COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

SENATE

ECONOMICS REFERENCES COMMITTEE

Finance for the not-for-profit sector

MONDAY, 26 SEPTEMBER 2011

CANBERRA

BY AUTHORITY OF THE SENATE

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ECONOMICS REFERENCES COMMITTEE

Monday, 26 September 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

HARDY, Mr Michael, Assistant Commissioner, Australian Taxation Office

Subcommittee met at 08:50

CHAIR (Senator Bushby): Good morning and welcome to this third 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 29 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 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 the assistant commissioner of the Australian Taxation Office, Mr Michael Hardy, and invite you to make an opening statement.

Mr Hardy: I have a fairly brief opening statement. The tax office is more than happy to help the committee with its inquiries. Financing is not a particular expertise of the Australian Taxation Office. We are more concerned with taxation matters, although of necessity we are exposed to financing and the taxation implications of that. I understand that my presence here today was on the partial recommendation of Ms Susan Pascoe, the interim chair of the Australian Charities and Not For Profit Commission that I work closely with in terms of trying to establish the ACNC at the moment.

Senator STEPHENS: Thank you for coming today. We are very interested in hearing how the proposition for the new Australian Charities and Not For Profit Commission is progressing and when we might see an exposure draft of the legislation establishing the regulator.

Mr Hardy: The legislation to enable the ACNC is of course being progressed by Treasury. They can speak more fully to it, but I understand their aspirations are to have an exposure draft out perhaps this year, subject to ministerial and parliamentary process. I understand that they would have an ambition—again subject to ministerial decisions—to try to have the legislation for the ACNC passed through parliament and available for the community to see well before 1 July 2012. Sorry, the enabling legislation is 1 July 2012. I was thinking about the legislation for the statutory definition of 'charity', which they hope to have quite early so that the community can look at the statutory definition. I believe the legislation to enable to ACNC is proceeding on schedule, but given that it is a fairly tight timeframe to have it available for 1 July 2012 it is likely to be available in time but perhaps not with an excess of time.

Senator STEPHENS: Could you provide us with some information about the work of the implementation taskforce and what the key priorities are for that taskforce?

Mr Hardy: The implementation taskforce is led by Susan Pascoe within Treasury. While I meet with her regularly, her particular functions extend beyond my role. I understand primarily they are concerned with consulting with the not-for-profit sector around the sorts of information that could be provided to the ACNC that could be reflected back in the public information portal proposal. They are looking at mechanisms by which red tape can be reduced. Some of this involves not just Commonwealth but state jurisdiction matters. I understand there is consultation through COAG with the states about what can be done in terms of the state-Commonwealth dynamic.

The main thrust of the work that Ms Pascoe is doing is mostly working with the not-for-profit community about their comfort with the role, structure and the organisational culture of the ACNC. It is with the tax office to enable that, because the budget papers were quite clear that the tax office had to do some things to support that. We are making arrangements to separate those applications that presently come to the tax office from organisations seeking to be endorsed for charitable tax concessions to separate out the question of the charity status from the question of the tax concession status. We are looking at how we hand over sensibly the functions about determining charity status to the ACNC for 1 July 2012. We are making the back office logistical arrangements available for the ACNC in terms of attempting to find it suitable accommodation to provide it with an operating environment to recruit staff on their behalf and work with the taskforce about the sorts of induction and skilling that the new staff require so that it is fully functional from 1 July 2012.

Senator STEPHENS: It is interesting that you as the ATO are going to be relinquishing some functions and yet keeping others. Is that a recommendation of the Productivity Commission? I do not want to put words in Mr Fitzgerald's mouth, but I think it is difficult to be both enabler and gatekeeper. What type of approach is the ATO taking in separating those two roles?

