going rate for capital then of course I would be attracted to it, but the government is not going to do that on a large or regular basis.

I ask those two questions because I have had a lot to do with social housing in various stages and was lobbied extensively by for-profit companies that were seeking to bring together capital to build tens of thousands of home units and houses in areas of identified need around Australia. Over the four-year period they came up with major impediments both in terms of taxation policy and sufficient attractive mechanisms to large-scale investors in both the for-profit and the not-for-profit superannuation sectors, which, as you know, are huge repositories of capital. My understanding is that those issues are now resolved or close to being resolved in terms of appropriate regulations and appropriate mechanisms going forward. That is a different solution to the solution advanced here of the government providing capital, instruments, seed capital, start-up mechanisms or advice.

My take is that out in the marketplace there are large licks of capital that would be attracted to a regular return of five, six or seven per cent over a 10-, 15- or 20-year period but the regulatory regime is not up to scratch for a whole range of reasons. Do you have any comments on that or am I just chasing the dog down the wrong path completely?

Mr Thorn: I think the principle is that it is very hard to get one government solution to a whole lot of different structures or instrument, so social housing will be different to providing capital infrastructure for a building or something else. I think the principles are: why would the government be better supporting one of these other vehicles than funding it themselves? So that comes down to the cost of capital, both from a government perspective and a community perspective, and then what the social impact of that would be. Following the section that you are drawing from in our submission we talk about the need for government to look at a rating agency and look at measuring social impact and returns. The question is: is the government better investing that? Will it get a better return than a private sector provider, who is not just providing capital but adding value through their other networks and the way they inter-relate with the sector they are trying to support? To answer your question, that is where there needs to be an understanding of what the specific requirement to be funded is, what the other value-add, if you like, of the provider who is providing that capital may or may not add. If it is just on a commercial term, then it is a circular argument: you come back to where you start. You just go to the commercial market.

In terms of other impediments, the bigger issues are around the structures that those organisations seeking capital might have and their ability to tap into a commercial market, whether it be, again, the ability to offer collateral or the ability to fund, finance, even at a discounted level. There are regulatory reasons that may create challenges for a not-for-profit. But, again, they are something that comes out of assessing—so social housing has particular issues and environmental funding will have others.

Senator MARK BISHOP: But funds for social purpose, for social housing, social aged care or social hospital, do not have to be provided by either government or philanthropic or charitable or not-for-profit institutions. It can be adequately provided by firms like yours or intermediaries that you act on behalf of or property developers or the like. What I am really asking is: are the appropriate regulatory mechanisms in place that encourage commercial or for-profit providers into non-social-capital purpose?

Mr Thorn: There are obviously impediments. In social housing part of the issue is collateral. Who owns the property—the government or the seeker of the capital? They are fundamental impediments and they need to be looked at in the context of a social housing conversation. Likewise, borrowing land for an environmental fund: there are issues where environmental land does not create an income stream, therefore it is very hard for it to fund the debt of capital that is raised for that purpose. So you need to look at what instrument or mechanism you might have that frees that up. That is why it is very hard to give you a single answer. At the end of the day, if you could just go out to commercial markets and get the capital, that is what these organisations would do, but invariably they are not doing it because there are specific impediments depending on where they are active.

Senator MARK BISHOP: So is there then value in having industry-specific subsector regulations that address the investment issues, the taxation issues, the superannuation attraction issues?

Mr Thorn: I would just make the analogy that within commercial markets there are sectors within sectors. You get specialists within sectors who understand the requirements of those particular sectors and are able to come up with solutions or offerings or services that will address the particular regulatory challenges of those market players. So, in a sense, I do not think there is anything particularly unusual. It is just that, in relation to the not-for-profit or social sector we often try to look at it as a total issue and try to find one total solution rather than drill in and work out what is required for that particular area. Again, going to the question about impediment of government—it is really helping the government work with the sector to understand that sometimes conversations have to be had at that subset level rather than at the broad level.

Senator MARK BISHOP: Yes, so there is some value in that alternative approach. Thank you.

Senator STEPHENS: Thank you very much for your submission, which is quite different from many of the others that we have received for the inquiry. I want to go to a few of the points that you have made. First of all, you raised a question in your submission about whether not-for-profits are investment ready. You propose that perhaps one of the things that could help would be to have some kind of a single set of requirements for approval for credit. Could you expand on that a little more for the committee and on where your thinking takes you in that regard? Then we get to the next issue, which is around the rating agency.

Mr Thorn: Sure. Again, it would be nice to say that all not-for-profits are the same. But obviously there is a huge range, both in scale and also area of activity. Our experience in providing financial services to even the largest nonprofits in the land is that some are very well prepared and have the resources and structure to have conversations around investment policy, how they manage funds, governance and the like. There are others that are on a similar scale, in terms of size, that are not in the same position. That can come back to allocation of resources internally, the experience they have had and the advice they have taken.

In terms of the smaller organisations, once you get beyond the level of whether they have done the work to be investment-ready or not, there is a real question around whether they have the scale to tap into the services that might be offered by providers. It goes to the point I was making to Senator Mark Bishop around having a tailored response to a tailored request. For some providers, the scale is just not sufficient from a stand-alone, not-for-profit to create a particular product or piece. The other side to that is that a lot of the product or service that is available for the non-profit sector is just an amended version of what is available to the larger commercial market and it is a question of how that is applied. Normally, if you are providing a suite of services and you develop a level of understanding of the not-for-profit, you can then build into that a scaled level of offering that will help you get over some of those issues of scale or access to capital.

The other piece at the end of that which I have touched on is the whole notion of social return. Is a not-for-profit really worth it, in terms of an allocation of capital. Is the social return that will be generated from that particular organisation's activities at the same level or at a different level to a corresponding not-for-profit? So, in terms of the rating piece, it is really around creating a body of research that enables the not-for-profits to become more investment-ready and understand what they need to do to attract social capital in its various forms and it also helps potential investors understand—if they put their money in and they accept a social discount—the value they are generating for the discount they are receiving.

Senator STEPHENS: Are you aware of any work that is going on in that space in Australia?

Mr Thorn: Yes.

Senator STEPHENS: Can you enlighten us as to who might be doing some of that work about readiness and—

Mr Thorn: At this stage most of the work in that space is done by the not-for-profit sector—the organisations that are actually working in the space. There are some of the other submissions from people like SVA and Foresters. Those sorts of groups are absolutely doing that because they understand the space and are able to have those conversations. We are seeing an emerging small group of stand-alone consultants that are coming out of either the not-for-profit space or the business space, the commercial space, to do that. Increasingly we are seeing interest from the commercial sector to help, but this comes back to the allocation of capital and resource investment in the space. The overall business case is still not clear. That comes back to the earlier question about whether it is about delivering community return or financial return. The piece I did not touch on earlier is about satisfying the needs of our clients who have a strong interest in investing in these sorts of products. They are trying to work out how they built that out to satisfy the various stakeholders.

Senator STEPHENS: This goes to Senator Mark Bishop's point earlier about regulatory frameworks for subsectors of the market. Are you aware of any thoughts around the impact that self-care packaging might have—for example, where work in the National Disability Insurance Scheme might impact this market; or in aged-care packaging, with more ageing in place or ageing in-home or ageing in appropriate facilities, much like the voucher system, where you know you are going to have the investment capacity and therefore a group of, perhaps, disabled young adults could pool their funds? Is that a product space?

Mr Thorn: That thinking is certainly happening. Again, I draw you back to the microfinance example, where individual lenders—we were talking about tens of dollars, or maybe hundreds of dollars—in their own right would not have any access to the financial system. I am talking about developing countries. Obviously, by pooling that and bringing in larger pools of capital that can be packaged up, you are able to break that down and deliver that. That has led to savings schemes, promotion of insurance and other things off the back of that. It is only because of the scale of the activity as it is pulled together and an understanding of the needs that products and services can be delivered. I think it is exactly the same in the developed world in some of these other markets, but it is about understanding what the scope and scale is and then bringing some techniques used in other places to analyse that and then delivering a product, an offering or a service that is going to add value to that set. Obviously aggregation is an important part of intermediation and, I think, will attract other players and also potentially drive new product development.

Senator STEPHENS: Is it often, or is it ever, your experience that a not-for-profit comes to you when it is in financial distress around trying to restructure and reorganise its finances? Is that a common experience for you?

Mr Thorn: No, and I would say over the last decade it has become less common. More and more, and particularly as not-for-profits get the scale, the issues are around corporate governance, having appropriate investment policies and getting the right people on board. There has certainly been a noticeable increase in not-for-profits' awareness of what they need to do to become investment ready. That does not mean there are not organisations that have not been through that process. Often it is a crisis or something unexpected that highlights where the need is. We saw that with the GFC, where there were some organisations that had done investment policies but had not necessarily communicated them to all stakeholders, so they still had issues in terms of the way they communicated and dealt with that in the marketplace.

But, generally, as organisations are getting larger there is a growing awareness of the importance of good governance. As we have seen in the philanthropy space with the private and public ancillaries funds, where there has been a lack of compliance it is more usually out of lack of knowledge rather than something else.

Senator STEPHENS: What about the issue of mergers and acquisitions? Are you seeing anything growing in that space?

Mr Thorn: Yes. There have been only a few in terms of true federated organisations that have come together. There are real issues where you have organisations with, say, a state based federation, volunteers and similar but not the same branding and fundraising issues, but I think, as conversations like the one we are having today continue to develop, that is forcing some of the traditional views to potentially change and perhaps cause people to consider working together. That might be, say, a state based federation of the same organisation, but certainly organisations that are in the space are understanding there is competition for funds and that, if they do not think through their own scale and their attractiveness to potential suppliers of capital, it might have an impact for them longer term. So were not seeing a lot of mergers and acquisitions, but we are certainly seeing organisations are starting to think through what that means.

Senator STEPHENS: On that point—the fact that you have many organisations under an umbrella title that might be a federated model—the work that was considered by the Productivity Commission went to issues like a national association model. In the interim report from the Productivity Commission there was a recommendation for something like a CIC, a community interest company. Do you have a view on whether that would help and enable or get in the way and add no value?

Mr Thorn: The observation from the US, where those models have been tried, is that there has been a mixed response to whether they are actually required or not. I think we are probably still at a stage before that where the frameworks that we have in place are sufficient to start the conversations. As they develop, whether we need to look at special purpose vehicles or not becomes a secondary issue. For example, in terms of structures, one of the issues we raised in our submission was a tax-free coupon like the municipal bond in the US. That is a very vanilla mechanism and is something that can be used in this space, but you need to get the scale and work out how you apply that across sectors. It is something that potentially could be applied across sectors. The issue then is looking at the ability of those who would be supplying the capital or investing in those products and how they would do that—for example, whether the difference in the return is going to affect the ability of a pension fund or a superannuation fund to invest in that. I am not sure if that is the case, but they are the sorts of questions you would need to consider.

Senator STEPHENS: You were also suggesting in your submission the notion of a not-for-profit rating agency for impact investments. Do you see that that could happen through existing financial product mechanisms—the ethical investor type fund or a badge or a tick or something?

Mr Thorn: Yes, I could see it happening that way. What is going to drive it is the integrity of the organisation or the individuals behind it doing the research. As I said earlier, to date a lot of that work has been generated from within the not-for-profit space itself, because the people there have had the most experience and exposure to that. My hope would be that, as commercial intermediaries grow and invest more into that area of activity, the research that they generate would provide the evidence that they need. I think one of the impediments—we have seen this globally—is that where a lot of time and effort has been spent on research and evaluation, to date the investment market, whether that be philanthropic capital, social capital or commercial capital, has been reluctant to pay for that research. That relates partly to issues around how relevant the research is and whether it is worth paying for. From a philanthropic perspective there is a view: 'I am giving my money away. Why do I need to pay someone to do that research?' Yet we know if that research is done that can have a very significant impact on the quality or the social impact driven by that philanthropic grant, if you like. So it is a bit of a circle within a circle. As more capital is invested, it is going to drive more demand for that research analysis. But, as to where it starts, it is still a bit hard to see.

Senator STEPHENS: Is that attitude peculiar to Australia?

Mr Thorn: No. It is consistent. The founders of New Philanthropy Capital have had exactly the same experience in terms of actually getting their key donors to pay for that type of research. It does not mean that the rating agency or the research is not required because, as I said before, if you are trying to identify the value of a social dividend it becomes fairly important.

Senator STEPHENS: You provided some international examples in your submission. You mentioned the municipal bonds. Can you point us to anywhere we could find out some more information about the Community Reinvestment Act in the US, enacted by congress in 1977?

Mr Thorn: I do not have the details in front of me to go into—

Senator STEPHENS: I should google it. It is all right. When you mentioned it in the submission, I thought perhaps it was one that had taken your eye. That is okay.

Mr Thorn: The thing about that, in relation to Senator Bishop's question, is that that was a particular organisation focusing on a particular area of housing, I think, and it was about trying to identify those deposits for that activity, which is really the reason it was included in the submission.

Senator STEPHENS: In your submission you make the point about JBWere hosting events across your network. Is that a very big network?

Mr Thorn: I suppose it depends how you define it. We manage money for several hundred not-for-profit organisations. We also look after a large number of grant makers, so across our client base people are setting up philanthropic structures. Then we also work across being on the board of Philanthropy Australia and the advisory board for the Centre for Social Impact, the Giving West board in Western Australia and some other shorter term advisory boards. It means that we do have fairly significant visibility of the sector and are able to convene those conversations where they are relevant. I think we can actually get to where a lot of the conversation is happening and then bring in extra parties.

Senator STEPHENS: Sure. I was interested in that comment, because in the next paragraph you say:

… as we have seen with microfinance, the investment risk is actually lower than comparative 'commercial' lending. This only further illustrates the need for a real understanding by those providing capital of understanding the risks involved, so capital can be priced accordingly.

So is that to the extent to which there is a lot of capacity building to be done in the sector about understanding itself and its attitude to capital markets?

Mr Thorn: Yes.

Senator STEPHENS: Thank you. It has been very interesting.

Senator WILLIAMS: Mr McInerney, is NAB the largest lender into the microfinance sector in Australia?

Mr McInerney: NAB runs the biggest microfinance program in the developed world.

Senator WILLIAMS: How do you define microfinance?

Mr McInerney: There are a few programs run against—the total commitment of the bank is between $130 million and $150 million. It is run through the bank and not through one of its subsidiaries. It has a combination of no interest loan schemes, the nil schemes, step up where capital can be matched not only for loans but also for savings programs and it extends across to Indigenous organisations with respect to land councils.

Senator WILLIAMS: Basically it would be a subsidy from NAB, would it? Obviously the money you lend out you could learn at big returns. Am I correct and I think that way?

Mr McInerney: Not so much a subsidy but as a commitment of the board is made—

Senator WILLIAMS: A charity type of thing. What I am saying is that if you lent the money commercially you could make more money. Obviously it is a generous approach by NAB.

Mr McInerney: I note that our competitors are not doing similar programs. Interestingly the arrears on these microfinance loans are less than we experience in commercial.

Senator WILLIAMS: That is what I was going to get to. With these microfinance loans obviously some are very small; they might be a couple of thousand dollars.

Mr McInerney: Correct.

Senator WILLIAMS: And the returns to the bank on the commitment are pretty good?

Mr McInerney: That is right. The default and the arrears are less than the commercial experience in comparable product lines. We are hoping to migrate the whole program out of where it originally started in the bank to have ownership by the bankers themselves and to be used through traditional channels—for example, through the branches.

Senator WILLIAMS: Does the bank ever monitor the success of these micro loans? Do you see the good results coming out of them? Do you see where the money is going and what value it is returning to our society?

Mr McInerney: Yes, extensively, and we show case those success stories. We have recently done a report on exactly that point and we can forward it to the committee for its review. They are quite impressive right across the country with geographically different industries and the different profile of the borrowers themselves.

CHAIR: Earlier Mr Thorn you touched on superannuation trustees investing in socially beneficial programs. To what extent does the sole purpose test that applies to trustees impact on trustees' decision-making powers? Are they constrained from marketing themselves as a superannuation fund that invests in socially beneficial investments? Are they constrained by taking a cut in the commercial return which they would accept in return for a social return by the sole purpose test and other regulations that apply to them?

Mr Thorn: Again it depends a little bit on which investment we are talking about in the sense that if you are supplying capital at a commercial rate of return that is commensurate with a return you get from the sole purpose test then that is fine but if it is not it does become an issue. It just depends where you sit along the spectrum of what the investment you are looking at is. If you can get the same commercial return with an ethical screen arguably there is not an issue. If all of a sudden the discount is such that it is taking you out of the realm of that sole purpose test, that is an issue you need to consider.

CHAIR: Is that something you think would be beneficial for government to look at in terms of how the sole purpose test works to enable a super fund to take into account a social return as part of meeting its requirements under the sole purpose test?

Mr Thorn: My response is that superannuation is there for a purpose and to widen that purpose to facilitate some of these other investments is a big question. It depends whether you need that at the end of the day and from a policy perspective it is whether the government feels amending that is worth while for the benefit you are getting. Further than that, I am not sure that I can comment on that.

CHAIR: That is fine.

Mr McInerney: NAB and its subsidiaries currently does not support any change to the sole purpose test at this point.

CHAIR: Thank you for assisting us.

CASELEY, Miss Louise, Operations Manager, Employment, Social Ventures Australia

LEARMONTH, Mr Ian, Director of Social Finance, Social Ventures Australia

ROBBIE, Mr Kevin, Director of Employment, Social Ventures Australia

TRAILL, Mr Michael, Chief Executive Officer, Social Ventures Australia

[11:45]

CHAIR: I welcome the representatives from Social Ventures Australia. Thank you for assisting us today. I invite you to make an opening statement.

Mr Traill: Thank you, Chair. We very much appreciate the opportunity to be here and share thoughts on a subject of some passion for us. We think there is an extraordinary opportunity in this market to build a more sophisticated and structured social investment/ social capital market, and it is something of deep need in the sector. I would like very briefly provide some background of SVA, share some thoughts out of our practical experience over the last decade, and offer some brief thoughts consistent with our submission to you in terms of next steps and opportunities.

We were set up in 2002 with a commitment to backing innovative programs specifically in the areas of education and employment. We feel very strongly that the keys to overcoming social disadvantage are in supporting organisations that do extraordinary work in those areas. What we know now in terms of our experience is that the challenge of providing a sustained funding base is absolutely vital to build those organisations to scale.

In terms of the structure of SVA, we now have a national team of 47 people. That is split broadly between three key areas. We have a particular focus, as I mentioned, around employment and education. About one-third of the team is involved in work in those areas. Four years ago we set out SVA Consulting. That provides a high-quality strategic and advisory support and service both to the organisations we work with and more broadly to the non-profit sector. Separately we have a particular focus around building a presence in social finance and philanthropic advisory.

We are a non-profit organisation, so we live and breathe the challenge of maintaining our own funding capacity. I can assure you, with my kind of midlife reincarnation as a social entrepreneur, some of the biggest lessons for me are about the challenges of building a sustained funding base, getting quality people on board and finding the capacity funding to do that. The experience we have in that and the experience we have had in supporting what we think is an outstanding portfolio of organisations have shaped what you see in our submission.

I want to briefly provide some background on my colleagues. Kevin Robbie is an unusual beast. He is Scottish—we will not hold that against him! He is an unusual hybrid of a social entrepreneur who also worked with the Office of the Third Sector. So he understands government. He drives our work around employment and social enterprise. Ian Learmonth is a former Macquarie colleague of mine who has 26 years of experience in investment banking. He has recently joined because we want to build an opportunity around social finance in providing the advice and support we know exists to support this market. Louise Caseley also has a background of over a decade of experience in the UK, both on the funding and fundraising advisory side but also extensively with government. People with that sort of background, that spread of experience, are vital to the work that we do.

Before I share some quick practical experience around the sort of work we have done in social enterprise and in putting together the fairly unique acquisition of 659 child care centres in GoodStart, I did want to share the structural framework that supports all the work that we do. We have a thesis that if we care about a civil society and a high-performing non-profit sector we must address in partnership three core structural issues that get in the road of that. They run as follows: one is that we have, we believe, pretty inefficient capital markets—that we do not have sufficient funding, we do not have funding necessarily going at the right time to the right organisation. So hypothesis A, which I know is a subject dear to the committee's heart, is: what can we do to improve the efficiency of capital and funding allocation to the sector?

Structural issue 2, we believe—and we can put this in simple terms—is the idea that there is a war for talent. Are we getting the best people drawn from across the sectors pointed at these issues? I say this respectfully, having been in the non-profit sector now for a decade. There are a lot of fantastic people with great skills in the non-profit sector; but if that is not supplemented with skills and experience from government, from the bureaucracy and from the business world our strong belief is that the sector will not achieve what it is otherwise capable of.

The third structural issue is very simple and very powerful: is there consistent and clear evidence of what works and what does not? I was on an interesting forum with the PWC with Senator Stephens a couple of years ago judging the best non-profit reporting frameworks. There was an interesting lesson that I took. We have got an incredible variety of reporting from across the sector. I am not here to defend the business world, but at least in the business world you get consistency and clarity of reporting frameworks. Good luck trying to find that in the non-profit world. This notion of better capital access, access to talent and clear evidence base is very important in all that we do both in supporting organisations individually and in looking at a 10,000-feet view of what we think needs to happen.

In terms of the practical experiences, as the committee is aware we were involved in putting together a syndicate that raised $165 million for the successful acquisition of the ABC childcare centres, one of Australia's more public corporate disasters. We are only a year down the track on that, but the early evidence is that we are making a very solid reality of running that with business disciplines for social purpose. This is a $600 million plus turnover business. It sits at the heart of a vital policy area for Australia. If you strip underneath the numbers you will be aware that 45 per cent of that funding base is actually from government in the form of childcare rebates, and that funding mix of government and of private philanthropic sources getting not just a return of capital but a 12 per cent coupon we believe is at the heart of a very interesting and replicable model that gets to the heart of the social capital social funding model.

We have also done quite a lot of work in the social enterprise area that Kevin has been driving, and we have been effective in backing and funding a range of organisations that have driven effective employment outcomes in social enterprise. The key to that, consistent with what we think is the key to the successful acquisition of GoodStart, is accessing funding from across the sectors, being very clear that these are organisations that need to be run with business disciplines but being very clear and transparent about what the expected social returns are. What underpins a lot of that social enterprise work is very clear work around social return on investment. That is key to accessing funding; it is key to accessing from funders who want a capital return but who want to see clear evidence of the social return.

There are three lessons out of that. Accessing that funding is extremely challenging and, if you know where to go to find it, we believe that it is possible to access it and that it can be accelerated if you can access it in partnership with government. Very simply, the GoodStart transaction would not have happened without the $15 million of government support. If we had not had that we would not have got to $45 million of the social capital layer, we would not have accessed $120 million of debt from NAB and the deal would not have been done—and I think that would have been a social disaster.

You need to be very clear about the mix of business and social returns. We think the core proposition in our social enterprise and GoodStart funding was the ability to access money from funders who wanted a 'reasonable' but below commercial rate of return. We think the number on that is a mix of art and science, mostly art. This is topical. I have just come back from the UK and talked to Social Finance and Impetus. These are organisations that are doing extraordinarily interesting work. They tell us that if you can get a single-digit to low teens rate of return you will attract capital for social purpose business driven organisations. We think the same opportunity, as we believe we are proving in the work that we and others like Foresters are doing, and that market does exist, albeit in its very early stages.

What can government do around that? This is just to leave you with some thoughts around next steps. Government partnership funding in catalysing this market is vital. The second issue is that we are not here to give you a detailed wish list of regulatory tax changes. One of the interesting things out of the UK is driven by the Ron Cohen task force. I think it is terrific that you are talking to Ron, as I understand it, later this afternoon. That task force in the late nineties was instrumental in establishing it in a structured and coherent way with the best input from heavyweight players from across the sectors driven by Sir Ron himself. It created a structural and sustainable framework that means the UK is now quite a sophisticated developed market. I think there is a bit of light on the hill around some of the opportunities and lessons from the UK that we should think about applying here. We are talking closely with the Community Council for Australia. We are delighted to be a founding and funding partner of that organisation and we think there is a need for a coordinated approach from the non-profits to be clear to the parliament about the sort of structural and tax changes that need to be made to build this market properly.

Finally, and this has come up again and again in the submissions that we have seen, we believe the role of intermediaries in this is vital. You can put us saying that down to naked self-interest, but we can say with some confidence and authority that you have to go to intermediaries who know how to access capital, particularly at the early stages of this market. Markets are built on the ability to access funding. In the kind of occasionally painful and tortuous nine-month journey of raising funding for GoodStart, if we did not know where to go to get that money, if we did not have the heavyweight support of people like Robin Crawford, who is chairing GoodStart and who personally underwrote $5 million of that $45 million of social capital, it simply would not have happened. So we need access to people with that sort of horsepower for this market to develop fully. Thank you. I am very happy to take questions to me and my colleagues.