Mr Hardy: It is a physical and structural separation. We have not quite accomplished the separation, but an organisation that seeks to be endorsed for some particular tax concession relating to a charitable status applies to the tax office and says, 'I think I'm a charity. Can you please confirm I am and, if I am, may I have these relevant tax concessions?' There is no particular piece of tax legislation that determines what is or is not a charity, so we are required to refer to the common law, and there is no particular role for the tax office to be the organisation that determines charity status. It is just a necessary precursor to determining which relevant tax concessions are available for the organisation. At the moment those applications arrive in the tax office and are handled by a single team of people who work through whether it is a charity and, if it is, whether they are entitled to the relevant tax concessions by reference to the tax legislation. Some of the staff that previously dealt with that integrated function will deal just with the question of whether the organisation is a charity and what particular type of charity it might be, and then cease any further deliberation about tax consideration. They would hand that information across to another team, once it has been determined to be a charity of some particular type. It would work through the taxation legislation to see what particular tax concessions are available. That is how we anticipate the tax office will work with the ACNC into the future. Rather than the ACNC just being a separate piece of the tax office, they will be a separate organisation that has determined charity status for Commonwealth purposes, including tax. That information will be handed to the tax office as a given and then the tax office will look to see whether there are any particular aspects of tax legislation about any particular tax concessions that the organisation is seeking.

Senator STEPHENS: That is quite interesting. Do you anticipate there will be changes? It is quite unwieldy how an organisation can be determined to have DGR status or get PBR status. Do you envisage that this will create a much simpler and more streamlined process through a new definition of 'charity' and therefore make it much clearer?

Mr Hardy: There are a couple of pieces to your question. One is the physical handling of information between agencies to accomplish something from the applicant's point of view, which is perhaps in their mind a single request, although it is divided into several requests. Then there is the question of the statutory definition of 'charity', which I will come to at the end.

If you just take the microcosm of an organisation saying, 'Am I a charity and can I have some particular tax concession?', which is presently handled solely by the tax office and in a singular process, it is difficult to keep equivalent functionality for the community if it has to pass first through the ACNC to do their processes to determine the charity status and then be handed to the tax office to do whatever additional requests might be required for the tax concession. That said, though, that is just a microcosm. Of course, not-for-profit organisations also make approaches to a whole range of other Commonwealth agencies for a whole range of other tax concessions where potentially the same process is repeated. The organisation determines whether they are a charity of a certain sort, do they have access to whatever concession, grant or payment is available through other organisations, and so when you contemplate that the ACNC should eliminate that charity question from all of those Commonwealth agencies globally it should be more efficient. In reality, it will take a bit of time for the ACNC to get good and efficient working relationships with other Commonwealth agencies to fully realise the benefits, but certainly the theory is quite sound that there should be a more efficient process.

As to the question of the statutory definition of 'charity', it could make the ACNC more efficient or effective in determining charity status for the Commonwealth, presuming any new statutory definition will have good explanatory memoranda, good interpretative material and contemporary interpretative material rather than the challenge we have with the common law at the moment with some of the material being hundreds of years old in some instances, which is sometimes difficult to translate to a contemporary environment. On the basis of being modern legislation I would imagine that it would be more straightforward for the ACNC to interpret.

Senator STEPHENS: It would be helpful for us to understand whether over time—I presume there will be a transition period to this new region—you envisage that in the harm prevention space the register of harm prevention charities, the environment trust register or an arts and culture register, which gain registrations through FaHCSIA at the moment, might eventually disappear and would all be streamlined through the ACNC?

Mr Hardy: Those options are possible depending on the choice of government and the parliament about removing registers and referring those powers to the ACNC. I understand that Treasury is undertaking a review of some of those registers and has been for some time. I guess that is an area of potential further efficiency. The only challenge I could foresee with that is that if, for example, an environmental register has something in its present legislation that requires a deep understanding of environmental issues, legislation or whatever, the ACNC may not natively have that particular expertise, but I am sure they could make reference to or take opinion from the relevant department responsible for the environment, if necessary, if they had that function.

Senator STEPHENS: Are you aware of how long the transition period will be or what is being discussed?

Mr Hardy: In July 2012 the ACNC will take over the determination of 'charity' for all Commonwealth agencies. With the tax office handover we will be fully functional working with them from 1 July 2012, in terms of people having access to tax concessions. That is perhaps one of the most significant things that a lot of charities seek when they apply to be recognised as a charity. I am not fully aware of how far Ms Pascoe's discussions have progressed with FaHCSIA or any other agencies in terms of the integration with those other agencies.

Senator STEPHENS: Just going to the tax concession issue, one of the things that we have heard consistently is around the interest of philanthropic organisations and private ancillary funds wanting to invest in social impact projects with organisations, and some of the challenges around that. On Friday we heard from the Sydney Community Trust that, while they have a women's investors group and women's project, women who had a PAF cannot actually invest into the community trust. There is no capacity for a private PAF to invest in a project in a public ancillary fund. Can you help us to understand some of the differences and explain to us why those sorts of things are in place?