CHAIR: Thank you, Mr Traill. It is a very interesting submission and I thank you for your opening comments as well. One of the themes that comes through a lot of the submissions is the difficulty of building the confidence of investors to actually invest in this part of the market. Even with investors who have a strong desire to invest in a way that has social benefits, there is still a lack of confidence and that is half the problem, certainly in Australia. That may well be being addressed in other parts of the world. What do you see is the answer to building the confidence of those investors so that they do see these types of investments as a viable alternative to other forms of investment, or alternatively, straight out philanthropy?

Mr Traill: I think that is a question that goes to the heart of the challenge of building this market. Let me offer an observation and then pass to Kevin. I think Kevin would have some interesting reflections on how the market has evolved in the UK where there is now some degree of confidence about what is investment ready. This market is at a very early stage. In the work that we do we are acutely conscious, particularly in relation to GoodStart because it has been such a large-scale and high-profile deal that if it fails it is a disaster, of the vital importance of going to a small group of investors who get and respect this mix of business discipline with social purpose. When you prove that these deals work, I can say with some authority and confidence that the 41 individual and foundation investors who provided a core of $22½ million in funding for GoodStart—and we are confident we can repay that money—will want to do more. We need the ability to build confidence from individuals who support the early deals so they will recycle that capital.

The second step, which I think is exciting and challenging, is that I have a strong belief that there is the ability to build a new asset class. While we were unsuccessful in approaching the industry funds on GoodStart, I think we were close. I think if we can go back in three to five years and say, 'Here is a deal where investors got a 12 per cent coupon'—by the way, without being too rude about it, how many investment fund managers have got that sort of return over the last six years—you start to build credibility for an asset class that provides a reliable return in the range of eight to 12 per cent. I think government has a vital role to play in creating that market. Go back to the numbers on GoodStart: 45 per cent of our revenue is from government. Can government do smart things in those areas of the economy where there is revenue-generating and profit-generating capacity connected to social purpose, provide some certainty and reliability about the government contribution to that revenue stream and in the process defease some of the risk to investors? That sounds to me like a supportable, sustainable investment class. Don't just think child care; think ageing. Having listened to the previous conversation, there are many other areas of the economy where with a bit of creative thought those opportunities could exist.

CHAIR: I think that is a fair comment. In my time in the Senate I have heard many comments about how the government could use its spending power better to deliver particular outcomes, but it is not that easy to actually put that into practice and to deliver those outcomes, particularly when you are talking about the scale of things that government involves it with. I am really interested in practical suggestions for how we might further that—not necessarily how we would do it; I do not think you could sit here today and tell us: 'These are the details of how you need to do it'—and progress it so that we can end up with programs that do fully leverage the use of government money or taxpayers' funds to deliver the best possible outcomes.

Mr Robbie: I think partly it is related to different types of government funding. My experience was in the UK, where the government looked at the contracts. They deliver and provide funding for organisations via that mechanism—and I think Australia is well advanced in terms of that, in terms of its public procurement processes—but separate to that the government acts that capitalise the number of funds. You have the example of the Futurebuilders England Fund, which was capital for organisations to improve their ability to deliver contracts, but the actual repayment of that capital came through the acquisition of contracts. It was just smarter types of thinking about how you put the money out. One part of the equation in Australia is already in existence in terms of how the money goes out to non-profit organisations in terms of contracts. It is how you create a culture within the nonprofits themselves so that they are willing to take on debt or take on different types of finance. That was a 10- to 15-year job in the UK working through specialist intermediaries to actually create that culture. Part of it is about managing expectations, because even after a 10- to 15-year period in the UK there is still only, a recent report said, 16 per cent of ideas coming forward that are actually investment ready, and it is bearing the cost of educating the market and having a long-term vision about what you want to do with this market and where you want it to be.

Critical within that in the Australian context at this point is the notion of brokerage, because investors will want to see the deals. I do not think the market here is that the point where people will just hand over the money to the likes of SVA or any other organisation. They will actually want to see in a bit of detail what they are putting their money into and understand the terms they are going to get. Again, that just costs. It takes time and it costs money, and that was the lesson out of GoodStart and some of the other deals that we have done as well.

CHAIR: That raises the question of GoodStart. So I can get my head around it, to the extent that I do not know how public the details of the deals that were done with investors were, is the return that has been promised there a fixed return or is it dependent upon the performance of GoodStart itself in running the childcare centres?

Mr Traill: Just to drill down on the GoodStart return and capital structure, the total amount of capital raised was $165 million. That was split as follows. There was $120 million of National Australia Bank debt, so that has first charge and that is at conventional bank rates. Underneath that is $45 million of what we have called social capital. That ranks in the following priority order. The federal government provided $15 million at the government bond rate. Then, after that, is social capital of the order of $30 million. Seven and a half million dollars of that came from three of the four non-profit organisations and $22½ million came from 41 individuals. In financial market terms that is a subordinated debt instrument paying a 12 per cent coupon. That coupon can only be repaid subject to performance targets and a cashflow that obviously the NAB has first charge on. But, based on the current and forecast financial performance, I think it is fair to say that we have a high degree of confidence that interest will be repaid and that the notes will be repaid in a time frame consistent with what was indicated to investors. To provide some commercial imperatives on this because I think this is interesting and important in the context of the broader market, in my prior life I was a co-founder of Macquarie Bank's original private equity business. In private equity you would for good performance expect a 20 to 30 per cent rate of return. In the 13 years I did that at the bank, our funds on $450 million invested had a 24 per cent rate of return. So the 12 per cent is about half what a conventional investor might expect as a return for that category of risk. As one of my colleagues at Macquarie put it, 'Essentially, Michael, what you are asking for is that I get half the rate of return I would expect for a risk of this nature on the basis that you can do significant social good.' I thought that was quite a good way of articulating the investment proposition that sat behind GoodStart.

CHAIR: On that basis you managed to pull together $30 million.

Mr Traill: $30 million of external capital. You asked before what government could do. This was quite an unusual, opportunistic circumstance. As I think the committee may be aware, we are in a competitive bidding situation for assets. The receiver has one obligation only, and that is to sell to the highest bidder. That made things pretty complicated from our end. From the government's point of view—and I will be blunt—it was almost as though it would have been easier for us to approach the government for a grant as opposed to a $15 million loan which we have high confidence in repaying. That to me is ridiculous. We must have the capacity to be flexible and creative around these hybrid structures.

The double jeopardy with the fundraising hat on was that I understood some of this in terms of the commercial sensitivities. I could not actually advertise to potential funders that the government would be a prospective funder of this initiative. That would have had significant consequences for the ease of raising that funding.

CHAIR: So what you are saying there is that, if the government had in place better streamlined ability to participate in this type of activity, whether on the short-term basis that this one had because of the circumstances that surrounded it or more in terms of longer-term planning, that would assist greatly the ability of intermediaries like you to put together deals including a significant amount of social investment?

Mr Traill: Correct. This is germane to our thesis. Express to the model of social capital for us is partnership investment. The notion of a war for talent is about getting talent from across the sectors. I dealt with some people in DEEWR whom I have huge respect for and learned a lot from, but if we are serious about building this market, unless we build commercial skills in terms of the analysis and evaluation of these opportunities, it has a decade-long horizon. For the non-profits that were galvanised by this opportunity, the light on the hill was that we had a once-in-a-generation opportunity to acquire a unique social-purpose asset. It is an intentional construct of this business, the constitution and the non-profit status that it is very hard for ownership to change hands, and we want that to be the case. We have a 10-to-20-year horizon about transforming the early-learning market in Australia. You cannot do that in two or three years. You cannot do that by changing and selling a business over three to five years. You must have a 10-to-20-year view, so funding structures that are consistent with a social purpose cycle that is five to 10 years long need to be embedded in the capital structures of these transactions.

CHAIR: Thank you.

Senator MARK BISHOP: Thank you very much for coming along and making your contribution today. Firstly, in terms of GoodStart, I would have thought the 12 per cent coupon rate was high, not low. You had an organisation that had a huge set of opportunities across Australia and 45 per cent guaranteed funding from government, but you regard—and, hence, I draw the conclusion—not as high a risk as otherwise might be the case if half your income is guaranteed by government on a monthly basis. Why do you characterise it as such a low return?

Mr Traill: As the great investor Warren Buffett said, 'Investment returns are all about timing and patience.' The context of GoodStart was at the height of the global financial crisis, so 12 per cent looked very appealing. But if you look at the sweep of history in private equity—and the reason I quote private equity as a parallel is that this was a very publicly bankrupted business, so the investor perception of that, which I would have seen the same way in my time at Macquarie, was that this was a high-risk turnaround transaction—you only invest in those things if you are confident you can get a very good return. A top-quartile, private equity type return would have been expected.

Senator MARK BISHOP: With the benefit of hindsight do you still characterise it as a high-risk transaction?

Mr Traill: Absolutely. I think we have done a pretty credible job in getting a very good quality board and management team to make sure that what we forecast and the turnaround has happened. We do not have the time to go through the details of what it took to make that work, but it was not a trivial process.

Senator MARK BISHOP: Even now, having done all the work to get it up and running and make it a viable concern, you still characterise it as a high risk then and now?

Mr Traill: Yes. To do otherwise would be in the category of Monday-morning quarterbacking. We could retrospectively adjust the risk based on what we now know and the fact that it is travelling well, but I think that would be inaccurate and unfair.

Senator MARK BISHOP: Okay. Secondly, that start-up in the childcare sector with 500 or 600 sites across Australia would, as far as I am concerned, have been on one level a very appealing sell. But, in terms of government itself as a partner or provider of capital, most government payments are essentially transfer payments. You have purchasing in defence, procurement and capital. Nearly all outlays of government are social security payments, pension payments, disability payments—those sorts of transfer payments from government to individual by either direct cash, cheque or subsidy, perhaps, to some sorts of organisations. I would have thought that government enterprise, apart from the childcare model and the GoodStart model, had little else around in that market—or do you identify opportunities that I do not see?

Mr Traill: I do not think this is naive. You can look at sectors where there is revenue generation and government is a significant client. Whether that is through childcare rebates or payments that are made in the ageing sector, if you can find a way to provide some certainty and reliability about those payment streams for investors, that is a really significant component of understanding risk. The first thing I do with a due-diligence, private equity hat on is understand the sustainability of revenue. In areas where there is a policy imperative, if government could be thoughtful and creative working in partnership with prospective intermediaries, my belief is you could find ways to package those so that you bring in investors and conventional institutional investors.

This is all about risk. I worked in an organisation—as did Ian—which created an infrastructure asset, because there was an understanding of reasonable returns in the context of risk. If government can be a party in those sectors of the economy where there is a policy purpose and a payment stream over which the government has significant long dated control, there is a chemistry in that that can lead to social capital.

Senator MARK BISHOP: So off the top of your head you would say aged care, home care, private hospital, schools funding—those sorts of things.

Mr Traill: All of the above.

Senator MARK BISHOP: They are a guaranteed regular transfer of funds.

Mr Robbie: I think it requires flexibility. My take on the Australian government is that, while it spends a lot of money—as you say, purchases and services—it is quite prescriptive in how it purchases. Rather than going, 'What we want is a job,' DEEWR go, 'We want the job, and this is how it's done.' You could catalyse the development of the social enterprise sector by having more freedom within the Job Services Australia program: 'If you provide a job of 13 weeks, you get paid this amount,' not 'You have to do all these things to get there.'

Senator MARK BISHOP: I get the point you are making. One final thing: Mr Traill, in your introduction you identified three shortcomings and then made a reference in passing to legislative or regulatory regimes. I had some experience through lobbying in the social housing market. I had a number of property developers come to me and extensively lobby me because they were having problems. They had the capital. They were for profit. They had the areas identified for building. They had state government and local government approval. Everything was ready to go. It took three or four years to resolve, but they had identified two issues: the taxation regime and the superannuation regime. They could not close the deals with potential investors in both the for-profit and the not-for-profit market. In terms of specific subsectors or niche areas of market where capital might be raised, is the issue of the appropriate taxation regime and having sufficient attraction or incentive to superannuation investors critical to the development of this overall market or is it just something that is important but needs to be attended to over time? I am trying to grasp how significant the appropriate regulatory regime is for subsectors of social need where private finance might be available.

Mr Learmonth: Just looking at some of the observations after having been in the UK recently and talking to participants and seeing models in the US and so on, I think it is more than a 'nice to have'. I think it would provide a significant improvement in the platform for taking particular private sector philanthropic money into social capital instruments and social finance. You need to get people away from that binary decision making, on the one side, of giving donations and grants with their philanthropic hat on and then putting their money into the most high-yielding investments on the other side. Anything to bring people into that middle ground I think is helpful and both improving the tax and legal environment for investing in social finance and having this social capital discussion that we are having I think is important.

Senator MARK BISHOP: How is it then achieved? Do Treasury and Finance set up some sort of a subcommittee or do they have an IDC? Or do they set out tender to firms like yours?

Mr Traill: As I have mentioned, we think there is a real need for this to happen in a coordinated rather than a fragmented way. We are very keen. We have had this discussion with David Crosbie, Chief Executive of CCA. We think it is very important to get practitioners and intermediaries like us, like the foresters and others, who have been around doing this to look at the precedents out of the US and the UK and have it led by somebody who has the equivalent experience, gravitas and horsepower of Ron Cohen, and to say, 'Here's half-a-dozen structural things that can make a difference and impact the market and we can draw on the experience from elsewhere.' If that is not done in a coordinated way, I think you will end up with a potpourri and I know enough about politics to understand that that would be a disaster in terms of—

Senator MARK BISHOP: By definition, if you are going to have such a high-powered committee, led by a high-powered person doing such important work, to my take, having been exposed to some of the issues that Treasury and Finance raised when they finally had to establish the regulatory regime, it would be appropriate for them to participate in that committee so they also learn and benefit?

Mr Traill: Absolutely.

Senator STEPHENS: Following on from that conversation, you are suggesting that we need something like a social investment task force here in Australia?

Mr Traill: I think that would be a really good idea. My sense is, having observed the UK and having visited there, as you would be aware, Senator, the footprints from that, now 10 or 12 years down the track, are everywhere. What it also galvanised was a level of interest in support for and where it is back to: 'the war for talent'. Ron Cohen and others have made that market interesting. They made it appealing when I was recently in the UK following up on Ian's visit and met with New Philanthropy Capital, Social Finance, Impetus Trust and Bridges. This is drawing highly talented, experienced people out of the top end investment banks and consulting firms, as well as experienced people from the non-profit sector. So people arrive in that space thinking about scale opportunities with access to capital. Bridges started as a pound for pound matching. They raised 20 million quid when I visited there last week. They have now cumulatively raised in the order of £250 million and they have a network of really interesting heavyweight people who are changing the landscape and making things happen. I think it is both a combination of doing the homework and coming up with practical recommendations and also being a bit of a magnet for talent in terms of drawing people into the idea that they can be constructively involved.

Senator MARK BISHOP: Drawing the talented people into this market, I did not think the reward would be similar to that you get, say, as a senior official in Macquarie Bank and like investment banks. Or do you think that would be the case?

Mr Traill: If I can say, as a reformed investment banker, one of the great joys of what I do is that we have a phenomenal pool of talented people who care about the society that we live in and want to use whatever business and commercial experience they have got where that can be directed to social outcomes. Frankly, it is a running joke in the office that we have a queue of people who want to explore that option, not just people who have done incredibly well financially and are now in their 50s and 60s but bright, talented people in their 20s and 30s who are saying, 'I want to pursue this as a career option.' I think the more we can reinforce that, the better it will be. If you go to the UK you will see there is a diverse, eclectic, interesting, sophisticated, intermediary market. It is very limited in Australia. You have obviously done your homework. You are talking to all the known suspects in Australia. It is not a big group. And that is a real pity.

Senator STEPHENS: Does that actually reflect that the market is too small, which is what has been suggested through—

Mr Traill: No. I feel very strongly about this, because I was told in 1989 that Australia was too small to support a private equity market. That is ridiculous. This is now a multi-billion-dollar market and I feel very strongly that a similar opportunity exists in social capital and venture philanthropy. So that is not the case. We are a smart, sophisticated economy that generally manages to better balance our weight and there is no reason we cannot do that in this space.

Mr Robbie: I just think that there have not been the catalysts in terms of things like the social investment task force. The Bank of England report was quite fundamental in terms of getting things going in the UK. The government put in £200 or £300 million into various funds to actually put the seed capital in, pump and prime it. Those were the key factors in terms of driving the development in the UK. You have not had things of that scale, aside from good stuff.

Senator STEPHENS: Just going back to your submission and the other suggestions that you have made so that we can air them. I think that would be helpful. You touched on the issue of tax incentives. Is there anything else that you actually want to put on the public record regarding your concerns about private ancillary funds and the regime in which they operate and changes that might make them more effective and able to be leveraged? Secondly, you make the point about trade associations. We have not had any discussion about that and their potential impact. Is there anything you would like to elaborate on there?

Mr Traill: In relation to the PAFs, I think that has been a success story. There is over $2 billion in PAF funds. That is a logical and obvious source of funding for social and capital investments such as a GoodStart. Our strong belief, after being cleared, is that it is a legitimate asset investment class for PAFs to invest in things like GoodStart. I think there is a non-trivial subsidiary point that is worth exploring around the deductibility of the gap between a commercial and a social investment return that would help that. That is more at a micro level, but there is a really good and interesting structure to explore there. There are some interpretations on the tax side that would use that and accelerate the opportunity for social investment. That is very important.

Mr Robbie: From an intermediary point of view and from Australia's perspective it is like in the USA where, say, some of the investment organisations select non-profit organisations. They actually have their own support elements within those organisations alongside the investment, roughly 20 or 30 per cent of the total. In my experience, in the UK a lot less was done externally, so you have the investors and then the people who are doing the investment-readiness work. My old organisation in Scotland used to do this. There are others like Community Enterprise Strathclyde et cetera.

I think Australia has a nascent sort of pipeline that is there, the beginnings of it with organisations like Social Traders; SVA, doing some work up in Queensland; Social Firms Australia and others. They need development because, if you do not have pipeline development, you will never get the investment-ready organisations going to the new forms of capital. So it is about how you link the pipeline with the actual capital.

Senator STEPHENS: I am thinking about this in terms of the way in which we deal with research and development and innovation in the science space—for example, the role of CRCs in bringing some of that thinking forward. Is that a mechanism that you think could be applied to this space? Is it something that is around a research capability?

Mr Robbie: I think that is one element of it. But I think you have to have the practitioners doing it so they can engage with the research element. In that sense, I do not think there are enough practitioners and enough pipeline development to really know what works.

Mr Learmonth: Maybe, just in terms of the fact that you are looking at other legal forms of variations on the company structure or the company limited by guarantee structure, that would be something that would be worth you looking at in the context of other tax changes that we have discussed. As you know, there is an impediment to putting capital into companies limited by guarantee and ultimately it will go in in the form of debt, which may not be appropriate for the enterprise.

Mr Traill: This is the point that Ian was making. Let us not kid ourselves that tax is other than a significant driver for many people who give socially or charitably, so some flexibility, which does not currently exist in the UK and US, to offer this in different ways around tax deductibility for organisations where there is a clear social purpose I think is certainly worth exploring and is a non-trivial incentive for attracting capital.

CHAIR: But there is potentially a huge opportunity cost in doing that. There is any number, tens of thousands, of worthwhile social purposes, and to have them driven by tax reductions or tax offsets, however it is framed, invites 10,000 worriers from Treasury to immediately come down and eliminate the proposition. It does. That is the real world. There is an opportunity cost there. There is an opportunity cost for other government ministers in terms of programs they might want to develop. There is an opportunity cost for the government as a whole in terms of revenue forgone. So, if that is the central foundation upon which this nascent market might go forward, I suggest it is going to be difficult. That is why I was trying to drive to a different place of for-profit organisations having the appropriate regime which gives them adequate return so that they can provide capital—I use the instance of social housing—as opposed to just being driven, without being too crude, by a tax concession.

Mr Traill: I understand and respect that, and there is some legitimacy in Treasury sensitivities around that. I think the non-profit sector has in some cases done itself a disservice. It is back to point 3 around the structural impediments in the market, clarity around an evidence base. If there is integrity and clarity around an evidence base, which is why for us social return on investment is powerful, it is very clear whether—

Senator MARK BISHOP: It is there.

Mr Traill: social purpose results have been achieved or not. I think the dots connect on that providing there is integrity and transparency around that. If those things are in place from a measurement point of view, then it is clear whether something should be deductible or not. You can measure it. You can track it.

CHAIR: I think we need to wrap it up.

Senator STEPHENS: Just a final question. You have also made this point in the social enterprise space around what you describe as a Catch-22 situation. Perhaps you could elaborate on that for those who are not familiar with the Job Services Australia contracts.

Mr Robbie: My background was in running social enterprises that created jobs for people who were long-term unemployed because of mental health problems. If they had not been working for us they would have been in occupational therapy at a cost of £20,000 a year. We provided the service for £4,500 a year, but that cost was greater than an equivalent commercial business that was our competitor. So how do you meet the employment support costs when you are running an effective business? One of the suggestions we had was that you could actually begin to free up and have some flexibility within the Job Services Australia system or even look at links between federal and state government. If you are working with people who are highly disadvantaged and distant from the labour market, actually some of the outcomes might be health related or social services related as well as employment related. So how do you structure the employment support element that would allow the businesses to be viable commercially but also have their non-commercial costs, which are greater than an equivalent business, met through different funding pools? I think there are thoughts about how you could begin to address some of those challenges.

Senator STEPHENS: Have you taken that up with the department?

Mr Robbie: Yes, we have given that feedback into DEEWR as well.

Senator STEPHENS: Thank you. If you have put your thoughts about that new investment class anywhere on paper, that would be quite helpful for us to have a think about. That will be something that you will probably be taking up with the CCA, I am sure, and may pursue further. Thank you very much for your submission. It has been really very interesting and helpful. Miss Caseley, you did not get to say anything.

Miss Caseley: No.

Senator STEPHENS: Is there anything that you want to add to prove that you were here?

Miss Caseley: No.

CHAIR: Thank you very much.

CROSBIE, Mr David, Chief Executive Officer, Community Council for Australia

MOES, Ms Louise, Policy Director, Community Council for Australia

[12:30]

CHAIR: I welcome representatives from the Community Council for Australia. Would you like to make an opening statement?

Mr Crosbie: Thank you for the opportunity and thank you for juggling the program to make sure that people could attend. I will make some very brief opening comments given the time. One of the really interesting things is that this inquiry is happening. The number of responses you have received is fairly limited. I have appeared at other inquiries, even before this Senate committee, numerous times as CEO of the Mental Health Council of Australia and as the CEO of other organisations. It is really interesting to look at the level of response and engagement in this issue. I think it goes to the heart of where we are. I commend the Senate committee for having this inquiry and thinking forward rather than waiting till we get to a place where it could become more problematic.

There is no doubt, as Michael Traill said, there is tremendous potential that is not being realised in terms of investment into the not-for-profit sector and investment by the not-for-profit sector. The not-for-profit sector holds a lot of assets. How we best create that kind of better investment and better use of the resources that are actually going in there is at the heart of the kind of community we want to live in in the future. I do not know we can continue the pattern of seven per cent compound growth in not-for-profit funding that has been going on for the last 10 years with governments increasingly putting more money in. We are still seeing that pattern at the moment at the state and Commonwealth levels. Ten years on I am not sure we are going to be in the same kind of position. We need to think about how we finance what our community prioritises in terms of services at a local level.

The Community Council for Australia has had numerous discussions, both closed discussions and open discussions. We have brought together chief financial officers from Australia's key not-for-profits and we have had discussions, as Michael said, with a number of people who might be seen as active players in this space. We are looking at putting together a kind of roundtable to sort out what is really needed here. When you talk to different parts of this market and different interest groups, you get a different idea of what is needed. The brokers, the not-for-profits and the finance institutions tend to have a particular perspective. That perspective is often removed from the other perspectives to some degree. The other components of this kind of investment discussion are often seen as a barrier.

I want to end my opening statement by giving examples of just how difficult it is. As I said before, I was the CEO of the Mental Health Council of Australia until about eight months ago. We worked hard at the Mental Health Council of Australia to build a reserve fund that enabled the organisation to operate for a year receiving no funding. On top of that we created a significant amount of other money—not a huge amount but enough to be looking at investments. We did a lot of work around what we could do with this. This was money we could use in a higher risk investment as we already had enough to run the organisation for a year without any additional funding. Do you know where we ended up putting it? Government bonds.

Odyssey House Victoria, a major drug treatment service, had assets worth $20 million and we did not leverage them at all. We used them to provide services. Even though I had one of the most highly powered commercial boards in the not-for-profit landscape—people who had been head of Channel 9, Southern Cross Radio and energy companies; people with very significant corporate expertise used to taking risks—the notion that we would take a risk or enter into debt was very difficult for them to accept in the not-for-profit environment. My experience as a CEO working in the not-for-profit environment is that you are not encouraged; you are actively discouraged from thinking about risk, from thinking about leverage and from thinking about developing sources of funding beyond traditional government sources. I think that is a real issue in this country.

CHAIR: I note in your submission you say the culture in NFPs is 'hand to mouth'. They take the funds and they deliver them, and that primarily arises because the objective of most NFPs is to deliver services. Ultimately, if they have the money, they can get out and deliver services with it. You talk about the need for education and you also mentioned brokerage to try and educate NFPs to look to the medium and longer term as to how they can set themselves up on a more sustainable financial footing. How can that be resourced? What do you propose needs to happen in the for-profit sector? What needs to be done by the not-for-profits, by intermediaries and by government to help develop that education process so that they can be on a more sustainable financial footing?

Mr Crosbie: I think that is an excellent question. My perspective is that not-for-profits respond to the environments in which they function. In Australia, the environment in which you address the issues of your community or your constituency are very much about looking to get government funding to address the issues. There are some very good strengths to that. We live in a country where if there is a problem the government should do something about it—we really do. When you go to other countries and start looking at the problems and if you suggest to them that the government should do something about it, they call you a socialist or someone who is trying to take government into places the government should not go.

In Australia, there are very few places that the community believes the government should not go. Because of that, I think we have a culture that says that the first port of call is to try and get government to provide some resources to address this issue, this target group or this problem. The nature of the way we do that is actually quite problematic in itself. I often use the example of Indigenous retention in schools; something everybody knows that is beneficial at multiple levels—health, employment, wellbeing and economic. If that becomes a policy of government, what they often do is call in a departmental group of people to look at how the policy goal can be translated into some kind of program or service. So you might call in FaHCSIA or a group of people and they make decisions about Indigenous retention and they turn it into a set of units of service. They will say, 'We should have so many social workers doing so many hours of home visits who are not at school and talk to their families.' Then they turn that into a contract with hours and qualifications, and things stipulated, and they go into the not-for-profit market and say, 'Who can provide this?' The not-for-profits in the community who are able to provide that say: 'This is stupid. There are no social workers. There is no housing for them. If there was, social workers going into homes will not make a difference. But we need the money and we want to do good work.' So they tend to try and fit what they trying to do into how that program or service is being translated into some kind of contractual or tender arrangement.

The problem for me is that we have created a lack of capacity for innovation in responding to the policy goals. I have actually been involved in increasing Indigenous retention at school through some of the boards of the organisations that I am on. I can tell you the most effective thing we did was buy four-wheel-drive diesel buses. When we bought the four-wheel-drive diesel buses, they could have an intercommunity football game between the under 9s and the under 13s teams. The kids could only play in the footy teams if they had been to school and not been in any trouble. So there was this real incentive to go to school so that they could play in the footy teams. The footy teams can now travel between communities because we bought four-wheel drive diesel buses.

The people who have come up with the policy goal of sending in social workers and other people are not going to know how to do that. For me, whether it is a massive organisation like GoodStart providing child care or just a small local group trying to do some land care, we need to focus on what we are trying to do and not always try and translate that through bureaucratic processes into tenders and contracts and then try and manage risk through compliance. Frankly, I have yet to see any evidence that massive amounts of compliance reduces risk. Risk is about relationships.

CHAIR: What is the lesson there for us?

Mr Crosbie: Imagine that you are the not-for-profit in that environment. Your capacity to respond to the issue and be innovative is almost non-existent, because in terms of trying to keep your programs and services going you have to respond to a set of government requirements—tenders, contracts, sources of funding. Your capacity to put your head above that parapet to say, 'I think we can do this completely differently,' is very limited. As a CEO of Odyssey House in Victoria for seven years I was never once asked if I reduced drug use. We were a massive drug treatment agent. I was asked how many beds I provided and how many people used the service and for how many days. But I was never asked if I reduced drug use. The culture in not-for-profits is not about focusing on the mission to the degree that we might think. It is about trying to provide the programs and services.

Senator Stephens and I have had some involvement in developing the national compact. I was a chair of the first expert advisory committee on the national compact. Louise has been involved in lots of the consultations. I cannot remember someone ever coming up to me in any of those consultations and saying, 'We need to look at our capital markets in the not-for-profit sector.' There are thousands of organisations.

CHAIR: Thinking that through in the context of why we are here today, one of the things that people have made submissions is social impact models. Correct me if I am wrong, but my understanding of how those might work—and to use your example of the Indigenous school retention rates—is that a government might say to a NFP that if they can go out and raise money to fund a whole series of diesel buses for Indigenous communities we will pay a reasonable return to those investors on that if you can prove that you have improved the retention rates of Indigenous students. Then it is up to the NFP to go out and work out how to do it, in a sense. They may decide to take the money that they have raised from the investment to buy the diesel buses. Is that something that could work? The government would only pay them if they succeeded.

Mr Crosbie: That would be absolutely fantastic. Not-for-profits would really welcome the focus being on the policy goal that you are trying to achieve rather than some kind of really strict pre-determined set of programs and services established by a bureaucracy that is often removed from the situation and from the policy.

CHAIR: In that circumstance, it really does fall on the NFP. The government might say that they will pay a 10 per cent return on the investment if you can reach these targets in terms of school retention rates; we will not pay it if you do not. Then it is up to you. If you decide that buying school buses is the way to do it, you will—

Mr Crosbie: The only caveat I would have is that you would need to give people a time. You would take a community, say, where there is low retention in school and where that is having massive impacts on everything from sexually transmitted disease, to employability and to many other things. You want to do something about that. You might take a five-year horizon. You would bring some money in and develop a relationship with them—not a contract, a relationship—around who they are and how you are going to engage with them. The government would give you five years to reduce the retention rate and guarantee them a cash flow of $500,000 a year for the next five years to address. At the end of that time, the government would review that to see whether to invest in it again. That might be done in 50 communities where there is very low Indigenous retention. The barrier to that is not the not-for-profits.

CHAIR: I can see that. There are two aspects to that. One is the degree to which government provides the NFPs with the flexibility to implement programs which they think will work.

Mr Crosbie: Exactly.

CHAIR: The additional aspect of it, which is really the focus of what we are talking about today, is the ability of the NFPs to go out to the market and say, 'Can you invest in this? If we achieve what we say we can achieve, the government will pay you a great return.' That is how I understand the SRBs work. 'If we fail to deliver the targets, the government will not pay you as good a return'—or no return, whatever has been negotiated. So the risk ultimately falls on the investors but it is up to the NFP to deliver to minimise and deal with it.

Mr Crosbie: When you already have that environment, you have created that kind of structure, suddenly the brokers become critical. At the moment the brokers are not brokering between people who are committed to doing things because there is a lack of appetite for the product from the community, from government, from not-for-profits and from financial institutions. There is not enough money in it. Not-for-profits operate in a certain way, in a certain environment. Governments are incredibly inflexible about how they work with not-for-profits and we find that time and time again. Frankly, I have had discussions with people in the community who have an investment portfolio and have come to me. I have talked to good investors who will often say to people, 'I would like five per cent of your portfolio to get a slightly reduced rate of return so that we can invest in Indigenous retention at school.' They might say that to them. The most common response, as I understand from talking to investors, is, 'Why wouldn't I just give them the money?'

With the notion that you are either investing or supporting, it is really hard to get to the middle ground—'Am I investing or am I supporting?' It is much easier for people conceptually to think it is either an investment or it is supporting. My understanding from talking to people involved in providing high-level financial advice to high-wealth individuals is that many of them are confused by the notion of reduced return for social benefit. They are happier to say, 'Let's just do a social benefit. What is the return stuff about? That's just confusing.'

CHAIR: If you can get that right, you can increase the pool because a person may be able to provide as a donation $100,000 but may be able to invest $1 million.

Mr Crosbie: If the environment were better—to go back to the Indigenous—if we were in a position where you are putting that kind of contract out as a government with that kind of flexibility, as Michael was saying, you could say to people, 'Government are putting this on the table and so we can now offer you a return; it would be a lesser return than you can get commercially but one which will enable you to leverage this good.' If there is a structure, a goal, an environment and retail selling of that investment, it can make sense. I think it is much harder to make sense just as an add-on to a normal portfolio without a structure around it.

Senator STEPHENS: Thanks very much for your submission and for appearing today. The role that CCA plays is quite different in terms of trying to bring together common themes and serious policy agendas, as opposed to managing some of the protecting patches. I was quite interested in your response to the other submissions to the inquiry, what you thought of—

Mr Crosbie: Do we have to say?

Senator STEPHENS: I am particularly interested in what you thought about the JP Were submission and their particular perspective as managing investors' funds and working for with not-for-profit organisations. The suggestions they made I thought were quite interesting and I would certainly like a comment there; secondly, the issues from Social Ventures Australia around a new investment product, whether you thought they had a role to play.

Mr Crosbie: I think they are all good suggestions and all worth pursuing—the notion of some kind of financial credit rating, which might better enable boards and others to feel secure in taking risk; the notion of creating an investment class; and the notion of looking at taxation treatment. When we were trying to boost the film industry we did investment things that I felt worked very well for the period they were in place—the 10BA stuff—although they ended up being rorted a bit I think. There is a lot of good work being done in Australia but it is sort of isolated and ad hoc. What will work best is, rather than trying to find one solution—'This is what we need to do'—as Michael was saying, we need to bring together and work through what we really want from each constituency and what we really need from each constituency to make this work. My reading of the submissions was that they tended to be a bit narrow in their focus because the ones from the finance sector focused on the finance sector and the ones from the government tended to focus on that. It is natural. We need to get all four key constituencies—the not-for-profits; the government; the financial people, including institutions and brokers; and the community—to a similar point around where we are or at least heading in the same way. At the moment it feels like you are trying to sell something that people do not want to buy. Yet it is so critical. The whole future of the not-for-profit sector in 10 years time is going to depend on how well we do this.

The most disappointing thing about the submissions was how few there were. They do not represent a huge investment of time and resources. I am not being critical of the people who have written them. I do not want to be seen as being critical. We did not invest a huge amount of time and resources either. It brings into question the capacity for forward planning and leadership and a whole range of other issues in this space and how we leverage that. As Michael said, the 20 key players in this whole thing in all of Australia are participating in this. How do we leverage that into something that is going to position the community? It is not just about increasing resources for not-for-profits; it is about having communities better respond locally to their own issues. How do we leverage that so communities can make real investments that make a real difference in people's lives? We need to move beyond, 'We just want government funding because there is a problem.'

Senator STEPHENS: It is a big challenge, isn't it? In relation to the extent to which overseas responses in this space kind of reflect some directions that Australia could take, the latest issue in the UK is the launch of the Big Society Bank and the Big Society strategy and policy. Do you have any reflections or thoughts about that?

Mr Crosbie: We were talking about that earlier and I was talking to Senator Bushby. From my perspective there are real difficulties translating the cultural environment in which not-for-profits operate in Australia to either the UK or the US, which most people have referenced. The US has a very different culture around not-for-profits. It is absolutely different. We would be seen as socialists in the way we support social organisations from the government perspective. If you walked around the back streets of San Francisco and asked local people how there could possibly be so many homeless people and why the government is not doing something about it, they would look at you strangely. They would say: 'It is not up to the government. These are not government issues. What are you? Are you some sort of red socialist trying to take over?' There is a sense that community good is largely driven by other factors. Against that there is a much stronger sense of responsibility to intervene as an individual and to give more. It is a very different culture.

The UK has had a long history of being a little more innovative in the way it responds to meeting community need because the structure of funding has often been around local purchasing authorities of various kinds in various parts of the not-for-profit sector. If you look at disability services in the UK, the whole brokerage model has been very well developed and is rolling out more and more where people are actually asked what disability plan they want for themselves and really given the capacity to purchase the services they need, so they are really consumer driven services. I think that works up as well. Services at a local level are often directed by regional authorities or have been. My concern with the Big Society is that it has a lot of strength in encouraging people to take more ownership of their own community and have input, but you cannot do that while pulling government funding out because you are diminishing capacity. There is no point in diminishing capacity and saying, 'We want you to do more.' I think you should say, 'We want you to do more and leverage the capacity that is there.'

CHAIR: Thank you for assisting us today.

Mr Crosbie: Thank you for the opportunity.

Proceedings suspended 12:55 to 13:36

DREW, Ms Belinda Ann, Chief Executive Officer, Foresters Community Finance Limited

WILSON, Ms Therese, Chairperson, Foresters Community Finance Limited

CHAIR: I welcome representatives of Foresters. If you would like to make an opening statement, please feel free to.

Ms Wilson: Foresters is a community development finance institution. CDFIs are in themselves social enterprises in the sense that they exist to fulfil a social purpose. The social purpose of a CDFI is to address financial exclusion. In Foresters' case we seek to address financial exclusion for individuals, for social enterprises and for not-for-profits. Those are three types of financially excluded entities or individuals that we recognise in our society.

It goes without saying that not-for-profits perform very valuable roles in our society. Those roles might otherwise fall upon government; therefore, it is in the government's interest to work towards their sustainability and growth, particularly in an environment where the welfare state has probably reached its limits and we need to look beyond that. The anecdotal evidence is that not-for-profits struggle to obtain appropriate finance, certainly from mainstream financial institutions. The reference to appropriate finance is twofold. This arises out of a research paper that Foresters has prepared, which I think has been provided to the committee. The first is in relation to risk assessment, the credit assessment, of not-for-profits and the second is in relation to an appropriate tailored product for not-for-profits.

First of all in relation to the risk assessment or the credit assessment, mainstream financial institutions often struggle to understand the risk profile of not-for-profits. It is not that they are necessarily not credit worthy but just that a mainstream financial institution may not understand their sources of income, for example. What is required is a different type of credit assessment, a more individualistic credit assessment. This may actually involve assisting an organisation to become credit ready. This is something that Belinda will talk about in terms of the work that Foresters does. That is a time-consuming and, therefore, necessarily costly process that may not be attractive to mainstream financial institutions because it is not particularly profitable.

In addition to needing a tailored individualistic type of credit assessment model for not-for-profits, it is necessary to provide tailored financial products—for example, products that are flexible, that take into account income cycles in a particular organisation and that focus on working with an organisation in terms of appropriate loan purposes. All of these things again potentially make this a more time-consuming and costly process, which may not be particularly attractive to mainstream financial institutions, because it is not necessarily profitable. Some mainstream financial institutions have begun to engage in this work and a lot of those activities are commendable. They do that largely under their corporate social responsibility banners. What I would say is that reliance on voluntary corporate social responsibility is necessarily tenuous. It can rise and fall on the whim of a CEO or the board of directors of the day. Also it is likely to be limited, only pursued insofar as is necessary to meet a corporation's strategic reputational purposes under the business case.

What we argue is a government response which is most likely to lead to improved access to credit for the not-for-profit sector is one which supports the growth and development of community development finance institutions. Because they are social enterprises, because they exist to fulfil a social purpose rather than having a profit motive as an end in itself, this places them well to provide the sort of tailored credit assessment procedures that I referred to and also the tailored finance products that I referred to. That government support could take the form of direct financial support but also encourage industry, including mainstream lenders—and this is where the mainstream lenders can play the most valuable part—to invest in community development finance institutions to enable them to do this work. That can be done, for example, through tax incentives, such as the Community Investment Tax Relief scheme that operates in the United Kingdom. Also legislation could be considered such as the Community Reinvestment Act that operates in the United States and encourages bank investment in community development finance institutions because the extent to which banks support that type of work impacts on their CRA rating, which in turn can affect the activities they are entitled to undertake under their banking licence and can have major reputational effects on them as well, which they take quite seriously.

Ms Drew: Building on Therese's comments, we also wanted, subsequent to our submission, to highlight for the committee some of the core principles that we see as important in terms of the work we have done over the last decade in what you might loosely call the social capital market for non-profits. I provided a copy to the committee. In terms of outlining these principles briefly, we would not be having this discussion if there were not a need or a demand for access to new forms of capital in the not-for-profit sector. I think that is now an inarguable thing. Although we have heard this morning that at times it is not obvious where that demand exists, I think it is clear in our work that it is there. This is the self-interested principle, the second one—intermediation in an emerging market. In time, as that market matures and develops, it may be the case that other financial institutions take over this work, but at this early stage intermediation is definitely necessary.

In order to attract capital it is clear to us that you need to be able to articulate the blended value of the investments being made by investors, both financial and social. We need to be able to replicate existing market mechanisms; so, perhaps instead of solely going down the path of inventing a whole range of new ones, rather look at investment structures that already exist and make best use of those. We need to engage in education and engagement both on the supply side, so on the capital side of the equation, but also in the not-for-profit sector itself. We need to provide investment incentives to investors. It is quite clear in our work that at this point in time the market is not ready to accept the risk-return ratio of investing in this space and needs incentives to do so. We need government intervention either in the form of direct action or, indeed, in some sort of policy approach. I would like to echo the comments made by Social Ventures Australia and Michael Traill in terms of the Social Investment Task Force in the UK and the benefits it brought to that market. We need engagement by private investors; if we are going to really tap into a new market of capital, we do need to look beyond government funding and philanthropists. We need to measure what those impacts are and in fact be prepared to measure them on the basis of the good and the bad, and we also need to pursue a principle of transparency. So we need reporting and regulation commensurate with the risk that the market presents to investors and to not-for-profits. Thank you.

CHAIR: Thank you, Ms Drew. For my information, what is the structure and ownership of Foresters?

Ms Wilson: We have a company, Foresters Members Ltd, which is a company limited by its share capital and which owns all of Foresters Community Finance Ltd, which is limited by guarantee. Sorry, it is the other way around: Foresters Members is limited by guarantee and Foresters Community Finance Ltd is limited by share capital, with a view to potentially attracting external investment if we thought that was appropriate. But at this stage Foresters Community Finance is wholly owned by Foresters Members.

CHAIR: Are its members publicly known or not?

Ms Wilson: No, the members are largely staff and directors at this stage, with some interested community sector based—

CHAIR: So there is some community not-for-profit-type involvement.

Ms Wilson: Yes, that is right.

Ms Drew: The membership structure goes to our history as a friendly society, so the membership base over time has been made up of a slowly diminishing elderly population of members.

CHAIR: I had not actually picked up the history as a friendly society, so that helps explain where you come from.

Ms Drew: Yes.

CHAIR: In your opening statements, in terms of assisting the NFPs to become more credit ready, Ms Wilson, you indicated that there is more individual assessment required to make that happen. Who are you thinking of to assist to make the NFPs more credit ready? Would it be intermediaries, or is there a role for government?

Ms Wilson: Intermediaries such as the community development finance institutions, which is part of the work that Foresters currently does.

CHAIR: I note that you also do some consulting work. JBWere, who were here before, indicated that NAB, which is their parent company, had engaged you to do some work. Is that something you do a lot of? Is that a major arm of what Foresters is doing, or is that done particularly with a view to trying to raise the profile of social benefit investment?

Ms Drew: Yes. We have made a commitment over the last, say, five years of our operation to engage with other partners like NAB to research the space so that we can build an understanding about the not-for-profit sector and finance and investment. So, yes, there is an education strategy in there—there is no doubt—but it has also been extremely helpful in terms of informing our own practice with not-for-profits. So it has both a practical and an educative function.

CHAIR: Is that something you have done for other organisations, or is the skill and expertise you have shown in that particular paper something you developed specifically for that particular project?

Ms Drew: No, we have done a range of research across the three areas of our market focus, so we have done research around individual exclusion and microfinance. We have also done research around social enterprise and its finance needs and around the not-for-profit sector as well.

CHAIR: So the expansion of capabilities from your friendly society days, I believe.

Ms Drew: That is right, indeed.

CHAIR: You also went through a number of things that needed to be done. One of the suggestions you made was to adapt existing funding mechanisms or financial mechanisms. How do social bonds, social impact bonds and arbitrage bonds, which we have heard some evidence about today, fit into that? Do you see those as new mechanisms, or are they an adaption of existing mechanisms?

Ms Drew: Possibly an adaption of existing mechanisms. The mechanism of a bond exists already in the market. My comments around using those existing market mechanisms would go less to social impact bonds. I do not consider myself to be an expert in that space particularly, so to comment would be maybe not so appropriate. But certainly within our work we have focused on using existing investment mechanisms. Foresters Community Finance has a subsidiary company called Social Investment Australia. It has an Australian financial services licence for the wholesale investment market and it uses the structure of managed investment schemes to offer social investment product to the marketplace, thereby using that as a vehicle to raise the capital that we then use on the demand side of the equation. We would argue in terms of our own work that as a result of accessing those existing market mechanisms we are already quite highly regulated as an entity. We are answerable to the Australian Securities and Investments Commission on the licence. We also hold an Australian credit licence as well for our individual microfinance work. So we would argue those mechanisms to provide a pathway to the creation of a market for this market.

CHAIR: So there are mechanisms that provide the pathway which, as you note, are already highly regulated. Are any of those regulations in the way they operate, having been set up for normal commercial markets, actually placing impediments in the way of you achieving what you would like to achieve? Are they an exact fit for what you are doing or does there need to be a degree of flexibility in approach to better enable you to develop those existing mechanisms in the direction you would like to see them go?

Ms Drew: In a way the answer to that is yes and no at the same time. If in an ideal world you were to design up a set of investment structures and vehicles for this kind of market it perhaps would not be the ones we currently have. But that is not a realistic proposition, in my view. So in order to get on with the work that we have been doing we have used what is there. The answer is: in the main they do not pose an impediment to us being able to deliver what we need to deliver. In fact, if we are talking about access to new forms of capital out of the pockets of private investors, it actually is a positive thing, not a negative thing, because those investors expect to see all the ordinary things.

CHAIR: Okay. I understand that I guess, but on the specific question, there are regulations that ASIC would have in its regulatory guidelines relating to what people going to the market to investors might offer and how they approach that, which may well have greater application when you are talking about commercial returns but may not contemplate in the way they are drafted the idea of a social return. None of what you have seen causes you any problems in terms of what you are doing with that?

Ms Drew: It comes down to disclosure. In the investment documents you offer to investors, if you are offering a submarket return—well, you simply tell them what return you are offering and they make a judgment about whether it is submarket. Certainly in the information memorandum documents we have put together we talk about the social value that we are trying to drive by making these investments. So all that we are doing is disclosed through that documentation and investors then make their own decision based on those disclosures.

CHAIR: So government, effectively then, is not standing in the way of the development of this type of innovation, but you obviously think that government could take positive steps to help foster it. You talk about that as well and you talk about the potential for direct action. I will not go into direct action in the broader sense at this point—I do not want to make it too political, as it has relevance in other areas. By 'direct action' you mean directly investing themselves. Obviously we have had evidence this morning about leveraging the money that the government spends to help deliver social outcomes. Do you have any thoughts on other ways that the government could approach these issues with a view to creating access to a pool of investment for not-for-profit?

Ms Drew: One of the areas that I think has come up this morning as well is around superannuation funds. I think in the last three or four years there has been a lot of discussion about being able to tap into that large corpus of capital and the sole-purpose test being raised as a barrier to that. This kind of goes to the point about what government can do. We previously operated a superannuation fund and we made investments through that fund which were of a social nature. The regulator, APRA, said very clearly to us at the time that if we wanted change in the space we ought not talk to them, that they are just the regulator, that we ought to talk to the politicians. That common stuck with me over a number of years.

CHAIR: Did APRA have a view at the time on those investments?

Ms Drew: Yes, a very clear view that as long as the investments were considered with financial returns first and the best interests of the members of the funds first, and all those criteria were met, there was no impediment to making the investment, which I think is a very important point. So in the context of superannuation funds, if you are going to offer an investment which is discounted to market there could be an argument for the gap to be made up through some mechanism. Certainly in the UK the tax incentive scheme they have used has had some limited benefit in those institutional settings.

CHAIR: So looking at a mechanism where, in the event that trustees made a decision to invest for social benefit dividend in addition to the financial dividend, they could offset the financial dividend they have forgone by doing that in another way, so still meet the sole purpose test.

Ms Drew: Yes.

CHAIR: You talk about transparency in the reporting regime. In that sense you are talking about the need for a standardised reporting system so that investors can have a degree of confidence as to what they are investing in. We heard earlier today that if you are investing, particularly into a listed company, you know exactly what the reporting regime is and you can compare apples with apples across different options, but with not-for-profits you have no hope of doing that. How would you see we could develop that? In terms of the outcomes of not-for-profits, it is not all about the dollars and cents at the end; it is really the triple bottom line. Are you aware of any framework that we could look at for doing standardised reporting along those lines for the not-for-profits?