Mr Hardy: Private ancillary funds were previously known as prescribed private funds, but they are now known as private ancillary funds. Broadly they can distribute funds or monies that they have into a deductible gift recipient agency. That is sometimes a preclusion upon where they can divert their resources because if the recipient organisation is not a deductible gift recipient they cannot provide funds to it. The reason is that when a person makes a donation into a private ancillary fund it is a deductible gift recipient organisation and so the donor receives a tax deduction. If it was then allowed to reinvest its funds into some other charitable or socially desirable organisation that was not a gift deductible organisation you would have circumvented the intention that gift to that organisation directly will not be tax deductible, but if you pass them through a PAF you would have received a tax deduction for it. It is just an integrity arrangement. I am presuming with that particular organisation the women's group was not a gift deductible organisation. If someone had a private ancillary fund they could not put money into it. Private ancillary funds receive their money mostly from donations of particularly a small group, a private group, of benefactors, and there would be nothing to stop one of those benefactors providing funds directly to the target organisation if they chose to do that or if they felt it was a desirable organisation and they wanted to support it. But if that target organisation is not a gift deductible organisation they would not receive a tax deduction for doing so. Without knowing the particulars—and I probably could not comment in detail on particulars—that would be my assumption as to the challenge and some of the background as to why PAFs diverts their funds into DGR organisations.

Senator STEPHENS: That is helpful. Just going to the financing issues that we are here to talk about today, this inquiry has emerged out of the recommendations of the Productivity Commission, which is really around the development of the social capital market. We have had some very significant and thoughtful submissions. One from the Department of the Prime Minister and Cabinet quotes the Charities Aid Foundation, which talks about four pillars and four second-order needs critical to developing a social impact investment market. The first is a confident and informed demand from the sector, and the second is efficient matching of supply with demand, as in the development of intermediary services that do not exist in this space. Many of the submissions talk about the intermediaries that exist in Australia. The School for Social Entrepreneurs was just one group. I cannot think of any of the others off the top of my head. There was Foresters. We have several intermediary services. Even Philanthropy Australia, as a peak organisation, and other peak organisations who are acting as intermediaries in this space in the whole regulatory reform agenda for the not-for-profit sector in Australia, are not themselves able to have DGR status. For example, Philanthropy Australia's members are not able to invest in the organisation, because they are philanthropic trusts or funds who cannot invest in their own organisation for capacity building or actually acting as an intermediary to build the space. But everything across the world talks about the importance of intermediaries. Do you think there is a case that we should be thinking about intermediaries being able to get some kind of a DGR recognition or a tax consideration?

Mr Hardy: There are two separate questions in there. Just because an organisation has not qualified to be a deductible gift recipient—a DGR organisation—does not mean that people cannot invest in it, cannot donate to it, cannot pay subscriptions to it or cannot contribute to whatever capacity building initiatives it might have. They will not receive a tax deduction for doing so, but there is no preclusion on an organisation sponsoring or a financial organisation looking at some intermediary and saying, 'I think they do good work and I think I am prepared to invest in them.' Without DGR they will not get tax deduction status, but otherwise there is nothing to stop the investment. There is some confusion that unless you are a DGR you cannot get investment. As an absolute that is probably wrong and should be dispelled. Although I do recognise of course that tax advantages make some investments more attractive than others.

As to whether there is a case for intermediary organisations that cannot presently qualify for DGR status to have them, it is a policy question fundamentally and one perhaps better directed to Treasury or for the government's consideration. There are a number of intermediary organisations outside the not-for-profit sector that successfully pursue their roles and do not have DGR status. I recognise that the nature of the not-for-profit sector is often somewhat different and it would really be a policy deliberation as to whether it is sufficiently different and sufficiently worthy of having some legislative benefit such as DGR status granted to the intermediaries in the sector.

Senator STEPHENS: Just going back to the first part of that answer, the evidence that we have heard has been that PAFs are not able to give to an organisation that does not have DGR status.