Ms Drew: There are social accounting frameworks and social return on investment frameworks. This goes a little bit to the whole discussion about social value in the not-for-profit sector. I think it would be fair to say and most of the not-for-profits we work with would say that over a very long period there has been an underinvestment in evaluation that would lead to clarity about the outcomes they are producing. I think that is an issue for government funders, for philanthropists and, no doubt, as well for investors. Concerning how you tackle the complexity of our marketplace where you have engagement at local government level, state government level and federal government level, there are some challenges there which are not present for example in the UK: adopting one model wholesale, I am not sure we would reach that point, but adopting a set of principles or requirements which led people in not-for-profits down the path of selecting a model that met a certain set of criteria where then you could take that data and aggregate it through that set of principles so that there was some commonality but perhaps also some accommodation of diversity. Whether that is social accounting or social return on investment, I do not have a particular view of that.

Senator STEPHENS: Thank you very much for your submissions and for all the work you are doing. Your submissions are quoted by almost everybody else, which tells you something. I want to ask you about a couple of things. One was your own source of funding, your own investment fund. How do you generate your funds to lend to others?

Ms Drew: Now through a mixture of fees, so our own revenue and funding. That would be how I would simply describe our revenue base. We receive government funding now from both the federal government and state governments for various programs. One of those is in the not-for-profit space in Queensland and Victoria. That funding goes to paying for all the front-end work—all that high-touch work that we do at the front end. That is very, very useful. We also charge fees to not-for-profits for the work that we do. We do some amount of consulting work and we also earn money from our funds management activities. So it is a combination of fees and funding.

Senator STEPHENS: That in itself is interesting. Thank you. What if we were to say, 'What do you want to see come out of this inquiry?' This inquiry builds on the recommendations of the Productivity Commission. Where should the government, the sector and the financial institutions be looking next?' This was one of the things recommended that we investigate. As a committee, we would like to be able to make some practical recommendations. Some people in the sector say that the government does everything or should fund everything, but there are some practical things that could be part of the recommendation mix. As people who are real players in the space, I am sure that you can see things that the government could enable. I would be interested in hearing about them.

Ms Wilson: One initial comment is: support for the growth and development of community development finance institutions. A CDFI industry, such as you already find in the United Kingdom and the United States, which is then able to operate as a financial intermediary and really support the not-for-profit sector as well as financially excluded individuals would, I think, be a key step. In terms of how you do it, obviously funding is one issue. There is some debate about whether CDFIs can ever be fully self-sustaining or whether they really require a mix of income. Certainly, the unfortunate demise of a large CDFI in the US recently, ShoreBank, indicates that some external subsidisation on an ongoing basis is probably required for these institutions to continue to operate effectively. But the comfort for government there is that it gets to the double bang for its buck in a way, because the government investment is matched by generated income to fulfil a social purpose.

Ms Drew: The other comment I would make is that, in the last 18 months to two years of our organisational life, it would be very silly to underestimate the power of government intervention. I mean that in a positive sense. As we have seen government come to the party, if you like, by not just providing funding but actually endorsing the work, that step change has been very significant. In the not-for-profit work that we have been doing in Victoria and Queensland, just by virtue of the fact of the state government funding that front-end work speaks to those sectors that this is something that government actively encourages them to get involved with. That has an enormous and positive impact on how organisations then behave.

We have been beneficiaries of funding of the federal government CDFI pilot through FaHCSIA. The secondary benefit of that funding being provided to us is that it opens up a whole discussion and debate around the value of the institutional form of CDFIs that we could not have had before. So it is immensely powerful and not to be underestimated. One thing that would be great would be coordination across various government agencies about the pursuit of this goal. This is where the market and the industry look at something like a social investment task force. Whether it is exactly that or not, it seems to make some sense because it would create that forum in which various players could come together in one place and have this kind of debate and discussion regularly, with a common set of goals to be in pursuit of.

Senator STEPHENS: Does the funding that you receive from Victoria and Queensland enable you to produce products for the sector or only to the clients that you are actually engaged with?

Ms Drew: What it enables is all the front end work that we do. If you were to summarise the steps that we take toward an investment outcome, it is market outreach, appraisal, project packaging and investment—four very clear steps. The government money allows us to undertake the market outreach and also the appraisal and project packaging work in readiness for the investment. So a relatively very, very small amount of money goes a very long way and then potentially leverages at the end of that quite significant sums of money, of capital, that is never going to come out of the pocket of government. My view has been certainly at the state level in Victoria and in Queensland that that shift has come out of a level of fiscal constraint, despite the continued tapping on the door for money. The sorts of models that we are presenting become more and more attractive in that context. I once thought that that shift would happen as a result of the pursuit of social good, but it has not. It has come through the pursuit of economic outcomes.

Senator STEPHENS: We had conversations with earlier witnesses about investment ready organisations. One of your 10 principles is about this issue of education and engagement. Thinking through again the circumstances that we are in here and what we are trying to achieve, is there a role for APRA, ASIC or somebody to take on some of that sector education role from the government's perspective, or do you think that is something that should be owned and driven by the sector and by intermediaries?

Ms Drew: No, I think it should be owned by everybody. I think there is a responsibility for individual not-for-profits to increase their knowledge and awareness. One of the reasons that that does not happen is that not all but many of the people who are trained and running not-for-profits are not trained in organisational development business finance. They come from different training pathways. So I think it is the responsibility of those organisations. I think it is also the responsibility of intermediaries like us to make information available and to make it clear. But there is also a role for government and for other regulatory bodies, certainly in both the Queensland and the Victorian contexts. We are working hard in Victoria at the development of a guide book for not-for-profits who are interested in pursuing finance as a means to property ownership. It is quite specific. It brings together some information and case studies and provides a vehicle for that state government to say to the not-for-profits it funds: 'Here is some information. Educate yourself about what this might mean in the context of your organisation.' What I would say is that each of those players will come at that education in a slightly different way. What we would tell not-for-profits is likely to be biased or influenced by what we would then like them to do. There is also what not-for-profits might seek themselves or be driven by what their board's view is appropriate or otherwise. Allowing some diversity in that is important.

Ms Wilson: I do not think the benefit of the one-on-one working closely with an organisation should be underestimated. I liken it to the whole financial literacy, financial education for individuals. Compare the effectiveness, or what I perceive as the effectiveness, of that sort of very expensive campaign with the financial education that just happens to be a part of some of the low interest loans and no interest loan schemes that are undertaken where low income individuals are actually working with community sector organisations and increasing their capacity in a very personal sense and learning an awful lot in that process. That is similar to what a CDFI can do with a not-for-profit in terms of working with them—in effect, financially counselling them to get them investment ready. I think that is a far more effective but more expensive and costly way. I do agree that there needs to be a range of strategies, but that is probably the most effective means of educating not not-for-profits and assisting them to become investment ready.

Ms Drew: I was just the other day consulting with a lawyer that we use who is currently looking at the constitution of a not for profit who wants to raise capital to purchase a building. We cannot assist them to do that because of what they want to do. They are a membership based organisation and they have more than a thousand members. They have done a survey of their membership, and their membership indicated that they would contribute capital toward the goal of purchasing this property. That would qualify the investment strategy as a retail investment strategy, and we currently do not hold the licence for retail investment, so we cannot be their investment vehicle. So we have gone down the path of looking at the constitution of the organisation to see what it allows them to do to raise capital.

The legal analysis of that suggests that there is no impediment in their constitution to raising capital; in fact, on face value they seem to be exempt from any of the requirements of either ASIC or APRA in relation to raising capital. The challenge they face is, if they pursue what seems to be a possibility, how they do that in a way that is within the ordinary limits of the law in relation to investment even if they are not captured? There is nowhere for that not-for-profit organisation to go to get that information. Consequently, our support in the end has been to link them up with a suitable legal professional who can provide them with all of the advice they need to understand the risk they might be in pursuit of if they follow that path.

In one way I think that education is great; in another way it worries me greatly. If they pursue that, they pursue that strategy without an intermediary. They come right up close around investment risk against their membership, and it would not take much for you to work out what the results might be if things go bad. But that information is not available anywhere for those not for profits—not on ASIC's website necessarily and not in a way that could easily be discerned for their purposes. So there is definitely a role there in making some of that difficult-to-grasp information more opaque for not for profits.

Senator STEPHENS: Is there potential for something like additional modules in accounting for not for profits, law degrees for not for profits and the like? I saw recently a certificate IV in social enterprise being developed. That is also a potential place for additional modules that go to the crux of the issues that you are talking about.

Ms Drew: I think so. The development of those organisations is two things. It is an internal view that they can reach out into different skill sets in the marketplace. In many organisations, particularly the larger ones, you now see that, but in some of the organisations we have worked with one of the things I would identify that makes those not for profits stand out from others is that they have engaged a different skill set than is ordinary for a not for profit. Those people who are going to end up there, because they have to provide direct services for people, for them to also have some level of training that helps them to perhaps be better managers of money and other, more organisational, strategic matters.

Senator STEPHENS: What about the issue of the exposure of the board members to legal action? Is that an issue in your space?

Ms Drew: The boards of not for profits are an issue mostly for not for profits who want to go down this path. We have seen deals fall over on the back of highly conservative boards. That is not an implied criticism of any of those boards. They take a view of the risk the organisation is prepared or not prepared to pursue and make a decision consequently. It sounds like there is an endless educational strategy needed here, but there is also a need to educate board members in the context where, as you are aware, they are largely volunteers. So there is a degree to which you would conclude that you need to make assessments about how fair it is to ask those voluntary board members to pursue strategies like this. But there are ways and means of going about that, and through our work we focus on making sure that, as we engage with the not for profit around finance, we engage not just with the senior management but also with the board. As Therese mentioned in her earlier comment, that process of delivering finance is as much an educative strategy as an outcome in itself.

Senator STEPHENS: Could you explain for the committee members who might be fairly new to this space the principles, constraints and benefits of patient capital and how that works?

Ms Drew: The principle of patient capital is that an investor might place that capital for a period of time. They are patient. They ordinarily might expect it back in five or 10 years, but they might place it for a longer period of time than that. Another feature of patient capital is the idea that, as it is invested, the returns may not be market returns, so the investor is kind of patient while the business builds up to a place where market returns might be possible. So patient capital often gets talked about in the context of—another bit of jargon—'quasi-equity' or equity-like investments, which are, as we have heard already today, hard to make in not for profits because of their structure. Patient capital really goes to leaving it there for longer than an investor might ordinarily leave their money there and also being patient on return over time. I say that, currently, there are probably very few examples in Australia of any investments made on the principles of patient capital through to investment structures. I think there are probably some examples of it being done in ways that are similar through philanthropic approaches. But, yes, it is a very new concept here in the Australian context.

Senator STEPHENS: Thank you.

CHAIR: Thank you to Foresters for assisting us today.

ADAMS, Ms Sarah, NAB Research Fellow, Centre for Social Impact, Australian School of Business, University of New South Wales

HEMS, Mr Les, Director of Research, Centre for Social Impact, Australian School of Business, University of New South Wales

KERNOT, Associate Professor Cheryl, Director of Social Business, Centre for Social Impact, Australian School of Business, University of New South Wales

[14:18]

CHAIR: Welcome. Professor Kernot, welcome back to the Senate. If you would like to make an opening statement, please feel free.

Mr Hems: Thank you. I would like to set out the way the Centre for Social Impact operates. It is a collaboration of four universities: the University of New South Wales, University of Melbourne, Swinburne University of Technology and the University of Western Australia. We operate at the intersection of the three sectors. We think there is a huge amount of opportunity in terms of social innovation if we can harness the resources of government, the not-for-profit sector and business. We believe that there is a fundamental problem for funding not for profits, social enterprise and social businesses and we need a 21st-century solution to those funding problems. We believe that creating a capital market for social investment is a viable, realistic strategy for not only government but the other stakeholders: not for profits, financial institutions and social investors. There are a number of transformations which are occurring at the moment which support that statement that we believe establishing a capital market is a sound strategy. Not only are not-for-profits behaving more enterprisingly but, in Australia, we are very lucky in terms of large not-for-profits which have strong balance sheets and are undertaking activities to support the growth of some of the most exciting social enterprises. There is also a move within government towards outcome-based commissioning and procurement of services and outsourcing, but I think it is the outcome-based commissioning which offers the greatest opportunity.

There is also a movement amongst investors to get involved not only in ethical investment but also in socially responsible investment. There is also, as we have heard, an appetite amongst business to create shared value, and that is reflected in initiatives like blended value, triple bottom line and, most recently, the International Integrated Reporting Committee, which is seeking to systematically measure not only economic and financial value but also social and environmental value. We believe that tapping into some of these mainstream transformations provides us with a huge opportunity.

In Australia we look abroad to see what is going on in the US, the UK and Canada. There is tremendous, tangible evidence of the use of capital in deprived communities and to support the work of CDFIs and other social enterprises and not-for-profits. We have just completed a piece of work for the New South Wales government on checking the feasibility of the social impact bond, and we found tangible evidence of an appetite amongst all the key stakeholders. We found not-for-profit organisations which were not only competent in terms of administering a bond but also legally capable of issuing a bond. We came across investors who had an interest in it—not just the philanthropically minded social investors but also some of the mainstream banks and investment houses like AMP Foundation.

We also found tangible evidence within the New South Wales government. We had interviews with most of the mainstream human service agencies, and they were able to identify programs which developed interventions or change processes which, if implemented, would deliver long-term cost savings for government. That is how social impact bonds work: by identifying programs where financial investors and maybe social investors will put up the capital in front and government promises to pay on the delivery of those outcomes. So there is strong support also from government.

We would also like to note the work that we have done for NAB with our microenterprise loans. We are doing an evaluation of that program at the moment. That looks extremely exciting and is a key component of this accessing capital for microenterprises including, we believe, social enterprises. We also note schemes like NRAS, which we think has great potential, and we would also like to commend case studies like GoodStart, which I think you have heard about today, and also some of the exciting initiatives of some of the cooperatives, including Hepburn Wind, who made an excellent submission to the Senate committee, and also West Belconnen Health Co-operative, which I think shows that cooperatives have a key role to play in terms of capital.

Prof. Kernot: Can I interrupt you to say we would like to formally table the document that you have handed out.

Mr Hems: Just looking forward, if we are to deliver a capital market for social investment then we believe that we broadly have to construct something along the lines of the diagram which you can see on the paper and also on the PowerPoint. Obviously there has to be a body and a pipeline of investor-ready third-sector organisations—not-for-profits and social enterprises—but we believe that this can be done if there is the right operating context in terms of legislation and public policy and an appropriate level of capacity building, including work around strengthening the board and senior management of not-for-profits to reduce their risk-averse nature, and if we develop the intermediaries, including existing specialist organisations like Foresters and also intermediation by mainstream organisations like JBWere, who you have heard of today and who are engaged with both mainstream commercial organisations and philanthropists. The other key point is we would like to promote the nurturing of the existing opportunities around the Social Enterprise Development Investment Fund—the five CDFI pilots. In the top right-hand corner, the most recent announcements in the UK is around the development of a social investment wholesale bank or source of capital to drive the change within this market place.

However, we do not believe that will happen unless there is a considerable amount of market development. I think you have already developed touched on some of the key areas around a task force to drive interest and to ensure that all stakeholders are well-informed, and the development of a knowledge base to ensure that people are actually operating on robust evidence and knowledge. As I mentioned earlier, I think we can tap into other initiatives like the integrated reporting committees work on creating a new reporting standard not just for not-for-profits but for all organisations.

The two areas where we think there are potentially problems is around the lack of awareness and understanding. We believe government has a key role in supporting initiatives to promote raising awareness. Indeed, by taking the opportunity which accessing capital presents to nearly all government departments that engage with not-for-profits, I think there are huge opportunities not only in the areas of affordable housing, the use of clean technologies and recycling, but in the mainstream human services areas around child restoration and juvenile recidivism. There are huge opportunities if we can develop these innovative mechanisms like social impact bonds.

Prof. Kernot: I need to disclose that I am an honorary member of Foresters Community Finance board, and have been for several years.

CHAIR: Okay. Thank you very much. Thank you Mr Hems, Ms Kernot and Ms Adams. I am particularly interested in your work with the social impact bonds. Firstly, you talked about the New South Wales government commissioning that. Was that the last New South Wales government that commissioned that work?

Mr Hems: That is correct.

CHAIR: Was that completed in the term of that government?

Mr Hems: It was submitted before caretaker mode, but we have since done another piece of work for the current government around the tax implications of introducing social impact bonds.

Prof. Kernot: Public servants have continued working with the incoming government. Were you to ask us, 'Is the issue alive?', I think we would say yes.

CHAIR: Okay. That is really where I was going: is the current New South Wales government still interested in it? It sounds like they are.

Prof. Kernot: Yes.

Mr Hems: There is at least one viable proposition on the table.

CHAIR: Very good. Ultimately, as you note, there can be some savings for taxpayers, depending on how these are set up. Once they get going and they are working it may actually deliver savings. Can you explain how that might work.

Mr Hems: Yes. Social impact bonds actually presents an opportunity to almost reengineer the key relationships government and the not-for-profit and also the not-for-profit and their funders and supporters, including philanthropists. The concept of a social impact bond is payment for success. The idea of being able to restore a child to the family of origin then when we know that the cost per child in New South Wales is around $40,000 per year. We know there are 17,500 children currently in foster care. If there is a program which is efficacious in terms of preparing the family of origin to receive their child back again, then clearly that presents huge future cost savings to government. Clearly you would need to measure it over a period of time, so you structure something like a bond with perhaps a five-year term and then during that five years you actually seek to restore, say, a number of children over that period of time. Units of reward payments are paid to the initial capital investors—the private capital that comes in is from investors. They will get their principal repaid and also a reward payment on the basis of delivering a certain number of children.

The one social impact bond which is up and running in the UK is based on reoffending. That is measured on performance over a two-year period to reduce the level of reoffending. So we have a viable mechanism which is up and running to demonstrate how it works.

Prof. Kernot: There are two examples. You have the key ingredients of a third social sector organisation with capacity readiness, with a highly engaged investor cohort of their own and a readiness to move from the philosophy of just a grant maker to a more engaged investor. Some of them would risk a lot of their investment; some of them would risk a little of their investment. But there is a spectrum of people who are ready to make that kind of leap into a social investment space.

CHAIR: It is interesting the degree to which there is an appetite for this type of investment. I will get to that in a minute, if I may. I am still in the social impact bonds to try and work them through in my mind. Effectively, what you would see is a shift of the risk from the government to the investors—

Prof. Kernot: But it is shared with them—

CHAIR: Yes—dependent on the success of the not-for-profit in actually delivering the outcomes. The not-for-profit incentive to make sure it delivers the outcomes is that, if it does not, people are not going to investment in it anymore.

Prof. Kernot: So it takes a risk, too.

CHAIR: It has a risk, yes. But the direct financial risk falls on the investors, with the government, depending on how you had constructed the bonds, paying on success a potentially quite high return or quite a commercial rate of return even, depending on the savings that it would make. So it is a win-win all round, but a shifting of the risk particularly, I think, for the not-for-profit. It would require a change of attitude for them to take on. If they do not succeed then they are not going to be getting money. It is an interesting concept.

Prof. Kernot: The two that we would judge to be ready, capable of doing it, actually have evidence based over time on the evaluation of the efficacy of their programs. There are not a lot of non-profits in Australia that have been collecting the evidence and the measurement for the period of time that is probably a prerequisite to have confidence to do this.

CHAIR: I can understand that. I will let others explore that further, because we do have limited time. In terms of the appetite, Ms Kernot, you think there is a demand out there for this type of investment, provided it is structured appropriately to reflect the true risks of these sorts of things?

Prof. Kernot: We feel strongly that we need to have a demonstration project. The type of investor who is going to volunteer to be involved in that is, I think, a little different from one should this develop into a commercial end asset class. There is demand and there is supply out there at this stage from high-net wealth individuals who would have been making grants. There is some interest from corporate foundations who want to again move from that scattering of grants to more engaged social investing, and then there are the people who have always been involved with a particular organisation and are willing to take a risk on investing in their champion organisation.

CHAIR: I think I have read in one of the submissions that there is some evidence that not-for-profits might be composed of boards which have people from all sorts of commercial operations that take risks all the time but as soon as they turn up at the board meeting for the not-for-profit they are far less inclined to take risks, because it is money that is there for a social purpose and they do not want to lose it, effectively, I guess. Is that a problem that presents itself when you are looking at the appetite for investment in these types of investments?

Mr Hems: That is one of the barriers that they have got to overcome. I think it is real. That is where the education piece comes into being. With the not-for-profit organisations that we have been talking to, as we noted in our submission to the New South Wales government, some boards are fully engaged and fully understand this. You need a couple of ingredients. You need a champion on the board—a champion supporter, a philanthropist or social investor—and you need senior management who really under this. One example I am thinking of at the moment is a chief executive, a completely engaged chief finance officer, a fantastic research department and hands-on operations. Like any investment, you look to see that the ingredients are in place. I believe that the small number of not-for-profits that we engage with have got most of those ingredients in place. But once we go beyond what we believe a demonstration project could actually achieve, we will then have to get into this education piece and work in with organisations like the Australian Institute of Company Directors. We will have to really raise the level of understanding of how—

CHAIR: How finance works too.

Prof. Kernot: We had Senator Nick Sherry open an impact investing conference. You have got his quotes from that conference in the material. He talked about the need to clarify fiduciary duty understanding, saying how much it has changed in the last 20 years and to basically free up trustees to have the legal ability to embrace share value. So it is not just the boards of the not-for-profits that need to put a different hat on; so do the trustees of the superannuation funds and PAPs.

CHAIR: We had some earlier evidence on the sole purpose test from NAB and JBWere. They were not at all keen on the idea of changing the focus of the sole purpose test, given that ultimately there is a community objective, and that is for people to be able to have the funds available to them at the end of the day—

Prof. Kernot: I do not think we are making it compulsory, though, are we?

CHAIR: No. I am just working it through. If you do allow people to accept a social benefit along the way, what impact does that have on their ability to look after themselves at the end of the day?

Prof. Kernot: What he is saying is that the placement of funds and the distribution of funds require a consideration of a much broader and almost certainly more complex set of issues and that it is important to consider those issues. This is because the stated goal of a PAP—I am talking about it in this case—will have a direct link to issues relating to socially responsible investment and trustees need to go further than simply passing the money over to a financial institution. So it is a more engaged and informed—

CHAIR: That is a different thing from taking a hair cut on the financial return in return for a social return.

Prof. Kernot: Yes, but we are not saying it is compulsory; that is the point. If you look at something like the Christian superfund, that is something they want to pursue.

CHAIR: The previous witness gave evidence that their instruction from APRA was that their primary purpose has to be the financial return but beyond that they can look at the other issues.

Prof. Kernot: What Nick Sherry is saying is that we need to look at it more broadly.

CHAIR: We will work through that one over the course of the inquiry. I note in your overhead, at the top of the green diagram, the wholesale social investment bank. Just as an aside, I am aware—and we will be getting some evidence on this later on today—that Big Society Capital, which was called the Big Society Bank, has just been established in the UK, as of late last week. Is that the sort of thing you are thinking of when you are talking about a wholesale social investment bank?

Mr Hems: Absolutely, but not necessarily in the same way of funding of it. They obviously utilise the unclaimed assets from—

CHAIR: I might ask Treasury about that later, as well.

Mr Hems: That is one mechanism of funding it, but there may be other mechanisms of funding it. It is actually the functioning of the wholesale bank that is the crucial thing, because that can be driving funds co-investing in funds like the Social Enterprise Development and Investment Fund and the CDFIs. I think it will open up the funds to a broader set of policy issues. I am thinking here particularly in terms of the affordable housing and funding community housing organisations that may be a beneficiary of a wholesale investment bank which is targeting social impact as well as financial return.

Prof. Kernot: Are you back on the social impact loans?

CHAIR: Yes.

Prof. Kernot: It is possible to have a social impact bond which can work jointly between the Commonwealth and a state government, particularly in the area of housing. You can disaggregate the savings at both levels.

CHAIR: The social impact bonds are a very interesting concept.

Mr Hems: We think the institutional investors will feel more comfortable investing in a wholesale social investment bank, like Big Society Bank, rather than the individual funds. We know that deal size is a big issue for super funds and so on. So the wholesale social investment bank is perhaps a domain where we get institutional investors involved and allow the more retail investors to get involved in subfunds, which are related to policy areas where they may have an emotive link as well as a desire to at least get their capital back and a suitable return on their capital.

CHAIR: I had better hand over to somebody else at this point.

Senator STEPHENS: Senator Williams and I would be very interested in your comments about how this could address market failure or thin markets in regional Australia. Our struggle is always about how you get equity of service delivery in regional Australia. In your consortium, or in your work, have you done any modelling around regional services?

Mr Hems: Yes. We have had that as one area of specific interest, and that is partly where our interest in cooperatives has come to the forefront. In particular, in those communities where maybe the for-profit organisations are finding it unviable, how you can facilitate community ownership and also employee buyout where there is the concept of shared ownership? These are huge opportunities to ensure that communities continue to be viable in remote, rural and regional areas. However, you need to have a pool of capital ready to support such initiatives. The problem at the moment is that there is probably insufficient focus of capital on those types of problems. Unfortunately, the community cannot get organised quickly enough or the employees do not have access to the expertise they need to enter into an employee buyout situation. Once again, I think there would be an opportunity if there was a fund that was actually dedicated to providing bridging capital until the community or the employees could get organised.

Senator STEPHENS: Do you think there might be a role for community foundations to act in that space?

Mr Hems: Absolutely.

Prof. Kernot: And local government.

Senator STEPHENS: Yes. In so many rural, regional and remote communities, local government is the only substantial structure.

Prof. Kernot: Absolutely. The Victorian government—the previous one, and the current one has continued it—has shown a very enabling approach by taking on a piece of work that we commissioned from Foresters on social procurement. They are rolling it out in every local government municipality in Victoria. They are saying you are allowed to do it and this is how you do it. That is a good model for how to drive that sort of change at the local government level.

Senator STEPHENS: Have you done any work in the Indigenous space in terms of native title trusts and those kinds of accounts?

Prof. Kernot: No, we have not.

Mr Hems: We have a colleague, a lawyer, who has done a PhD on this issue. We are just starting some work on this, but we have not actually completed any research.

Prof. Kernot: We have looked at social enterprise in Indigenous communities though.

Senator STEPHENS: I am thinking about the investment funds created by mining companies on Indigenous lands through ILUAs and other things. Perhaps that is another opportunity.

Prof. Kernot: I did some teaching in Perth earlier this year. Some of the students came from the corporate social responsibility and community engagement arm of mining companies and they were very keen to pursue a different approach to the traditional approach that already existed through looking at those opportunities for investment.

Senator STEPHENS: One of the other submissions talked about the potential of trade organisations not in Australia but in other countries. NSW Farmers has its fingers in a few pies. I wonder whether that kind of organisation could legally participate in something like this.

Mr Hems: Yes. I think there are examples of that being a platform for the development of social initiatives. This is part of the more informal development of a market where we can actually provide some mechanisms which help provide a solution to a particular kind of problem. So you could see trade associations managing a fund which facilitates its members continuing viability and, indeed, growth. Certainly with the community foundations, you could see them being responsible for a fund to facilitate these types of activities in certain localities.

Senator STEPHENS: Are there any regulatory impediments to PAFs participating?

Mr Hems: As part of the New South Wales government work looking at the tax implications, we have had a look at the private ancillary funds, and we think the existing rules would allow PAFs to invest in, say, a social impact bond or, indeed, any investment which might offer a below-market rate of return. The PAF guidelines already articulate that, if a PAF holds office space which it decides to rent out at a peppercorn rent, it can include the difference between the market rate and the peppercorn rate as part of its distribution. If that is a precedent, then I do not see how that is any different from a PAF investing in a financial instrument which may not yield a full market return.

Senator STEPHENS: I know this is a little bit left field, but what about engaging with other banking models such as sharia banking? Have you done any work in that space and talked with other ethnic organisations and communities about the way they manage their financing and loans?

Prof. Kernot: Yes, I have. There is a sharia banking specialist at the National Australia Bank, and I had him in my class as well. Most people find sharia banking incredibly confronting; at one level, they do not understand some of the concepts. But I would see no trouble with pursuing those conversations. The blended value that they have is inherent in the way they do it. But we have not done any specific work on it; it was just a guest.

Mr Hems: We have looked at the balance sheets of some of the churches and how they utilise capital to support their service delivery arms, and we think there is huge potential there. We have looked specifically at the Uniting Church and some of their funds. So, if they are able to develop some really compelling social impact investment products, I would expect them to be pretty near the front of the queue to get engaged, especially if one of their own service agencies is involved. Along with private ancillary funds, there are the churches and one or two other engaged funds. That is partly why we think there is an appetite amongst investors.

Senator STEPHENS: What about organisations like the RSL, which is involved in retirement trusts and building villages and things?

Mr Hems: There are huge opportunities. Although we look at social impact bonds as an innovative structure, we think they are just one type of what we call social impact investment partnerships. We always have to say that. Public-private partnerships have a chequered history—usually when we are talking about New South Wales—but we think there are huge opportunities if we take those basic structures of public-private partnerships, especially in those opportunities where you can combine financial institutions, not-for-profits and recognised investors, and obviously where there is strong government interest. You only have to look at the population forecast to see that aged care is going to be a key issue, and this is probably the opportunity to start getting some of these demonstration projects off the ground. We know that the Macquarie Group has five-star villages and we know that Anglicare has great villages as well. The question is whether there is a new mechanism to bring the best of each of the parties together.

CHAIR: How would you see that working, using an aged-care facility as an example?

Mr Hems: Follow the structure of PPP and actually get a consortium together which contains all of the necessary ingredients. At the moment you are getting Macquarie, who can formulate hotel-style five-star quality, and Anglicare, who are focusing on the clients and the beneficiary and so on. What we are proposing is that, PPP style, we are actually going to set some parameters of what you are trying to achieve in terms of the financial robustness of the proposition but also the scale and quality of support that is provided over a period of time. I think the key thing is consortium building. Once again, I think there is real enthusiasm to pursue it.

CHAIR: That is not so much taking an innovative approach to something like the social impact bond; it is more an innovative approach to getting different parties together, getting them to talk and getting them to come up with an outcome that works for everybody.

Prof. Kernot: We have found that the word 'bonds' is laden with expectations about risk-return guarantees and all of that. In fact, the one in the UK is very much a partnership really. In the US they are calling them payments for success. So although bonds sound great they have had some baggage as well in terms of discussing it with the very commercial end of the investment market.

Mr Hems: The Benevolent Society's Apartments for Life is an example of how you can potentially restructure it to address one of those key problems.

Prof. Kernot: What you are saying, Senator Stephens, is that there are untapped pockets of social finance out there.

Senator STEPHENS: What is your view about the need for a different asset class? Social Ventures Australia suggested this morning that we need to actually create a new investment vehicle to do this.

Mr Hems: I think that is a long-term strategy. I think in the meantime there is enough going on in terms of related initiatives. There is plenty of scope in terms of tapping into mainstream activities and also building the existing specialist intermediaries like Foresters. If you look at the NAB Microenterprise Loans scheme, that stands as a good example with the five CDFIs. This is an emerging asset class. Ultimately the way an asset class develops is by creating a mechanism for sharing the knowledge. So these demonstration projects and initial pilots and so on should be done with complete transparency. There needs to be a huge investment in the whole measurement component so signals are being sent to not-for-profits, investors and financial institutions that, if you construct these mechanisms in the right way, they are actually viable and there are investors who are willing to engage. The knowledge raising component is probably the stage we are at in Australia at the moment—starting to share and build the knowledge base.

Prof. Kernot: One of the things that is different in the social impact bonds between the UK and Australia—this is relevant to what Les was saying—is that the UK has a paid intermediary and New South Wales Treasury said they were not impressed at the costs involved in that. Secondly, most of the champion investors who were ready to invest in the two organisations that we felt were ready to run a social impact bond pilot said that they preferred not to go through a paid intermediary, that they preferred to be on an advisory committee of the organisation itself.

CHAIR: Senator Stephens, if I may, I will follow up a statement that Mr Hems just made about transparency and reporting. I note that you have been working on an integrated reporting project. Would you mind outlining what you are doing there and where it is likely to head to?

Mr Hems: My colleague Sarah is actually the specialist in this, but in terms of a broad description there is an international initiative at the moment around integrated reporting. It is very much building on the blended value and triple bottom line, John Elkington, and so on. In the documents that have been issued to date there is recognition that the straightforward financial accounting is inadequate. Indeed investors are requesting information on social impact and environmental impact. So the argument behind the need for integrated reporting is that investors are requesting it. Similarly, other stakeholders are wanting—

CHAIR: Are they requesting it across the board for all investments or specifically for investments in this area?

Mr Hems: All investments. These are mainstream institutional investors requesting effectively triple-bottom-line reporting and our argument is that the social impact component is going to be the most difficult to standardise and report in a meaningful way. Therefore, the not-for-profit sector and social enterprises should actually provide the set of case studies to allow integrated reporting to develop. A couple of weeks ago we announced a piece of research with the Salvation Army and their Employment Plus program. We are actually going to help them over a five-year period systematically capture the impact of their programs on the long-term unemployed, people with mental health issues and pathways to employment in recognition that this is the type of change that will have to happen within the not-for-profit sector. Not-for-profit sector organisations across the board have got to take evidence and systematically capturing the impact of their programs into their DNA. This will require a lot of capacity building, but I would say almost every not-for-profit organisation and social enterprise that we have spoken to has recognised the need for doing this and are willing to engage in programs to help build up these case studies to build up a methodology to systematically report social impact, building on the pathfinding work on social return on investment and social accounting.

Prof. Kernot: Mission Australia has a very sophisticated case management system that they have now put in place which will enable them to capture the data and integrate it across the entire organisation.

Mr Hems: This is keeping in touch with clients post treatment program and seeing that they are still in a job six months, 12 months, 18 months and two years later. The social impact bond is still restored.

CHAIR: It is vital, if you do set up social impact bonds, to be able to assess whether it has performed and whether the success fee is payable.

Prof. Kernot: The problem is that many non-profits do not have the resources to invest in that even though it is a fundamental requirement of being capacity ready for greater social investment. There is an enabling role for government and other partners there.

CHAIR: Is the integrated reporting project that you are working on looking at those particular issues?

Ms Adams: At the moment we are trying to develop which charities we are going to be working with. I think it is important to keep in mind that the integrated reporting approach is going to be principles based. Each individual organisation will identify which issues are most material to their organisation and will report on that basis.

Mr Hems: This is why it is so important for not-for-profit organisations. That surely is the most material activity of their organisation. The financial aspect is all around sustainability to ensure they can continue to deliver their social impact.

Ms Adams: There is a bit of a tension between standardised reporting, reporting the same thing across all organisations, and reporting the most material aspects, which will vary between different organisations. I think that is something that will need to be balanced later on.

Prof. Kernot: In the corporate sector there has been a bit of a hijacking of the whole notion of reporting sustainability simply along environmental lines. Most people now recognise the challenge of incorporating the social in that triple-bottom-line, blended value approach. There is a huge shift going on in the corporate sector in its understanding in that particular sphere.

Senator STEPHENS: I will move on to a different issue. Watching CSI's influence moving into different spaces and looking at the fact that you are established as a business partnership between the four universities, who do you see as your customer?

Mr Hems: We are multistakeholder. We serve multiple audiences, but our focal point is around social innovation and beneficial social impact. If you take our partners in Western Australia, UWA, we have got a long-term three-year project with BHP Billiton where they have partnerships with 45 community organisations. They have eight social investment pillars relating to homelessness, drug and alcohol addiction and education. We are helping them develop a more sophisticated way to invest around $80 million a year into those social programs. We sit right on the intersection of three sectors and we see all three sectors as being our key stakeholders. We seek to build strategic partnerships with those innovative organisations across all three sectors.

Prof. Kernot: And our teaching program seeks to develop emerging leaders in that area of cross-sectoral influence. We have senior public servants in our class. We have corporate sector emerging leaders. We also have social sector emerging leaders as well.

Senator MARK BISHOP: So the growing Indigenous market will be important.

Prof. Kernot: Yes.

Senator MARK BISHOP: Professor Kernot would know this better than most, but deriving from the land rights movement there are now huge sums being negotiated and paid over a 20- and 30-year period to relatively small communities. They are going to need socially innovative advice but sound advice, too, as to how those huge funds are going to be invested, managed and used for 30 or 40 years. Do you see that as part of your market?

Prof. Kernot: Yes, we do. Equally, we would see something like Twiggy Forrest's Aboriginal employment covenant going beyond just getting a sign-up for a job and actually transferring to Indigenous ownership of the employment organisations that contract back to him. That is the kind of huge evolutionary thing that is happening up there.

Senator MARK BISHOP: Yes, it is starting to happen now over there.

Senator STEPHENS: I have a question about the teaching program. You heard that I asked Foresters about whether or not there is capacity, potential or anything happening in the space of developing curriculum across the higher education space dealing with the issue of innovation and scaling up capacity in the not-for-profit space.

Prof. Kernot: Yes. I can see some of my students changing jobs and being promoted within their sector or moving across to the other sector. I have also been talking with the TAFE sector about how to introduce capacity and knowledge into the stream of TAFE which looks at the old community development stream. That is very top-down grant laden, and we need to encourage that to be more community social investment. They are expressing a need to know more about how to do that.

Senator STEPHENS: And are you seeing modules being accredited in some courses? You are the people who are right at the coalface, so I am interested in knowing whether or not people have got to the stage of accrediting some modules and being able to integrate those into their workforce training beyond you.

Prof. Kernot: Slowly. The transparency awards which PricewaterhouseCoopers runs, just for entering that competition, gives you a two-day module of training in non-profit management and finances. But I think it is going to take us a while. In the UK, for example, they have social business and social enterprise alongside traditional small business in all of their school curriculum. For me, I think it would be great to get to that in Australia.

Senator STEPHENS: Thank you.

Senator MARK BISHOP: I have two questions. Who issues them? Who buys them? Who prices them?

Senator STEPHENS: That is three questions!

Mr Hems: Unlike the UK, our recommendation in New South Wales is for the not for profit to issue the bond. We got legal advice for the two or three not for profits which were identified as having viable propositions that they were legally able and could take some of the exceptions in terms of the use of information memoranda and so on. So it is beneficial that a not for profit issues them.

Senator MARK BISHOP: Who buys them?

Mr Hems: In the UK it was all charitable trusts, but within our discussions with investors we found a broader set of support. We have spoken to a number of mainstream financial institutions who have expressed support in these types of initiatives as long as they are big enough. For them it is the deal size that is the problem. Fundamentally, it is all about negotiation. This is all based on an outcome based agreement between government and a not for profit, but pricing can only be done when governments have agreed what outcomes it is achieving with a not for profit, the scale and the reward payment for a child being restored or a period of reoffending. That negotiation is the key. To articulate how far we have got in some of the discussions, some of these are pretty close to being investment-grade products, so these will be attractive to all investors.

Senator MARK BISHOP: Would you require a set of regulations to be issued by the Commonwealth, or are existing regulations adequate?

Mr Hems: Existing regulations are adequate. We did a follow-up piece of work with cause to clarify that to make it absolutely clear that there were no impediments.

Senator MARK BISHOP: For those who buy the bonds for whatever rate of return is offered, is that a different market from philanthropic or high-wealth individuals with a social perspective? I am very familiar with a lot of the arms of both the Uniting Church and the Catholic Church in Western Australia, and I assume it is the same elsewhere. They do tap into a range of high-charity, high-philanthropic, high-net-worth individuals for a whole range of particular purposes. Is the market you propose to issue the bonds to a different market from that group of people? That group of people essentially make grants. They do not seek a return.

Prof. Kernot: That is why we have to influence the culture. There will always be people who just want to be philanthropists, but there are a lot of people who would have considered themselves philanthropists and whom I have spoken to who have said, 'That's quite a good idea, because maybe I can get my capital back and reinvest it.' So it is a cultural thing. If you look at all the things that have to be done, there are so many cultural changes that we have to enable to make the pieces fit.

Mr Hems: That is why there is an overlap. But we are talking about a new market. We are talking about commercial investors who are seeking a more blended return in terms of social value. So it is an additional market.

Senator MARK BISHOP: The reason I pursued that is I wondered why you would go into that high-end, social philanthropist market that does provide a lot of money in grants for worthwhile purpose and does not seek a return. But you say it is a new market or an additional market.

Prof. Kernot: That high end is changing too. They are being educated around seeking more than just feel-good experience. In the US there has been a huge move from venture capitalism to venture philanthropy. It is a really complex range of drivers, but it is happening, including with people with money who want to give back but also want to be on the board at the same time—more engaged.

Senator MARK BISHOP: I understand. Thank you.

CHAIR: One final question that occurred to me while listening to some of the questions from Senator Bishop: have the ratings agencies taken any interest in or had discussions with anybody about the social impact in the UK or what you were looking at in New South Wales?

Mr Hems: We have had some preliminary discussions, and the key thing ultimately is the contract. The rating agencies will rate the contract between government and the not for profit, and our indications are that they will give a rating which will then attract—

CHAIR: Depending on the involvement of the government and the degree to which it is guaranteeing things, I guess, it would have a huge impact on where those letters would end up.

Mr Hems: Yes.

CHAIR: Thank you very much and thank you for assisting us this afternoon.

Prof. Kernot: There are some impediments around legal forms, but I guess you will look at that.

CHAIR: One other thing before you go: was the handout you gave to us a complete copy of what you had on the overhead?

Ms Adams: It does not have the comments from Senator Sherry, but I can provide those.

CHAIR: If you could, that would be good. We could not find those comments from Senator Sherry.

Prof. Kernot: Sorry; it was on my copy.

CHAIR: That is all right. If we can get the rest, that would be much appreciated. Thank you.

JACOBS, Mr Martin, Acting Principal Adviser, Personal and Retirement Income Division, Department of the Treasury

LEGGETT, Mr Chris, Manager, Philanthropy and Exemptions Unit, Personal Retirement Income Division, Department of the Treasury

HARTWICK, Ms Tamara, Senior Adviser, Philanthropy and Exemptions Unit, Department of the Treasury

[15:09]

CHAIR: Welcome. Would you like to make an opening statement?

Mr Jacobs: No, we do not have an opening statement.

CHAIR: We do not have a submission from you either, so that makes it challenging for us. We do have the government's submission from the Department of Prime Minister and Cabinet and the Department of Education, Employment and Workplace Relations. Can you explain what role Treasury has had in scoping the potential for venture capital in the not-for-profit sector?

Mr Jacobs: The Treasury has been tasked with taking forward a series of not-for-profit reforms mainly in the taxation space. At the moment, we are working on setting up the Australian Charities and Not for Profit Commission along with an implementation task force. The government has also announced changes to better target the tax concessions for charities. There is also some work going on in public ancillary funds guidelines. The government is also committed to a statutory definition of charity.

CHAIR: In terms of the tax concessions, what impact are those changes likely to have on revenue? Is it likely to be revenue neutral or is it likely to enable the not for profits to have better access to deductibility and, therefore, a negative impact on revenue? Will it have a net positive impact on revenue by tightening things up?

Mr Jacobs: The budget does not contain any revenue implications from those changes that we are targeting.

CHAIR: It has been considered and it is considered to be revenue-neutral?

Mr Jacobs: Yes.

CHAIR: Okay. Have you conducted any research or fielded any comments from the not-for-profit sector about how those concessions will assist them in their cash flow?

Mr Jacobs: Currently we have undertaken a submissions process. The government released a consultation paper on the design of those changes. We have received 117 submissions in relation to that and we are currently working through those submissions.

CHAIR: On the whole, is there a mix of opinions?

Mr Jacobs: There is certainly a mix of opinions.

CHAIR: Some like what you are doing and some do not.

Mr Jacobs: And some of them have suggestions about how you could refocus or make changes.

CHAIR: So presumably there are some not for profits that are going to lose in some respects as a result of these changes, which is why there is a mixture of submissions.

Mr Jacobs: The fundamental behind these reforms is that they are looking at where they receive profits from unrelated commercial activities. There is no loss of concessions as long as those profits are put into the altruistic activities of the charity. They might cause some issues in terms of how charities report those unrelated activities, but if they put the profits back in towards their charitable purposes then there is no loss of tax concessions.

CHAIR: Is there a perception or evidence that the government has that not for profits are not doing that at the moment? Is there mischief that is being addressed?

Mr Jacobs: These reforms have been implemented as a result of a High Court decision in the Word Investments case. The government is looking at the extent to which tax concessions which are there to achieve charitable aims are being used for that purpose or the extent to which they can be used to run a commercial business. The government in its discussion paper is saying that, as long as the profits are being put for the charitable purpose, they can continue to retain access to the charitable concessions.

CHAIR: So it came out of that court case.

Mr Jacobs: Yes, in 2008.

CHAIR: Presumably the findings in that court case suggested that there are claims being made for purposes that in a policy sense are not considered to be the purpose of what the deductions are for in the first place. If these changes tightened that up, surely that would have an impact on revenue.

Mr Jacobs: Only to the extent that charities do not use those profits for their charitable purpose.

CHAIR: So there is an assumption built into the assessment of revenue that any existing behaviour will change. If there are not for profits that are conducting their activities in accordance with what the court found to be inappropriate then they will change their activities and put it all back into—

Mr Jacobs: Yes.

CHAIR: Okay. I understand. To what extent is Treasury liaising on the tax concession changes with the Office for the Not-for-Profit Sector?

Mr Jacobs: Treasury works relatively closely with the Office for the Not-for-Profit Sector. We also attend Not-For-Profit Sector Reform Council meetings and working groups of the Not-For-Profit Sector Reform Council.

CHAIR: Quite clearly your responsibility as a unit is to look at the tax concessions that are provided to the not-for-profit sector. How is what you do working in with what the Office for the Not-for-Profit Sector is trying to achieve?

Mr Jacobs: I know you have the Office for the Not-for-Profit Sector coming along after us. In effect we work to consult with the reform council on these changes, so we have discussed with them the proposals that are in the consultation paper.

CHAIR: Potential changes to the overall approach to assisting the not-for-profit sector generally do its job better and more efficiently may involve the Office for the Not-for-Profit Sector talking to Treasury and liaising with you about other potential tax changes? I am not asking for specifics, but generally.

Mr Jacobs: That sort of gets into future consideration of policy changes. On the existing government announcements, certainly we are working with the Office for the Not-for-Profit Sector and the reform council to consult with them and get their input into those changes.

Senator STEPHENS: This hearing is about building a social capital market. We heard from witnesses this morning about some of the challenges of doing that and some of the opportunities and the interesting new instruments being developed. Given that social ventures and start-up ventures need to retain some of their capital rather than distribute it for altruistic purposes, how do you see this change that has come about in the High Court Word decision playing out in terms of preventing social ventures or other capital raising over time to become economically viable?

Mr Jacobs: That will have to be seen. The changes are saying that to the extent that there are tax concessions there which are set up for benefiting charitable activities and to the extent that an organisation undertakes commercial activities it would need to put those profits back into its charitable purposes to retain the access.

Senator STEPHENS: And distribute them all each year?

Mr Jacobs: In effect what we are doing is consulting about the mechanisms to achieve those aims, but yes it is about those profits being directed back into the charitable purposes for which the concessions are provided.

Senator STEPHENS: To what extent do you allow those organisations under this new proposal to build an investment fund that enables them to become more economically independent over time?

Mr Jacobs: There are existing activities that have done that already.

Senator STEPHENS: In the proposal for the changes, are 'altruistic purposes' clearly defined?

Mr Jacobs: They are the current non-statutory definition of 'charitable purpose'.

Senator STEPHENS: There is no change?

Mr Jacobs: There is no change to the existing law. The government has announced codifying a statutory definition of 'charity' from 1 July 2013.

Mr Leggett: When we have used 'altruistic purposes' in most of the discussion papers it was I suppose a shorthand version of being able to describe the various categories of entities that are entitled to exemptions and concessions under the tax law. There are quite a number of them, including charities, scientific institutions, sporting clubs et cetera. 'Altruistic purposes' was our shorthand way of describing each of those categories without having to specify them each and every time in the discussion paper.

Senator STEPHENS: Officers from PM&C and DEEWR will be appearing before the committee this afternoon. I am interested in following on from that discussion about the definition of charity and whether you are taking as your starting point the 2001 definition of charity under the inquiry and the outcomes of that. Where are you starting from in all of this?

Mr Leggett: The government announced that the statutory definition of charity will be based on the 2001 inquiry, but we will make changes to reflect recent court decisions, including AID/WATCH. So the 2001 inquiry will be the starting point, absolutely, but there have since been subsequent changes that we have had through court decisions that we will attempt to take account of, including AID/WATCH and Word Investments.

Senator STEPHENS: You might like to describe for the committee what AID/WATCH was about. I had forgotten that one.

Mr Leggett: The AID/WATCH decision was about the extent to which charities can undertake advocacy as part of their charitable purposes. In the case of AID/WATCH I guess it furthered its charitable purposes by lobbying government about its foreign aid policies. So, up until AID/WATCH, most charities could not undertake advocacy. It had to be ancillary and incidental to their general activities. The High Court has found that in fact charities can undertake advocacy as part of their primary purpose of achieving their charitable outcomes.

Senator STEPHENS: How far down the path are you in terms of determining scope and shape of the regulator with regard to the implementation task force that is moving towards 1 July?

Mr Leggett: I suppose the best thing would be to explain what the role of the task force is versus the role of ourselves. The task force's job is effectively to stand in the shoes of the yet to be formed commission and to begin to undertake the administrative preparation works—so to begin organising the staffing, accommodation, budgetary requirements et cetera that go with setting up a new agency, and then to begin consultation on the new reporting framework and public information portals and systems et cetera that need to be up and ready for our 1 July 2012 start of the new commission. The legislation and preparation work for setting up the commission rests with Treasury proper, which is ourselves, so that work has commenced.

Senator STEPHENS: Are you expecting a draft piece of legislation to be out in the public domain?

Mr Leggett: Yes. The government's plan is to issue a draft legislation package for public comment.

Senator STEPHENS: Do you have any sense of the time frame for that?

Mr Jacobs: No, we are not aware that it has been announced at the moment. There will be an exposure draft of the legislation to set up the statutory body of the Australian charities not-for-profit commission.

Senator STEPHENS: But that exposure draft will have to be out in time for a response and a determination before 1 July next year?

Mr Jacobs: Yes, to have the legislation in place before 1 July next year.

Senator STEPHENS: So it is actually something that we may all be looking at before the end of the year in the legislation committee. Thank you.

Senator MARK BISHOP: There are two issues I want to pursue. You were earlier discussing the profit of commercial enterprises established by charities in return for charitable purpose. Does that also address the issue of retained earnings?

Mr Jacobs: To the extent that that commercial activity generates profits and does not return them then they would form the retained earnings.

Senator MARK BISHOP: But the return of surplus is after all—

Mr Jacobs: Old expenses.

Senator MARK BISHOP: Thank you. I just wanted to clear that point up. Secondly, Treasury was involved in the drafting of either the bill—which is probably an act now—or the regulations relating to the government's social housing policy?

Mr Jacobs: I am not able to answer questions on the social housing side.

Senator MARK BISHOP: Is anyone else able to?

Mr Leggett: It really depends on which part of the social housing package you mean. I suppose we have had some involvement in elements of the National Rental Affordability Scheme and first home saver accounts.

Senator MARK BISHOP: Yes. Why was there need for separate regulation and what was it based around?

Mr Leggett: What do you mean by separate regulation?

Senator MARK BISHOP: The taxation concessions.

Mr Leggett: We have had very limited involvement in the National Rental Affordability Scheme, particularly dealing with how charities interact with the scheme rather than the core concessions, which are handled by our business tax area. So to the extent they go to how the operation of those core tax concessions works or how the tax offset works, we will have to take those questions on notice for our business tax colleagues.

Senator MARK BISHOP: That is where I want to go. I want to go into the background there.

Mr Leggett: How those certificates et cetera work? You will have to put that on notice. That goes to our business tax division, so we have not been involved in that.

Senator STEPHENS: You made those comments about retained earnings. What about the issue of the current discussion paper about unrelated commercial activity tax measures? Can you explain to the committee what that is about and whether or not you have given any thought to the impact on start-up enterprises? Secondly, has there been consideration of some kind of a threshold of the unrelated commercial activities to the commercial activities of the charity or the not-for-profit, and is that is coming into play?

Mr Leggett: The 'related, unrelated', I guess, is the threshold question. We are only really interested in unrelated activities. There is a lot of discussion about carrying on commercial activities, but we are only really interested in commercial activities that are unrelated to the charity's core purpose. So we are not concerned about hospitals running commercial operations or aged care et cetera. The fact that they might run their charitable activities in a commercial way is not our concern. Our concern is commercial operations that have absolutely nothing to do with your charitable operations.

Senator STEPHENS: Does that go back to the Word case as an example?

Mr Leggett: Yes, exactly. It was a funeral business unrelated to Bible translation. It was just there to generate funds in order to further the charitable purpose.

Senator STEPHENS: To fund the Bible translation.

Mr Leggett: That is the sort of activity we are looking at. There are different labels. 'Related, unrelated' is how the US describes it. 'Primary purpose, non-primary purpose' is the way the UK describes it. Those terms have been bandied about. That is the sort of dividing line that we use to determine whether or not the tax concessions should be available. They should be available to your related activities, your charitable activities. They should not be necessarily available for your unrelated activities. That is the initial dividing line, I suppose, in order to make the assessment as to whether the reforms apply to you or they do not apply to you.

CHAIR: What about if you were—to use an example we discussed earlier—the Uniting Church looking to invest in the new New South Wales Social Impact Bonds, which may then go on and fund a correctional facility or something like that? Would that be likely to be considered an unrelated purpose to their core activity?

Mr Leggett: The issue with the bonds?

CHAIR: Yes, and the return that they then got on the bonds following it becoming a successful outcome—

Mr Leggett: The bonds are usually issued by these entities rather than bought by these entities, so the issue with the bonds themselves is not necessarily relevant.

CHAIR: We have had some evidence today that some of those institutions actually do have considerable resources and at times would be looking to invest some of those and they would be quite keen to do that in a socially responsible way and take advantage of this type of investment.

Mr Leggett: The reforms do not apply to passive investment, so investment into infrastructure or those sorts of bonds will be unaffected by these arrangements. But, to the extent that members of the public are investing in them, then that is not necessarily impacted directly by these reforms.

CHAIR: So the sorts of mechanisms that we have been looking at today involving innovative ways to attract investment into the social—

Mr Leggett: Yes, and usually that is investment in their related activities, not investment in their unrelated activities.

CHAIR: That is right. But, in trying to look forward to what might be problems if things develop that way, you do not see any potential taxation impacts or likely stumbling blocks that could fall in the way of any of these organisations as a result?

Mr Leggett: No. For most of the discussion on where the social impact bonds are going, because they are investments in their related activities, we do not see any particular concerns. The concerns could arise if they were to start moving those bonds into investing in unrelated activities, but that is not necessarily the existing plans of most charities.

Senator STEPHENS: On that point, where do social enterprises fit into this space? Mission Australia is running a commercial cafe—Charcoal Lane in Melbourne, a profitable trading entity. Where do those kinds of organisations fit?

I am concerned that this funny split is going to discourage innovation and entrepreneurship where some of our charities are trying to move into innovative new responses to social issues. It may be not as complicated as a new prison, but it is a commercial entity that they are trying to establish and operate in its own right.

Mr Leggett: To answer your earlier question, there is a small-scale, low risk threshold cut-off, so the reforms will not apply to low risk, small-scale activities. We are consulting as to whether—

Senator STEPHENS: Described as? What is that? What is 'small-scale, low risk'?

Mr Leggett: We are still consulting on how big the small-scale low risk threshold is. In the UK it is £50,000—

CHAIR: That is turnover?

Mr Leggett: yes—and South Africa has 150,000 rand turnover, so we are still consulting on some of those questions. Maybe we will come up with a whole different test. That is one of the issues out for consultation.

Senator STEPHENS: Would we not align with the small business thresholds that we have in place now for engagement in—

Mr Leggett: Possibly, but some of these reforms are there to provide a level playing field for all businesses, in which case we could not say that we are providing a level playing field for large business in Australia but not providing a level playing field for small business in Australia. Some of those particular issues need to be considered when coming up with a threshold, but what the threshold should be is a matter for consultation which the government will choose in due course.

Senator STEPHENS: If you are looking to create a level playing field for small business, and we look at the local community cafe, where do you take into account the social return on the investment?

Mr Leggett: Coming back to social enterprise: we always see there are two different types of social enterprise and people use the term in different senses all of the time. There is a whole range of social enterprise that is a commercial way of furthering a charity's purpose directly, such as starting a pizza business and hiring disabled people in order to run it. We consider that related activities are therefore unaffected. But businesses that are merely run in order to create profits and returns to be moved back into the charitable purpose, the altruistic purpose, then they are, yes, caught by the reform to the extent that their profits not directed back to the charity will incur income tax, at least for the period in which the retained earnings are left inside the business, and will be refunded when they move out. To that extent, are you saying that there are some arguments out there that that will hinder the growth of the business? What we are doing is effectively putting that business of the charity in the same position as any other small business in Australia which has the ability to grow.

CHAIR: With the same consequence that if any small business in Australia made a profit and then donated all of that profit to a tax-deductible entity, it gets a tax deduction.

Mr Leggett: Exactly.

CHAIR: In the same way here if a charity or a not-for-profit is running a commercial enterprise, retains it, it pays tax, but if it pays it all into itself as a not-for-profit, it gets tax deductibility.

Senator STEPHENS: Senator Williams and I have an interest in the whole greening agenda. I have had approaches from, for example, a local environmental group who want to set up a nursery that would provide seedlings to plant out. They would be almost wholesaling to other nurseries or other Landcare groups, which would be a commercial activity in its own right for a small organisation, which could grow into a viable business for a regional community with reforestation or whatever. Where do those kinds of organisations get to draw the line? Is it going to be about how they structure their business and their organisation that is going to allow them to weave through this new proposal?

Mr Leggett: It is really hard for us to provide definitive answers to where things fall on the line when we are out consulting at the moment as to where that line ultimately should be drawn and the principles underpinning it. Without all of the facts—often these questions are fact and circumstance about how the entity is structured, what its objectives ultimately are, how it is being run, who its customers are—it is hard to make definitive judgments about which side of the reform line they will fall.

Senator STEPHENS: It is the issue of innovation and being responsive to emerging opportunities and needs and how a small not-for-profit can move into a big space very quickly and then find it has fallen foul of Treasury and the tax law because of the way in which they have been established.

Mr Leggett: It is a balancing judgment all the way, because a nursery that is being run by a small business down the road would probably say, 'They are getting an unfair advantage; they are putting me out of business, because the government has seen right to give them a tax concession to run a business that I am not personally entitled to.' So we get complaints on both sides, of course.

Senator WILLIAMS: With this line that has to be drawn is there going to be a taper or are you on one side or the other? When you draw a line between small business and not-for-profits like that it seems to be very unfair. Let us say you did $100,000 turnover. Someone who has $102,000 turnover is out of the equation. Is there going to be a tapering off system? Is that what your idea is?

Mr Leggett: We are out for public consultation on what the small-scale, low-risk threshold for exemption should be and we will take all those views into account when setting it.

Senator STEPHENS: On the point about competition, we have our fire brigades out in our communities having car washes on a Saturday afternoon. How does the income that they generate there compare to the commercial car wash down the road?

Mr Leggett: For those small things like lamington drives and hot dog stands outside of Harvey Norman et cetera, the government's intent is that those are small-scale, low-risk and would be exempted out of the system.

Senator STEPHENS: So it will depend on whether or not the SES has a monthly car wash? Is that going to be the threshold?

Mr Leggett: It depends on what the threshold is ultimately set at, I suppose. If you use the UK as one of the examples, £50,000 from car washing over the year is quite a significant amount. So these are not small cut-offs.

Senator STEPHENS: You have not washed any trucks!

Senator WILLIAMS: Speaking of trucks, what about service clubs if they go through some enterprise? Take the local Apex club. I remember the Jerilderie Apex Club used to raffle semitrailers and sell hundreds of thousands of dollars worth of raffle tickets. Where do the service clubs, such as Lions, Rotary and Apex, come into this?

Mr Leggett: Most of those sorts of club arrangements are mutual clubs, so they are already subject to income tax and therefore, as the government said, are mutual organisations.

Senator WILLIAMS: They are subject to income tax?

Mr Leggett: They are usually subject to income tax on their non-mutual income. So your usual clubs, such as Ainslie Football Club et cetera, only pay income tax on their non-mutual income—their interest income and their income from non-members—and therefore are unaffected by these reforms; we are only affecting those that are in receipt of an income tax exemption, fringe benefits tax concessions or GST concessions.

Senator WILLIAMS: What about services clubs? I have had one question put to me that I am always confused about. If I own a motel in a town, which is a company-run business, there is 30 per cent company tax, yet if a service club owns a motel it is 15 per cent company tax. Is that correct?

Mr Leggett: I would not think they were at a different tax rate; they would be treated as a corporate.

Senator WILLIAMS: I had a motel owner in my home town say to me: 'I don't mind the RSL Club building a new motel. What I don't like is that they pay 15 per cent company tax on the motel and I pay 30 per cent.' That was what the motel owner put to me.

Mr Leggett: As far as we are aware, the statutory rate for clubs—whether they are big corporates or clubs—is exactly the same.

CHAIR: I have a couple of questions about the ACNC. JBWere submitted that the government could fund an independent not-for-profit rating agency for impact investment that would provide independent evaluation of social impact investment opportunities. I do not know if you have seen JBWere's submission. In that context, is that something that the ACNC would be doing? What is the current scope of activity of the ACNC? Is there a potential for that to be expanded and deal with more things?

Mr Leggett: The government announced that the ACNC's initial responsibilities would include determining charity status, including public benevolent institution status; providing education and support for the sector;

implementing a one-stop-shop reporting framework for the sector; and implementing a public information portal. Initially, they will be focusing on charities in the first three years and then move on to other not-for-profit organisations after that. Ultimately, it will be built up over time, adding more and more responsibilities over time. We are also negotiating with the states and territories about a national regulatory approach for the entire sector. As those negotiations move forward, we will have a better idea of what the ACNC will ultimately be responsible for and what its entire scope will be. The ACNC is expected to take on additional functions over time.

CHAIR: So as socially beneficial investment becomes a larger segment of the market—

Mr Jacobs: Consideration could ultimately be given to—

CHAIR: (*inaudible*) maybe even up to the point where it may well rate potential investments to help provide confidence to investors.

Mr Jacobs: Ultimately, it is a statutory agency, so it will depend upon the concepts—

CHAIR: Policy.

Mr Jacobs: What the legislation allows it to do.

CHAIR: In that way, it would not necessarily preclude it from adding those types of—

Mr Leggett: No. It is an area where we know it is going to be growing over time, particularly as we negotiate with the states. I guess its ultimate end result functions are undetermined and will be subject to across state agreement. So it will be built over time; it will not be limited to being able to take on those functions if the case requires it.

CHAIR: One of the things that we will be looking at is the 'report once, use often' reporting framework. What does 'report once, use often' mean?

Mr Leggett: The ultimate aim is for all reports that the government wants to use from the not-for-profit sector—every report it asks for—to come in once through the ACNC and then be delivered to other government agencies from the commission.

CHAIR: That is the one-stop shop?

Mr Leggett: That is exactly right. It will be one-stop reporting. You report for all your purposes to the ACNC and it will disseminate those reports, or the elements of those, to the relevant agencies.

CHAIR: To the Australian Taxation Office, ASIC or—

Mr Leggett: To the state and territory regulators, to Health and Ageing, whatever the requirement is.

CHAIR: Other sectors of the economy might see it as an interesting model and decide they like it as well. I do not have any further questions.

Senator STEPHENS: Tomorrow we have hearings about the Australian national business names registration framework. Was that part of the negotiations of state and territory governments around the models of association and the single point of entry as part of the charities commission's consideration?

Mr Leggett: We have not been involved in the business names registration process. That is handled out of our markets group area. It has not been part of the charities stuff at this point.

Senator STEPHENS: Where are we up to with the national fundraising legislation given that, as I understand it, the BRCWG, Business Regulation and Competition Working Group, had signed off on that almost a year ago. Where is all that up to now?

Ms Hartwick: I think the working group and the Ministerial Council on Consumer Affairs have looked at where they can harmonise fundraising regulation. I believe they are reporting to the BRCWG on progress and their recommendations to the next meeting. I do not think the outcome of that is public at this stage.

Mr Leggett: What the government did announce, though, in the budget reforms is that the Commonwealth would be undertaking a review of fundraising in its own right.

Senator STEPHENS: You have not acted on that yet?

Mr Leggett: No, it was announced in the budget. The government is yet to release a discussion paper. But that will happen in due course.

Senator STEPHENS: Treasury will release a discussion paper?

Mr Leggett: The Assistant Treasurer will release a discussion paper.

Ms Hartwick: Their work on the fundraising will be coordinated with the other not-for-profit reforms, in a similar time frame.

Senator STEPHENS: A similar time frame. So you think something else will happen on 1 July 2012?

Ms Hartwick: I do not think by 1 July 2012. I think they will be looking at reporting arrangements under the same time frame as the reporting arrangements for the not-for-profit sector more generally, which are due to be implemented by 1 July 2013.

Senator STEPHENS: In terms of the other part of the commitment to the ACNC, what about the red tape reduction. Where is that going?

Mr Leggett: The initial bits that we are seeing are the reporting framework and the information portal, which will mostly work towards reducing red tape because it will be consolidating many existing reports into a single reporting framework. You will be dealing with one entity specifically. The ACNC's role will also be as a central repository for application processes as well, so the aim will be to follow what we have seen as the New Zealand model of a seamless application process: you will put all your applications for government programs through the ACNC. It makes its decisions as required and it then forwards it on to other government agencies to make their decision and forwards it back with one single response. I suppose the role of the task force is to bring together all those reports and introduce that new reporting framework and information portal. That is one of the key focuses of the task force on red tape reduction. The remaining areas are pretty much in the space of us negotiating with the states and territories about regulatory overlap. We have to move that forward with the states and territories.

Senator STEPHENS: The 'report once, use often' mantra sounds great in principle but, in practice, consider an organisation such as Anglicare—we will pull that one out of the air. It provides a range of contracted services and other services to the community funded by government and then it reports back on impacts, through puts, outcomes or whatever. FaHCSIA has an online reporting framework for family relationships services. Then there are mandatory child protection frameworks reporting. How on earth do you think we can consolidate a single reporting entry point into one organisation like that, when those organisations are actually reporting on very complex, very different and very individualised contracts?

Ms Hartwick: There are a number of processes and ways that the government is looking at implementing these. For a lot of those, you might want to talk to the Office of the Not-for-Profit Sector. What we will be looking at in Treasury to begin with is the general purpose reporting requirements. Where you provide, for example, your financial report once to government, you will not provide that information again. So if the ACNC decides that you are a charity and you are solvent and you meet our governance requirements then other Commonwealth agencies will take that as a given and if they want the financial reports they will be provided through the process. There are other processes that are looking at other reporting and information, but it is probably best that you hold those questions for the Office for the Not-for-Profit Sector.

Senator STEPHENS: So you would be looking at the fiduciary responsibilities of the charities at this stage as your first point of reporting—governance structure, board structure, constitution and maybe insurance? What other kinds of things—financial statements?

Ms Hartwick: Yes, financial statements, directors reports—it is something that has not yet been specified and it is something that the implementation task force will be working on—but general reports that are provided, containing the same information you provide over and over again, as opposed to perhaps the specialist information that you are providing once.

Mr Jacobs: So, at the very least, they will have to harmonise where there is various reporting and, hopefully, there is the process which asks, 'Is this information really required' and they will do that checking.

CHAIR: Thank you to the officers from Treasury.

Proceedings suspended from 15:48 to 16:00

ADDIS, Ms Rosemary, Social Innovation Strategist, Department of Education, Employment and Workplace Relations

RONALDS, Mr Paul, First Assistant Secretary, Office of Work and Families, Department of the Prime Minister and Cabinet

CHAIR: Welcome. If you would care to make an opening statement.

Mr Ronalds: I am happy to kick off. From the Department of the Prime Minister and Cabinet's perspective, encouraging increased social investment is critical for at least three reasons. The first is that the social sector is growing rapidly, and we have seen the Productivity Commission's estimates of the contributions of not-for-profits and how that has grown over the recent decade. Second, there are increasing demands on government's limited resources, and yet many policy problems are actually growing in their complexity, so we have got a real tension in that area. Thirdly, leveraging community and private assets is not only likely to promote efficiency and help bridge the resource gap; it is likely to promote broader community ownership of the social change that we are trying to seek as well. There is not only a good resource reason; there is actually a deeper policy benefit from this area. For this reason, the department and in particular the Office for the Not-for-Profit Sector within PM&C is leading this whole-of-government approach to the not-for-profit sector to social investment more broadly and certainly looking to work very collaboratively with our colleagues such as those in FaHCSIA, DEEWR and Treasury on the work of this space.

PM&C certainly welcomes the work of this Senate committee and believes that there is a need to change both from a supply side in a social investment arena as well as on the demand side in the social investment arena, and both are equally important. On the supply side, the range of products, the expertise and intermediaries, the risk appetite of financiers et cetera needs to be enhanced. On the demand side, not-for-profits and other organisations involved in pursuing a social return must increase their own capacity to secure the resources from a broader range of sources.

We believe the government has a clear role to play in assisting this change. That role covers three different areas. First, as an investor itself second, as a regulator; and, third, as an advocate of the sorts of changes that we are talking about today. So we are delighted to be here and appearing before this committee.

Ms Addis: We think for many of the reasons that have been highlighted by our colleagues at Prime Minister and Cabinet that this is a really important area and we welcome the interest of the committee and thank you for inviting us here today. A social capital market is really taking shape globally and is in its early stages in Australia. The Australian and international context was highlighted in our submission. We think it is important to acknowledge that there is a context of longer term trends which are challenging all sectors and creating opportunities to work differently. Sir Ronald Cohen, with whom I understand you will speak next, is on the record as saying it is really an important part of a capitalist system to have a powerful social sector to address social issues.

Capital is a critical element of the systems to achieve that. Not-for-profit organisations need capital to operate effectively, and capital and infrastructure can also encourage a broader range of innovation and entrepreneurship to address social challenges. But it is not just about money. As Mr Ronalds has noted, other factors need to develop hand in glove with capital to achieve an efficient and effective system—skills, capacity and leadership, meaningful measurement and risk assessment, efficient intermediation and development of common languages and tools. There are no panaceas but there are a range of concrete ways to expand the repertoire of tools and options. On a spectrum with grants at one end and mainstream finance at the other, in our view we can get more organisations using more of the spectrum, encourage more capital into the system for social purposes and also build out the middle or the space in between grants and other finance that recognises explicitly social purpose and environmental purpose as well as economic results.

The Australian government has followed others internationally in testing the investment potential and providing catalysts for some market development. The Social Enterprise Development and Investment Fund, SEDIF, was designed to provide more capital for social enterprise but also to attract other investors into this market. The $20 million that was made available will provide the cornerstone for two or more new investment funds. This government money will be matched one to one from day one with leverage from other investors. The funds will operate at arm's length from government and they will offer more appropriate financial products to a range of social enterprises to enable them to grow and increase their impact in communities.

SEDIF was shaped by a public consultation process and the Australian and international evidence. It attracted a strong field of applicants. The relative assessment process was supported by an expert advisory committee and we look forward to the minister being in a position to make an announcement very soon. We will be very pleased to update this committee once that announcement has been made.

In conclusion, our submission points to a number of live issues for government and for the not-for-profit sector to target resources more effectively and efficiently, to attract capital to the right places at the right time and to promote innovation and collaboration. Thank you.

CHAIR: Thank you very much for that opening statement and for your submission. Your submission to this inquiry discusses the meaning of the terms 'social economy', 'the third sector', the 'not-for-profit sector' et cetera. To what extent do vague definitions of terms such as these confuse discussions relating to the sector and financing it and make it harder to develop the degree of confidence that is required from the investors' perspective to invest in the area?

Mr Ronalds: I think it is a factor of the relatively immature nature of the market here in Australia. Clearly there is a maturing process to happen. Part of that will be the education. There will be a refining of those sorts of concepts. I think it is a pretty natural thing that will happen over time. As there are more committee meetings like this and there is discussion more broadly around that, it will clear up. It is an issue. I do not think it is a significant issue and I do not think there is any sort of systemic problem that we are talking about there.

Ms Addis: Increasingly, as people become more mature in this investment market, they will look to the strengths and weaknesses of particular transactions, look to what the proposed social outcomes are as well as the economic outcomes, get better at measuring and assessing the risks of those and embrace a spectrum of actors.

CHAIR: In terms of confidence we had some evidence earlier today that what you really need are some investment options to occur and be proven to start to build that level of confidence. The obvious one is the purchase of the ABC childcare centres, which appears to be going very well at this point. I guess it needs to in order to build that confidence for investors to look at those sorts of options as viable alternatives.

Mr Ronalds: I think that is right. If we can five or six solid transactions and then use that as a base to go forward then I think we are going to see some real developments in the market. I think that is a focus early on.

CHAIR: Is the size of the Australian market in terms of socially beneficial investment, being as small as it is, to do with the lack of confidence or is it to do with lack of action by governments? What is that reason why we seem to be behind the UK and US in this regard?

Mr Ronalds: I do not think there is any one reason. Certainly the sorts of things you have talked about are part of the problems. We look at those supply-side issues around financial organisations that are perhaps not yet prepared to invest in the sector, the lack of intermediaries and a whole range of things there. On the demand side I think you have already had evidence that the risk appetite of not-for-profits and other social actors is limited and the capacity of senior management in those groups is variable. There are a range of these sorts of issues. I would caution against identifying any one factor as the thing that will solve all of this. I certainly think government leadership is likely to assist the situation. We have seen that occur in the UK market in particular with some of the work being done there. It has encouraged a much larger range of actors to come in. Certainly there is a role for government in all of this but it would not of itself be sufficient in my view.

CHAIR: Speaking of the role for government, where is the government currently at? I know you have detailed this to some extent in the submission, but what measures is the government currently looking at that will in your opinion specifically help foster the availability of finance for the not-for-profit sector?

Mr Ronalds: There are a range of things that the government is currently doing which help. First of all the creation of a range of institutions that are likely to provide a better regulatory environment for the sector is very important. So the creation of the Office for the Not-for-Profit Sector last year and the process we are going through to create the new regulator in Treasury that we have just been talking about are critical in creating the right sorts of foundational underpinnings for the sector. The sorts of things we are trialling in the Department of Education, Employment and Workplace Relations and in FaHCSIA will build momentum and critical mass that will help to get us there.

CHAIR: You outlined that we have set up some offices. I do not argue about the need or the potential benefit of setting up offices, but setting up offices and a regulator do not in themselves actually deliver outcomes. I am interested in knowing where we go from there. Having set that up, the Office for the Not-For-Profit Sector is clearly charged with delivering certain outcomes. How will those outcomes assist at this stage? If you are not yet at that point then tell me, but how is it intended that those outcomes can help foster the availability of finance for the not-for-profit sector?

Mr Ronalds: There are two ways I think. One is getting a regulatory environment that is much more certain, that is more efficient and more effective, which is one of the key goals of the office.

CHAIR: Around regulatory environment around what aspects—

Mr Ronalds: For not-for-profits in particular.

CHAIR: So in terms of their reporting and what they can do?

Mr Ronalds: All of those sorts of things. You have just had evidence from Treasury in relation to a much sounder footing in relation to the definition of 'charity' and exactly who is in and who is out. All of these things create significant transactional costs and slow things down. All of which are, if you like, the antithesis of promoting good investment in the space.

CHAIR: Then we are confident that by playing with regulation as it applies to not-for-profits we are not actually creating additional regulatory burden that is going to slow them down as much as it might free them up?

Mr Ronalds: That is certainly a risk as soon as you start doing regulatory change. It is something that the Office for the Not-for-Profit Sector is acutely aware of. It is something that other departments involved in the regulatory reform process such as Finance and Treasury are very aware of. We will be monitoring those things very carefully. We have very strong relationships with the sector, particularly through the reform council, that again provide us with expert advice into the regulatory changes that we are proposing. So, while it is a possible risk, we think it is a risk we are mitigating and is unlikely to occur and is something we are very watchful of.

So the regulatory environment is one part. The second part is the work that the office is doing in thinking about the whole-of-government approach to social investment and volunteering. We have a team within the office who are dedicated to working with colleagues in DEEWR and FaHCSIA and other places, as they are also involved in this work, to make sure that we are creating the right sort of environment within government. That is for the institutions that I talked about, it is about culture and it is about education. There are a range of things within government that we can do. It is also about working with our colleagues who are piloting the sorts of things that you would build capital markets off, such as the CDIF initiative.

CHAIR: On that second aspect of it I presume that innovative ways of partnering with not-for-profits, such as those the current and the last New South Wales governments have been exploring through social impact bonds—not necessarily that particular thing—are the type of options that government could be looking at in the second stream.

Mr Ronalds: Certainly, although I would say social impact bonds are only one. My view would be that social impact bonds will play a role in helping to address particular policy challenges. They require a whole range of preconditions to exist. I think some of the evidence that has been led here this afternoon has pointed towards some of those preconditions. They will not exist in all situations. So while it is a very interesting tool and certainly one that we are looking at, it is by no means the only one.

CHAIR: I agree with that. I used that as an example. It appears that there are a range of innovative ways that government can partner with not-for-profits in order to deliver outcomes that are consistent with both government and the relevant organisation's objectives, and they are developing. We have heard evidence this afternoon that there is an alignment of circumstances at the moment, which probably makes it more likely or easier for some of those more innovative approaches to be tested and built up and worked on. Are those the sorts of things that the office is looking at working on? Is that an active outcome or assessment that you are conducting in terms of where it can go, or is it currently not at that point?

Mr Ronalds: No, it is an active agenda. It is one that, in due course, I can imagine further announcements being made in relation to it by government. So they are very complex. There is a lot of international experience that we need to digest and understand. We do not want to make mistakes that have been made by others. That would be foolish. We are gathering all the evidence but we are very actively involved in looking to find opportunities to trial some of these sorts of things, even in relation to the recent budget announcements after the Building Australia's Future Workforce initiative and the very flexible Local Solutions Fund that was announced as part of that package of measures. We are considering opportunities in that case for making the money that government has put aside for that program go as far as possible by being more innovative and creative in relation to the grant guidelines of that program, as an example.

CHAIR: I am sure you would acknowledge some of the benefits of some of these more innovative approaches, which do not just go to extending the money as far as it possibly can go, which obviously is an advantage that all taxpayers would hope governments are trying to achieve. The benefits also go to ensuring that there are better outcomes or increasing the likelihood that programs, when delivered, will maximise the potential for the outcomes that are to be delivered as intended and provide appropriate incentives for the NFPs and also for investors to put their money from outside into those sorts of programs.

Mr Ronalds: That is exactly right, which is why in my opening comments I really drew attention to this issue of more creative financing methods as a way of promoting whole-of-community ownership over the social change that we are trying to create. Part of it is leveraging the assets that might exist within a community that can be added to government's assets and therefore having resources that go further. But there is also this issue—and I think you are alluding to it—that where a whole range of parties within a community have, if you like, got skin in the game, then actually we have got a whole range of people, not just government, that are all moving towards the social change that we are trying to achieve, and that is a very, very powerful thing.

CHAIR: As you say, they have skin in the game and there are personal incentives for each of those players, whether it be financial or social, to achieve the outcomes that ultimately we all want.

Senator STEPHENS: We have heard this morning and throughout the day we have had quite long conversations about social impact bonds and I wondered whether or not Prime Minister and Cabinet had actually been considering that model and the pros and cons and applicability.

Mr Ronalds: We have been looking at this and carefully watching some of the examples that are going on both in Australia and overseas and determining the advantages and disadvantages and some of the pitfalls. As I said earlier, we are cautious in relation to them. They will not suit every circumstance, and it has been quite interesting watching where some of the early examples of social impact bonds are being applied and in what sorts of policy settings; what are the preconditions for those sorts of things; and then sitting back and looking at the Australian context and saying, 'Righto. Where do those sorts of preconditions exist? Where might be some of the, if you like, rich pickings to trial this sort of thing in our own context? So very actively involved. We will see how it all plays out.'

Ms Addis: I think is a also important to say that that social impact bonds are one of the innovations in a context where there is a diversity of mechanisms that are developing, and there are some really innovative products in the market now with individual not-for-profit organisations issuing bonds, some strapped as where governments overseas have sought to partner with others to develop funds that enable them to pull some of the opportunities and that there is scope to look at a range of options, each of which have different considerations in terms of the evidence based measurement and the value for money outcomes.

Senator STEPHENS: I cannot remember which article it was I was reading online where someone was writing against the social impact bond model and their concerns were about creaming the easier clientele and churning through clientele. I cannot remember which one that was so I will not go there. This submission is excellent, thank you, and a really good reference document. In some of the evidence we are have heard this morning is around the taxation treatments and taxation barriers around who can and who cannot invest in these kinds of new mechanisms. Is that something that you have been considering as well?

Mr Ronalds: We have certainly been talking to our colleagues in Treasury about that, and there are a range of other investigations that are looking at that. The Office for the Not-for-Profit Sector does not have the sort of expertise to look very carefully at this, so we are aware of it as an issue but I would not say that we are as actively involved as some of our other colleagues would be.

Ms Addis: From our perspective also, we are working with our Treasury colleagues on those things but we also acknowledge that there is an important interplay between things like the pricing and risk assessment as well as tax treatment of these types of products.

Senator STEPHENS: There is also the suggestion from several witnesses this morning about recommending to us that Australia should set up a social investment task force to consider these issues more broadly with the key players in the industry. Is that something that has been under active consideration in terms of where you are a trying to position social change?

Mr Ronalds: I am certainly aware that in the UK context it provided a strong degree of legitimacy around this as an asset class and that that of itself was a pretty important part of the maturing of that market. We are certainly aware of some of the benefits that the United Kingdom found in this process and are therefore considering them in the Australian context as well.

Senator STEPHENS: Senator Bishop is not here but he asked a pretty important question about the extent to which Indigenous communities in some of these new mining contracts are engaging in long-term projects and going to have an investment stream into their communities that will need to be managed over the long term. Is that something that has been part of your consideration?

Mr Ronalds: Certainly not in any detail but, in terms of a source of capital that might be orientated towards social outcomes, it is a significant one. The other interesting issue around that is the amount of land controlled by Indigenous people that might be useful from a carbon sequestration perspective and the ability of those. So all of these sorts of things go back to whether we can create the right sort of innovative environment where the social returns and financial returns add up for the particular investor we are talking about, we still have strong levels of accountability and we have, of course, the strong measurement that is required in all of these contexts.

Senator STEPHENS: Foresters provided us with 10 principles which they believe underpin what needs to happen in this space. They are all the things that we have been hearing about this morning, but I think you make the point about measurement—the collection and collation of data on social value. Where is the government's positioning and thinking around what CSI is doing in terms of the international benchmarking and social return on investment and other investment measurement and tools?

Mr Ronalds: Certainly at the Office of the Not-for-Profit Sector we are acutely aware of how critical it is that we have the right sort of data and that we have evaluation frameworks. Whether the best outcome is that we have one evaluation framework that we are all able to use I am not at all sure. It may be that we have a range of evaluation frameworks that are appropriate for different policy settings, but the underlying need to improve our data to have a much greater emphasis—and this is from a government perspective as well as from a not-for-profit sector perspective and a for-profit sector perspective—on evaluation and a strong measurement of outcomes is undoubtedly a critical issue in all of this.

Ms Addis: I think the measurement question is really such an important one in assessing risk and other aspects that will go to market development. What is encouraging, though, is that internationally there are lots and lots of approaches that are developing and testing the different ways of measuring social impact. I think the Young Foundation is on the record as saying they have counted up over 150 different approaches and there is active work happening in the US and elsewhere on the types of measures that might become rateable in terms of our market, looking at how you target the types of measures you need for individual transactions or individual types of impact as well as the global concepts that you need to put around the measurement of social impact. We now have commentators like Michael Porter saying that capturing the social and environmental impacts, even in a commercial context, is really important to the future of markets. So I think there are lots of places for government to look in terms of the way that that is developing and to benefit from the huge amount of work that is happening internationally.

Senator STEPHENS: This morning we heard from JBWere—another excellent submission for us to consider. One of the underpinning questions, really, is: are not-for-profit organisations investment ready? Do you see that as an issue in our sector?

Mr Ronalds: I certainly think it is a significant issue on the demand side. I think the number and sophistication of not-for-profits that are able to engage in capital markets is pretty limited. I think it is rapidly changing. We are seeing more sophisticated management either growing up within the not-for-profit sector or moving to the sector from other places that have those sorts of skills. We are slowly seeing boards of directors of not-for-profits grow in terms of appetite for risk in this. I think we still have a long way to go both from a management perspective and from a governance perspective. So things that we can do to help that, I think, are well worth looking at.

Senator STEPHENS: JBWere suggested this morning that one way in which government could enable this would be to perhaps create a financial rating system, perhaps based on the Global Compact Principles for Social Investment or some other thing. Do you think that that would be helpful, or is it too nascent now because there is not enough to actually rate yet?

Ms Addis: I think there are areas that we can look to in terms of good principles, like the principles for social investment. There are also a number of things that have evolved through responsible investment, which is more of a negative screen on investments. I think that this will evolve over time as there are parallel reforms, like what the office and the regulator are doing in terms of building some of the accountability and transparency in the sector. There will also be an evolution as more products become available and as organisations from within the sector want to engage. There will be an education process of understanding what is required in order to qualify for some of those financial products. Even if they are more tailored and appropriate to the sector, they still will involve obligations like repayment and meeting the commitments of the particular facilities.

Senator STEPHENS: The other suggestion in their submission was about the idea of government issuing social debt or government guaranteed securities and government seed capital. Other than CDIF, do you think any of those proposals might have any legs?

Mr Ronalds: Another interesting example in this space is the work that the National Housing Company is doing off the back of NRAS. It is an interesting example of capital markets and of debt with different risk profiles being used. We have already mentioned today the example of GoodStart. I think another interesting example is an overseas one, the Global Alliance for Vaccines and Immunisation, where they took long-term pledges from government and turned them into bonds that they sold in the market to get their money upfront and then get a much higher social return from having a much higher level of immunisation earlier on in the program than would have otherwise been the case. So there is a very large range of things that we can do here. From a government perspective the question is: can we create the right sort of environment where we unleash some of the innovation that is possible from all of these creative people coming at these social problems with quite new ideas? That is one of the most exciting opportunities for government in this space.

Senator STEPHENS: I do not know if you were here for the witnesses prior to the break but we were having the conversation about related and unrelated business activity of charities and not-for-profits. To me there still seems to be a big challenge in the extent to which unrelated business can actually fund the early stages of some of that innovation. A concern that some of the charities and not-for-profits have expressed to us is that what is proposed in the discussion paper could actually stifle people taking the risk that they now would to engage in a commercial operation that would fund something that the government would not fund. Have you had a look at Treasury's paper?

Mr Ronalds: We have. We are working quite closely with Treasury on this. The role of the Office for the Not-For-Profit Sector is whole-of-government reform and there are a very large number of reforms that need to be coordinated. This is a really critical one and the risk that you identify is a real one, but it is one that Treasury, from their own testimony here this afternoon, are acutely aware of. It is an issue that is coming up a lot through the public consultation process that they have been running. So it will be something that they factor in as a very significant issue as they are finalising their policy position in relation to this issue.

Senator STEPHENS: We also heard from Treasury that the exposure draft of the legislation that would create the charities commission will probably be released before the end of the year in reasonable time to have feedback and discussion and get it into the parliament so it could be enacted by 1 July. Do you have any better sense of the time frame?

Mr Ronalds: No. Treasury are managing that process so their estimations will be the ones to take most account of.

Senator STEPHENS: In your submission you have taken some of the McKinsey work looking at key trends, one being the ageing of our population. In scoping for future change, knowing that we have an ageing population, what demands in the not-for-profit space are the office most conscious of? Is it about skills?

Mr Ronalds: I think the workforce issues are particularly acute. If we look at reforms that are happening in the aged-care space, reforms that are already happening in states and territories in disability services and if we look at reforms in a whole range of other social policy areas—and that is before we have gone into environmental reforms et cetera—we are seeing a sector that was already growing at a very significant rate and potentially growing even faster in the future. Whenever you have that you are going to have very significant limitations on the number of people who have the sort of experience you need. You have that growth factor but at the same time, as the discussion here has made very clear, we are expecting much higher levels of sophistication as well. So there is a sort of double whammy that I think is impacting on the not-for-profit workforce and the sorts of skills they have. So yes, that would be one of the most significant issues, but there is a range of others as well.

Senator STEPHENS: Including?

Mr Ronalds: Outside of people skills, financial resources is another pretty critical issue. Clearly governments are in a fiscally constrained environment, so that is one issue. Questions about how we grow philanthropy, how we use capital markets and how we use these innovative mechanisms are other related areas that we need to talk about. I think regulatory reform is another. We are asking not-for-profits to do perhaps more sophisticated tasks than what we have expected in the past. We are placing higher levels of accountability, such as demands for transparency, measurement and a whole range of other things. What is the sort of regulatory environment that fits with that? So there is a raft of issues that the not-for-profits are facing and the government needs to be actively involved. I think that is one of the reasons the Office for the Not-for-Profit Sector was created.

Senator STEPHENS: I agree with everything you have said, but the one thing you have not mentioned is the internet and the interactivity of the internet. There is an expectation for organisations to be engaged with that. Has the office had any kind of input into the national broadband considerations?

Mr Ronalds: We have been engaged over the potential for the National Broadband Network to benefit not-for-profits. Clearly the sort of technological change that you brought up is one of those areas where not-for-profits are increasingly expected to be more sophisticated, and not just on the fundraising side—it is about how you deliver services and communicate with beneficiaries to maintain or promote your own legitimacy as an organisation. There is a whole raft of areas. Again, it is an issue that we are aware of and involved in. Although, I should say that the office itself is a relatively small entity within the Department of the Prime Minister and Cabinet. We have to carefully prioritise our work. It has been our view that creating the right sorts of foundations, such as the right sort of regulatory environment, needs to be the primary goal. Cutting existing red tape and finding more efficient funding mechanisms for not-for-profits, such as contracting and grants, are the sorts of things that we are most concerned with at the moment, but we also have a significant watching brief on all these other sorts of issues and we become involved where we can.

Senator STEPHENS: I appreciate that you are a small office and you try to actually keep high and strategic rather than delving down into the specific. But when you look at who the submissions have come from, I was really intrigued that we have not had anything from, say, the communications industry around how that sector might actually engage with service delivery in the not-for-profit space and whether or not there was some capacity for some kind of market mechanism to help engage the NBN and roll it out in the sector. I was kind of intrigued that there was not that kind of forward thinking happening. We might pursue that and see if we can get some late submissions in. Thank you.

CHAIR: I have a couple of questions. Earlier on you talked about other options other than social impact bonds and Senator Stephens asked you about some of. What other options are there that we have not really discussed that you may have been looking at in terms of mechanisms that can be used to increase finance for the not-for-profit sector?

Mr Ronalds: There are a large number. Examples perhaps to draw to the committee's attention would be more effective use of existing grant money—so going out with your tenders and rather than perhaps saying, 'The government would like to have an organisation do X for it', say, 'This is a social policy goal that the government has. What organisations, for-profit and not-for-profit, are willing to come together and co-create in relation to the sorts of things?' That is an example. Y mentioned the Building Australia's Future Workforce and the Local Solutions Fund—that is an example where we are thinking much more creatively about how we engage local communities, local employers, local NGOs in addressing those sorts of social problems. That is a bit of a culture shift again for government. The whole notion round co-creation of these sorts of things challenges some cultural settings in government. It can raise issues around accountability and a whole range of political issues and things like that. So we are having to work through all of those in these sorts of trials.

CHAIR: Some of these innovations do require government moving to a very safe place in some respects and taking a little bit of a risk and moving away from tried-and-true governmental—'bureaucratic', for want of a better word—approaches to issues that may well deliver better outcomes. But it takes a brave government, I guess, of the day to make the decision to go there. We are seeing that elsewhere but not so much here yet from any flavour of government.

Mr Ronalds: That is right. It is one of the reasons why the Office of the Not-for-Profit Sector is working so closely with the Department of Finance and Deregulation, because we need to make sure we have got very clear understanding about what governments requirements are and, therefore, within those requirements, how much innovation and creativity is permissible, encouraged—those sorts of things—and make sure we have got the right settings between appropriate accountability, which is obviously critically important, without if you like inhibiting the sort of innovation that we are wanting to promote at the same time.

CHAIR: Similarly, for the not-for-profit organisations we have heard from earlier today to become more innovative in their approaches they also need to move away from where is a very safe and secure place in terms of how they have been operating. But sometimes to be able to deliver improved outcomes they may need to look at that as well. I presume that is part of what you are looking at. How to, for example, not so much increase the risk per se, but examine the risk profiles of alternative ways of doing things and weigh that against the potential increased benefits.

Mr Ronalds: One of the issues we have spoken about already this afternoon is the issue of measurement. I think this is where it becomes very related to the issue of risk. What we can measure very easily, and what we are very good at, is the financial risk and these sorts of things. So we therefore concentrate on those things that we can measure most clearly. We have not been able to be very good at measuring outcomes. The risks associated with not what achieving an outcome do not necessarily get the same weighting as the financial risk. Yet, if you ask beneficiaries what was more important to them they would say, 'Well, of course, it is the outcome that I am as interested in.' So you can see where the interplay about the data that we have, how good our valuation tools are, plays into our risk assessment and therefore the willingness of organisations to perhaps accept a certain level of risk in one area to overcome an existing risk, say, in not achieving the ultimate policy goals. That is another reason why this data and evaluation issue is just so critical.

CHAIR: I do not disagree at all. As I see it, the main reason you take money off taxpayers is to deliver the outcomes that you are supposed to be delivering. You do not take money off them to churn it around and lose half of it on the way; you take it off them because there are desired outcomes that you want to deliver. That is what you should do with the money you take off taxpayers. So it is not just about the risk; it is about marrying the financial risk with ensuring you deliver the outcomes you are supposed to be delivering.

Ms Addis: The Productivity Commission noted—and we have talked about it today—that there are a range of roles that government can play, in addition to that of funder, in helping the market to develop the skill base et cetera. We are in the fortunate position of being able to look at what some governments have done internationally and the outcomes and learnings from that. We have referred to a number of those initiatives and learnings in the appendices to the submission.

CHAIR: I want to ask some questions about the international comparisons. We heard today that the UK and the US appear to be further advanced in terms of social benefit investment than Australia generally is but that they are also very different markets. The US is obviously far less interventionist in terms of government solving problems and there is a greater degree of expectation that the community rather than government will solve some of the social problems. In the UK, probably not so much, but the evidence suggested a lot more of it is done at the local government level than at the national government level. There are differences inherent in those different jurisdictions. When you have been examining the way they approach these issues in other jurisdictions like the US and the UK, to what extent are you finding that differences inherent in the social structures in those jurisdictions make it less likely that the mechanisms they have developed will translate directly in Australia?

Ms Addis: In our experience—for example, doing the design work for the social enterprise investment funds—we found that there were some differences but also some common themes that we could draw upon. We are fortunate that there is quite a volume of international literature and commentary in this area—not just the material about what governments have done, but also a range of commentary on that—that we are able to draw upon, and we are very fortunate to have access to a number of the commentators as well. I think there is an opportunity to learn from that in Australia and take some big steps in learning what has happened in other markets. We have spoken to a number of people in the UK and the US about their learnings, both inside government and outside government, but you obviously need to make some judgements because there is no certainty about how new things will translate.

CHAIR: You mentioned in your submission that PM&C, DEEWR and the Office for the Not-for-Profit Sector are continuing to examine developments in the not-for-profit sector and that you are working together. Do you do that with a formal committee structure? Do you meet formally?

Mr Ronalds: We have established an interdepartmental committee that essentially seeks to coordinate all of the reforms across the whole of government. To date we have focused on creating the right institutional changes, reducing red tape and getting Treasury's regulator announced and moving forward. But certainly that structure, over time, will be used to have the sorts of discussions that we are having here today. It is a place where my colleagues from other agencies can bring forward some of the things they are doing to make sure we are taking a whole-of-government approach to ensure that the learnings that might be accruing in one agency can get shared and we can see some of the novel ways we are seeking to address some of these sorts of issues. So yes, we have created that sort of institution.

CHAIR: Which departments are involved in that IDC?

Mr Ronalds: I think all departments are involved in that IDC, which is chaired by the Department of the Prime Minister and Cabinet. But not-for-profits go across all agencies and therefore it is appropriate that they are all represented.

CHAIR: Does it meet regularly?

Mr Ronalds: It is meeting about four or five times this year.

CHAIR: So that is on an ad hoc basis rather than a regular meeting schedule?

Mr Ronalds: No. I have to check, but I think it might be quarterly or a little bit more often.

CHAIR: Okay. You mentioned that it looked at regulatory issues and a number of other aspects like that. Quite clearly, you have considered the issues of funding for not for profits, because of the excellent answers you are giving us today. Does the IDC also consider that issue? If so, what percentage of its deliberations is that? Is that a major part of it or just a minor part?

Mr Ronalds: The not-for-profit reform agenda is pretty significant. To date I think—I might need to check this—we have had three IDC meetings since the office was established. They have focused on things like reducing red tape and getting up to speed on what the Department of Finance and Deregulation is doing in this space and what Treasury is going. We would see that, as that agenda becomes a little bit more mature, a lot more time is being devoted to the sorts of issues that we are talking about today. So it is really just a matter of prioritisation in the short term.

CHAIR: I understand that. As I mentioned, you provided some excellent responses to our questions today on the issues that we are examining. Where has the consideration from that come from? It does not sound like it has come directly through the IDC. Is that just directly through the office itself?

Mr Ronalds: Certainly. The work of the office is part of that, but there is also working closely with those parts of government that are more engaged in this space, particularly our colleagues at the Department of Education, Employment and Workplace Relations and in FaHCSIA, on a bilateral basis. They have products that are alive in here, so we are working very closely with them to see what learnings we can get out of that, how some of these pilot programs go and the extent to which they are a cost-effective, efficient way of addressing the issues.

CHAIR: One of the core responsibilities of the office would be to maintain a watching brief on things that are occurring elsewhere, whether in New South Wales, the UK, the US et cetera that impact on that not-for-profit sector. As part of your day-to-day work you would discuss those developments and work them through. Whether that means you pass them up to government with advice attached to them on future options is another matter, I guess.

Mr Ronalds: It is. We meet very regularly with a whole range of stakeholders. Many of the stakeholders who have appeared before you today we meet with on a regular basis and keep very much abreast of the issues that are at the forefront of not for profit's mind and internationally as well.

CHAIR: Senator Stephens touched on this, but JBWere's submission to the inquiry suggested that the government could fund an independent NFP rating agency for impact investments, and that would help provide transparency and accountability in the market. Their suggestion was that the agency would provide independent evaluation of actual social impact investment opportunities. Is that suggestion something that has come before you before?

Mr Ronalds: It is not something that the office of the not-for-profit sector has looked at in any detail to date.

Ms Addis: We have looked at various mechanisms around the world that either rate or look at the performance or opportunities. There are a range of things internationally, including generated out of some of the South American companies. There are stock exchanges for some of these types of investments. Some of the philanthropic agencies have intermediaries that look at the merits and try to provide some comparability of the opportunities for philanthropic dollars to be directed to particular organisations. And there are a range of organisations internationally. Some of the commentary raises the same issues of comparability even amongst those ratings. Some other jurisdictions have relied more on their regulators and the type of reporting that is provided. That is more of an apples-to-apples comparison, also in relation to not for profits.

Mr Ronalds: Some of those rating agencies—and I am sure this is not what JBWere is suggesting—that have been established to date have been relatively unsophisticated and have essentially used what I would describe as input indicators as a way to measure a not for profit's suitability for further philanthropy or social investment. That tends to have a whole range of very problematic consequences. If this were something we wanted to look at in more detail, it would need to be a much more complex and sophisticated tool to be useful.

CHAIR: We also had some statements this afternoon that the ratings agencies proper, for want of a better way of describing it, have taken an interest in some of the larger, social impact type bond things that have been put together. If New South Wales proceeded to foster an offering, the ratings agencies would probably come in and give it an investment rating of some sort anyway.

Ms Addis: Certainly the work that has been done out of bodies like the Global Impact Investing Network, in which the Rockefeller Foundation and others are active. They are doing work on a measurement system known as IRIS which now has even a beta database that is available on the web. They are looking at developing those types of mechanisms towards a rateable type system out of the US. There is similar work happening in Europe.

CHAIR: You would concede that there are advantages if people can assess potential investment opportunities in this sector that have been properly rated against some objective standard, increasing the level of confidence investors might have and, therefore, their appetite for such investments.

Mr Ronalds: That is right. One of the issues associated with the new not-for-profit regulator and the information portal will be the extent to which we could put some of the sorts of information which would allow a whole range of members of the public to make value judgments about the outputs and, hopefully, outcomes of not for profits. That is an example where you could get a range of very generalist types of information. On the spectrum there are the more sophisticated: Standard and Poor's and others.

CHAIR: They are only likely to rate major offerings that are of significant size, whereas, particularly in Australia, I would imagine some of these socially beneficial investments are not necessarily going to attract their attention but nonetheless would still benefit from some form of objective rating so that investors could compare it with various standards.

Mr Ronalds: If we could improve transparency around some of these sorts of things across 600,000 organisations then it might have some very beneficial consequences for good, old fashioned philanthropy and the public's trust as well. That is why there is such a broad spectrum of things that we can do here and we need to look at the horses for courses type issue.

Senator STEPHENS: I go back to when you were talking about the unrelated business activity. The challenge of balancing that argument with social procurement presents an opportunity for you, Ms Addis, to bring the committee up to date on where the social enterprises are that were supported through the jobs fund and on how many of them have continued to trade. What has been the learning from that whole experience?

Ms Addis: In relation to the jobs fund, the department supported approximately 80 social enterprises that were aligned with the objectives of that particular fund, which was focused on employment generation and retention. I would have to take on notice exactly how many of them are still in operation. Certainly there have been some real successes from that investment.

Senator STEPHENS: It would be helpful for us to understand that. The notion that something that is unrelated business activity is then deemed not investable in the altruistic activities of the charity brings me to the point where, on the one hand, we are looking at the issue of social procurement and how that distorts the market and, on the other, what the benefits of supporting social enterprises in that way delivers in a community, particularly if there is market failure. I would be interested in any learnings that have come from that.

Ms Addis: I am happy to take that on notice. Of course, there are a range of types of enterprises supported through that initiative.

Senator STEPHENS: Thank you.

CHAIR: Thank you to your two departments for assisting us this afternoon.

COHEN, Sir Ronald, Private capacity

[17.06]

Evidence was taken via teleconference—

CHAIR: Welcome. Senator David Bushby speaking. Do we have Sir Ronald Cohen there?

Sir Ronald Cohen: Yes, indeed. I managed to watch a few minutes of your proceedings on Skype, but unfortunately the Skype connection is not being effective at the moment, and so the telephone.

CHAIR: That is disappointing, but fortunately we do have the option of falling back on the reliable telephone. Thank you very much for joining us this afternoon in Australia. I think it is morning there, in the south of France.

Sir Ronald Cohen: That is right. It is a great pleasure.

CHAIR: We are all very jealous of the fact that you are in the south of France and we are here in Canberra in the middle of winter.

Sir Ronald Cohen: I am sorry about that!

CHAIR: Thank you again for your submission. If you would care to make an opening statement we would be happy to receive one.

Sir Ronald Cohen: I have been told about five minutes would be right. Is that correct?

CHAIR: That would be fine.

Sir Ronald Cohen: I come to Australia frequently and on my last visit in December I participated in several discussions on the subject of social investment, including with the New South Wales Premier and her staff and with several social sector organisations. I have read with interest the report that was sent to me by Mr Sawtell. I believe we are on the cusp of a revolution, and just listening to the questions that were being asked—I managed to catch about 10 minutes of your proceedings this morning—you are clearly of the same view. I suppose in my own country, in the UK, this whole process started at the end of 2000, when the Social Investment Task Force reported that, in addition to philanthropy, there was the possibility of bringing in social investment to play a major role in resolving social issues.

Basically, our capitalist systems deals brilliantly with its business and financial consequences but does not really have a part of the system that is powerful enough to deal with the social issues, and that between the public sector and the private sector there is a very considerable social sector, generally called the voluntary sector or the third sector. In the UK it comprises about 100 billion pounds of foundation assets and 800,000 full-time equivalents working in not-for-profit organisations. If one wants to focus on developing the capability of the social sector to deal with social issues then we need to create a system to support that role, and we need to innovate in order to make it effective. Over the decade since then, we have seen the creation of social venture funds, which have invested in the poorest parts of the country for profit and delivered excellent returns. The Bridges Ventures fund, which I chair, was supposed to achieve 10 to 12 per cent returns. It had some government incentives built into it through subordinated debt and it ended up achieving 20 per cent.

We then had the Commission on Unclaimed Assets and the idea arose that the forgotten assets in banks, where account holders had died or left the country and forgotten about their assets, should be taken and applied to these social purposes. Just last Thursday—I believe you may have a copy of the press release—the UK government agreed to deliver £400 million plus of unclaimed assets and our leading banks agreed to deliver £200 million of equity, and we announced the creation of Big Society Capital, which is a social investment bank that is a crucial part of the system, in my view. The innovation has already started to make it possible for organisations that achieve a social outcome to read across to a financial outcome, and that, in my view, is the significance of social impact bonds. For the first time, a social entrepreneur can say, 'I achieved a 10 per cent improvement in the dropout rate from school, in homelessness, in health care at home or in recidivism and I can pay 10 per cent on my bond.' It has never existed before. It will, in my view, be a revolutionary instrument and I think we can begin now to apply the same sorts of resources to supporting social entrepreneurs that our countries have devoted to supporting business entrepreneurs over the last three decades or so. I will be delighted to answer any questions you would care to ask.

CHAIR: Thank you very much. Should we refer to you as Sir Ronald?

Sir Ronald Cohen: No, you can call me Ronald or Ronnie, which is what I am generally called.

CHAIR: Okay, thank you. You started by noting that the capitalist system essentially deals well with some things but not so well with delivering social outcomes. Isn't what we are talking about here, though, really providing incentives for the various parties so that the market system, in a sense, will actually deliver the social outcomes by attaching social and financial incentives depending on which party you are talking about—for example, with a social impact bond—which then leads to the self-interest of those parties, whether they be social or commercial, delivering the best outcomes?

Sir Ronald Cohen: Absolutely, and this has been our aim. I am saying the system does not have it in it but that it is there in a latent form in the social sector. If we make the social sector powerful, then we will have a strong element in our system to deal with social issues. So it is not that the system cannot cope; it is that in the past it has relied on philanthropy to cope with social issues where government has not taken on the responsibility—and we need to go beyond that. I am in no way saying that the capitalist system cannot cope with it; I am saying we have not focused on making it cope.

CHAIR: I think that is consistent with what I was saying. It is not so much that the capitalist system has failed; it is more that, as there will no doubt be pure commercial mechanisms that the capitalist system will throw up in the future that we have not thought of yet, there are possibly socially beneficial mechanisms that the free market could quite happily adopt with great vigour that have not yet been fully developed and what we are talking about here with the social impact bonds may well be an example of that.

Sir Ronald Cohen: Correct.

CHAIR: On the social impact bonds, you said that the idea was developed in 2007 among a group of four or five from both the finance and the voluntary sectors. Would you elaborate on that.

Sir Ronald Cohen: Yes. It was developed by an organisation that started in 2007. When the government decided to support the creation of what was known as a social investment bank in our report, it did not make sufficient amounts of money available to do it. We decided to prove the proposition by raising some philanthropic money, a couple of million pounds, and creating the social investment bank. Social Finance was the name of this organisation.

In 2007 we started with one person; we have built up to about 24 people today, I believe. In the course of the first 18 months we worked with a number of different parties and we developed this new financing tool and began to negotiate with the Ministry of Justice in the UK. In September last year, having raised the money, we launched the first social impact bond. In your report there was a reference to the fact that there might be some doubt about whether the money had come from external sources. In fact we raised £5 million entirely from foundations, and two-thirds of the 17 foundations and charitable trusts that put money up kept it on their balance sheets rather than taking it out of their grants allocation. That is a very significant development because you have £100 billion of assets in foundation balance sheets, and you have a couple of billion pounds that are given away by foundations—£2 billion to £3 billion—a year. So if you can begin to use these financial instruments to attract capital from the balance sheets of charitable foundations, you start off with a massive amount of money that can be focused on social issues.

CHAIR: We have had some discussions about social impact bonds during the day, with various witnesses providing their interpretation of how it will work. Would you mind explaining to the committee, as one of the people involved in the original concept, how you see these sorts of bonds would work in practise and the involvement of government?

Sir Ronald Cohen: Sure. The easiest thing to do is to use the example of the social impact bond focused on Peterborough prison in the UK that was launched in September. Basically we went to the government and we said, 'Look, we can raise some millions of pounds to deal with the issue of recidivism if you will agree to pay, on the basis of results, six to eight years from now.' The government agreed to sign a contract to be a commissioner of such a bond. We raised £5 million from foundations and charitable trusts—as I said, most of it coming from their balance sheets rather than their grants allocation. We will use this money over a period of three or four years—'we' being Social Finance, the social investment bank that launched the bond—and it is really more like venture capital than private equity in the sense that Social Finance has expertise in recidivism in-house. We use this money to initially fund three not-for-profits that are working with prisoners—that is, training them while they are in prison, funding them when they leave prison so they can make it to their first benefits cheque, helping them to find jobs and giving them the community and psychological support that they need to reintegrate into society. If, over a period of six or seven years, these not-for-profits are unable to reduce the rate of recidivism measured against the control group—this being a group of prisoners 10 times the size of the assisted prisoners with similar demographics across the UK—by 7½ per cent then the money is lost by the investors, so it ends up being a philanthropic donation. But if we are successful in reducing it by between 7½ per cent and 15 per cent, the government will pay back the capital and a yield of 2½ per cent to 13 per cent a year. According to our calculations, government would be paying out one-third of the saving. So you can see that it is a very powerful instrument because for the first time the St Giles Trust and the other not-for-profits that are being funded have access to significant capital over many years and are focused on achieving social outcomes; their performance becomes crucial to their ability to raise bonds in the future.

CHAIR: In the way that that is constructed, quite clearly the principals that have been put in by investors are at risk if the not-for-profit that is instituting the program fails to meet the targets?

Sir Ronald Cohen: That is correct.

CHAIR: So if it, for example, reduced recidivism by six per cent the government at that point would not have to pay and would have achieved quite a positive outcome regardless, but the investors would miss out. I am not really asking you to comment; I am just thinking aloud with that.

Sir Ronald Cohen: No, I think that is exactly the concept. I think it is a powerful instrument because it begins to say to a social entrepreneur, 'Look, if you can deliver social performance you can access the capital markets.'

CHAIR: It certainly shifts the risk from government to the not-for-profit provider of the services as well as the investors. It is different, obviously, because one has a very much exposed financial position and the other one has a reputational risk associated with it.

Sir Ronald Cohen: Correct.

CHAIR: We have discussed these types of bonds with various witnesses today. The government witnesses, in particular, have indicated there are, in their opinion, some limitations on the applicability of the bonds partly because of the difficulty in measuring outcomes in some circumstances. They essentially said that the bonds might well be a very useful approach but only in very particular circumstances. Is that something you would agree with or do you think there is a broader capacity to use these in a way that maybe the other witnesses had not considered?

Sir Ronald Cohen: I would say that metrics are crucial to it. Certainly, social impact bonds cannot be applied right across the board. However, I have two or three more mature reflections, having worked with them for about a year. The first is that there are major foundations that are prepared to pay out, as commissioners and instead of government, in areas that interest them on the basis of a scorecard which may not give quantifiable metrics, but in their view provides a sufficiently clear indication of whether or not the intervention by the not-for-profit was effective. We may well discover that the government accepts situations where the metrics are clear enough—as in the case of recidivism where a proper contract can be signed—and where charitable foundations are prepared to be commissioners in a somewhat looser set of metrics.

CHAIR: Governments may well accept that in some circumstances. Where the outcomes that need to be met are not precise, they may say, 'Okay, that is close enough' and they will pay out and keep everybody happy. The flipside of that, where it is not particularly precise and the government says no, will obviously cause problems with investors.

Sir Ronald Cohen: That is right, and you need to have an independent assessor. In the case of the Peterborough bond that I was referring to, there is an independent assessor of the metrics where the metrics are very highly quantifiable. I could see how you could get to situations where government departments become quite comfortable in paying out on this basis, particularly since the money has been put up. They have not taken the risk and they can see the results on the ground. So I think the applicability of social impact bonds will be a lot greater than we expect.

The big question is, 'Do we give government departments the budgets to pay out several years from now?' Again, there was a reference in the report I read that somehow a weakness of the first bond was that the Big Lottery Fund in the UK, which is a charitable pool funded by the lottery, had had to put money up. The only reason the Big Lottery Fund came in alongside government is that the Ministry of Justice did not have sufficient money in its budgets, six to eight years out, to pay out in the event the bond was successful. We are talking with the government in the UK in order to get social impact bonds going. The second one is being funded now. The first investment of Big Society Capital is in fact in backing the Private Equity Foundation to launch a social impact bond dealing with adolescents at school who are in danger of not finding a job. I think we can already see that governments are going to need to make a pool of capital available six to eight years out to pay out on the success of social impact bonds, which government departments either have a specific allocation from or compete for.

CHAIR: I can certainly see some potential issues given the time lines. I am not sure about the UK, but in Australia we usually only have forward estimates for the next three years and then there might be some projections beyond that. Particularly when we also have three-year terms for government, committing to make payments for certain things six or seven years out would require some serious forward planning I think at the Australian level. You are I understand a regular visitor to Australia.

Sir Ronald Cohen: Yes.

CHAIR: Looking at the Australian situation and what you know about it, do you think that the concept for social impact bonds that you have developed and are now seeing in practice in the UK will translate directly into Australia? Are there any fundamental differences that you are aware of between Australia and the UK that might require some tweaking or present greater challenges?

Sir Ronald Cohen: No. I think it would apply extremely well in Australia as it would in the United States, Canada and Israel, which are all very interested in the concept. The big constraint on using social impact bonds, apart from the availability of budgets at departmental levels, is the number of not-for-profit organisations operating in the country that can deliver a decent social outcome. I think the availability of the money will lead social entrepreneurs to come into the field and take over existing organisations or, if they are already in existing organisations, to begin to think differently about their metrics and their performance. When we first recommended the creation of a social investment bank part of the purpose was that it is very difficult for a new sector to arise without a catalyst to help increase investment readiness first of all and to support financially organisations that are experimenting with different approaches to dealing with social issues. I think the issue for Australia will be: at what stage do we too have to create a social investment bank with a sufficiently strong balance sheet so that social entrepreneurs know that the capital is going to be available if they decide to devote their energies to social organisations? Culturally and entrepreneurially and in terms of social conscience I think Australia is an extremely attractive place for social investment.

CHAIR: Thank you.

Senator STEPHENS: Thank you for participating in this inquiry. It is very interesting to have your perspective. We did receive the media release about Big Society Capital being launched last week. Congratulations on that. Is Big Society Capital able to borrow in its own right or is it only managing those funds that have come from the investors?

Sir Ronald Cohen: No, it is able to access the capital markets as an organisation that is independent of government. It is a private sector organisation funded with public money technically. It is capable of accessing the capital markets. Initially we think the way to attract additional capital into the sector, since we will have potentially £600 million of equity, is through matched investment of one kind or another. So, in the case of the investments with the Private Equity Foundation, we would be providing half a million pounds alongside half a million pounds from the Private Equity Foundation. We would be underwriting half a million pounds of additional capital raising and they would be doing the same. So I think we see ourselves as cornerstone investors attracting a multiple of the capital that we had initially. But down the line we could even issue social impact bonds to be distributed—because we are a wholesaler in the system—to social organisations that then fulfil the social mission.

Senator STEPHENS: I am interested in that concept of being the wholesale investor as well. You gave us the example of the prison and then a second example about young people at risk of falling out of the education system or out of work. I am trying to envisage a situation here in Australia. As an example, if we were to look at a social impact bond being developed to address issues of Indigenous disadvantage, we would be unlikely to have one organisation. We would need to have a network of not-for-profit organisations involved in trying to really drive a significant social outcome. Can you see that that would work in that kind of an environment, where you would have many players?

Sir Ronald Cohen: Yes, indeed. In the case of the Peterborough bond, we start off with three players. I think the number has been expanded to five as others are becoming interested in it. I could see that there would be many bonds that are raised by organisations which have the internal expertise to deploy the money to a number of not-for-profits and to test the not-for-profits for their effectiveness and then give more of the social impact bonds issued in subsequent years to those who are performing better. So the model does not require you to raise social impact bonds for one organisation, although there will be some organisations with the credibility to do that.

Senator STEPHENS: We have had previous discussions today about the way in which this, as an investment instrument, could be used in rural and regional Australia, where there are very thin markets and it is often very difficult for us to get services provided in those regions. I appreciate that you do understand the Australian context a little. Can you see a role for local government?

Sir Ronald Cohen: Indeed. I think one of the challenges is going to be whether local government can issue bonds and, to the extent that local governments do not feel able to pay out the whole sum, whether the national government which inherits some of the benefits in the event of the success of the bond is prepared to top up. One of the challenges in launching the first bond is that, although we were dealing with the Ministry of Justice, which deals with the prisons and the legal system, the savings to the Home Office for the police and so on could also turn out to be considerable. And there are savings right across the system. It is very difficult to quantify these, but in the case of local authorities and national government, in many cases, it is necessary to try to quantify these, because the resources of local authorities are insufficient to pay out on the bond, in many cases. So, it is another issue that is going to need to be sorted out. One of the purposes of the pool at departmental level that I was talking about for the UK would be to top up local authority payments in the event of performance targets being breached.

Senator STEPHENS: Yes. Here in Australia we have different levels of local government in different states in terms of the capacity to take on this work. It is an interesting dimension to the concept I think. I want to take you back to the Social Investment Task Force. One of your recommendations was the introduction of the community investment tax relief program. Can you tell us how successful that was in attracting investment to the sector in the UK and are there lessons of that concession that we could apply to the Australian context?

Sir Ronald Cohen: Yes, it is crucial for government to play a partial enabling role if we want this area to take off just as it was for government to play a similar role with regard to business entrepreneurship in the United States through changes in legislation and in the UK. Unless you have powerful tax incentives it is very difficult to attract capital initially. Community investment tax relief ended up being a shadow of what had been intended. When the Social Investment Task Force got approval for the idea and the government implemented it, the idea was to have £200 million go into funding community development finance associations. In fact, the scheme was stopped after about £40 million or £50 million had been distributed. Yet there were very powerful examples of how this had been successful.

The most eloquent example was the Charity Bank which takes deposits from the public and then lends to philanthropies. The Charity Bank got qualification for its depositors to receive tax relief on interest paid. You could phrase that slightly ambiguously. If you deposited money in the Charity Bank, you had the choice of getting a low level of interest or not getting it at all but in any case you got a tax credit, which if you were a bottom rate taxpayer would have been equivalent to a five per cent tax credit a year for each of five years and in the event that you were a top rate taxpayer would have been about eight per cent. As soon as this began to become obvious £30 million to £40 million of depositors' money went to the Charity Bank. There was a very powerful example of why it had been successful.

The problem was that it was housed within a government department which was going to be reorganised and as often happens decisions are made that do not really make very much sense from the perspective of the original intention. They somehow deal with organisational changes that have come subsequently. I am very pleased to say that the Chancellor rejected calls for the abolition of community investment tax relief in the last budget and has extended its existence. We are working to extend its scope because its scope was also defined so narrowly by the exclusion of community development finance organisations that were providing personal finance and the exclusion of those that were providing finance for the purchase of property.

In the United States I think the figure is $126 billion under the new markets tax credit. It is some astronomical sum which has been attracted. A lot of it is for property and personal finance. I think with the expertise and the perspective we have developed now for community investment tax relief we will be able to extend its scope and it will be a crucial part of the architecture of the system.

Senator STEPHENS: Yes, I can understand that. Are you looking to extend the scope beyond those things that were originally excluded—personal finance and property?

Sir Ronald Cohen: Yes. I think once you have done that you are probably covering the whole waterfront.

Senator STEPHENS: Are you considering how social impact bonds might be used to address issues around climate change?

Sir Ronald Cohen: There is the possibility of doing that. In the UK we have also announced the creation of a green bank with £1 billion of capital. We have defined our role of big society capital as dealing with social organisations. But I suppose the carbon credits system is another performance-like measure to achieve a social outcome, so you could argue that it has already been applied in a slightly different way.

Senator STEPHENS: Yes, indeed. You give the example of a new social impact bond to address homelessness—an investor who wants to refurbish buildings to use for homeless people and who plans to move them into a second part of the building to pay rent once they have a job. Is it the case that the concept of the social impact bond only works where there is some projected final gain?

Sir Ronald Cohen: The power of the social impact bond is that, providing you can manage the social outcome, you can give a revenue model to a not-for-profit organisation that does not have one. Take, for example, the St Giles Trust, which is dealing with recidivism. It does not really have a revenue model today; it has been reliant on philanthropy. But through the social impact bond, if it can deliver a reduction in recidivism, it can pay an interesting yield on the bond and it can access the capital markets again. So I think the answer to your question is no, it is not just where you achieve a financial gain. Providing the investors are prepared to put money up on the basis of the performance metrics, and the commissioner is prepared to pay out on them, that in itself provides the gain to the not-for-profit; that is the power of it.

Senator STEPHENS: Indeed. You emphasise the importance of banks being required to emphasise what they are doing in poor areas. Can you explain what you mean by that? Why do you think that is important and what kinds of initiatives do you envisage banks disclosing?

Sir Ronald Cohen: In the United States the Community Reinvestment Act, which I think was introduced in the seventies, required banks to reinvest in the communities from which they often derived deposit capital. It was toothless until the Clinton administration came in in the nineties and said if you cannot give as adequate proof that you have played this role, we are not going to approve your acquisitions of banks in states other than your own. This immediately puts teeth into legislation, which meant that the banks began to invest massively in disadvantaged areas.

In the UK we suggested in 2000 in our social investment task force report that the banks should disclose voluntarily what they do—and, indeed, many of them started to give more information about it. But you did not have sufficiently accurate information to be able to understand who was doing a good job and who was not. We said then that if after a few years we do not have the information base we need to answer that question then we ought to introduce legislation in order to achieve that. I think a voluntary system just cannot do that; it is not central to the banks' preoccupations because it is a very small part of their total business. I do believe that the banks have been well intentioned and, in several cases, they have made real efforts to improve on the information they had, which is just not sufficient. I think we need to move to something like the community reinvestment banks in the United States. It has been nearly 11 years since we published our reports, and banking flows dwarf all other flows of capital into these areas.

Senator STEPHENS: Have you had the experience of a social impact bond being oversubscribed, and what do you do you do in that case?

Sir Ronald Cohen: We were oversubscribed, I am proud to say, for the first social impact bond. We had to cut investors back pro rata—and, I am very pleased to say, several were very unhappy about that!

Senator STEPHENS: Thank you very much. It has really been very interesting.

CHAIR: Thank you, Sir Ronald, for your assistance. Enjoy the rest of your day in the south of France; I hope it is a beautiful one for you.

Sir Ronald Cohen: Thank you very much. I will be back in Australia in December. If any members of your staff would like to meet, I would be delighted to do so.

CHAIR: Thank you very much.

Committee adjourned at 17:46