Mr Hardy: That is quite correct. A PAF, by the nature of the particular organisation of PAF, has rules about how it can apply its funds. As I explained earlier, a PAF is constrained to direct its funds to a deductible gift recipient because when the benefactor puts their money into the PAF they got a tax deduction for doing so. To have an outcome for the PAF to direct it anywhere it likes would create a tax deduction where none would otherwise have existed. As an integrity measure a PAF can only direct its funds to a DGR. However, the benefactor who puts their money, say, as a private individual, directly into their PAF, if they felt that some particular intermediary organisation was a worthy organisation and they knew they could not direct money through their PAF to it there is nothing to stop that individual investing directly into the intermediary organisation.

Senator STEPHENS: Yes, I understand that point. The growth of PAFs has been quite significant. I think we are up to about 900 now.

Mr Hardy: It is somewhere in that order.

Senator STEPHENS: Has the tax office modelled or predicted how many more might be established and is it encouraging the establishment of PAFs?

Mr Hardy: We have tried to do some estimation of growth both of the numbers of PAFs and of the total resources under control in the PAFs. The global economic crisis has a bit of a dip in terms of the continuity of that time series. Some of the recent amendments to private ancillary funds have caused maybe some pause whilst people reassess how they wish to pursue working with PAFs. The other thing we are noticing is that some of the smaller ones are becoming dormant. It was not particularly evident prior to this last passage of legislation how you would wind up or encourage a fairly dormant PAF to wind up or to merge with some other PAF. We may start to see some of that winding up or merging activity somewhat probably more enabled by the recently passed legislation.

Senator STEPHENS: Is it difficult to wind up a PAF?

Mr Hardy: Technically it is not particularly difficult. Often a key individual has established an organisation to give possibly in their own name, and so there is an awful lot of personal ownership. People are often reluctant to close down something that they started. That is probably one of the psychological reasons why historically there may have been some reluctance to close down PAFs, even when they were a relatively small corpus and seemed to be almost dormant. As perhaps a comparator I cite not just charitable trusts but trusts more generally. A business may establish a trust at some point in time for some particular project. It undertakes the project. The trust becomes redundant for whatever purpose it might have been formed, but they tend to stay within the organisational structures of corporate groups. There are no carrying costs for them. You never know when you might need it again. So, PAFs may be somewhat similar in the mind—they are often very much trusts in terms of their formation—of people in terms of, 'It doesn't usually cost me particularly much to maintain them and you never know when it might be handy to have it again.'

Senator STEPHENS: Can you tell estimate the current resources in PAFs at the moment?

Mr Hardy: I would have to check the last figures, but I think it is probably approaching $2 billion or somewhere in that order.

Senator STEPHENS: Chair, I asked Mr Hardy if he could have a look at the Lifehouse proposal. It is on page 55 of Friday’s papers. We had quite a big discussion on Friday with the representatives of Lifehouse and the Benevolent Society about the issue of social investment bonds and a mechanism for doing that. I know this is a bit outside of your field, but I wondered if you could give us the benefit of your wisdom about how this might work and whether or not the ATO has considered the issue of social impact bonds as we are seeing the pilot roll out in New South Wales. It would be helpful if you could give us your reflections on that.

Mr Hardy: To my knowledge, we have not considered social impact bonds, partly because we largely administer Commonwealth tax concessions. Unless it was a Commonwealth matter that we had to administer, there is plenty of work that we need to do rather than contemplating something that might be too expansive. As I understand the concept of the bonds, just from having had the chance briefly to read this submission, I think the concept of the bond is like any other bond. If it is seen to be a valuable proposition to the investors they will take the investment. From what I understand, the not-for-profit sector and the Productivity Commission report indicated that because the sector is not driven by profit and is perhaps looking for social outcomes as opposed to financial outcomes, conventional financial investment banks or other investors have no way of equating what is a one percentage interest point benefit versus a one percentage social point benefit. I do not think there is any equivalency that people can find or that they are comfortable with except as private individuals making their own choices. With that there is a risk that social bonds might suffer in the same way. If they are primarily looking to be used in a pool of funds to support and capitalise social outcomes, if the financial return is not as attractive as the financial return of some other bond, a purely financially driven investor will probably pursue a higher yielding financial bond. So, other than just scanning this material, I would imagine that same challenge arises for the social bonds.

Perhaps going a little bit beyond this particular submission—and I have not had a chance to read it fully—and drifting a bit into the portfolio of my Treasury colleagues and the announcements around the better targeting of tax concessions paper, to the degree that the outcome of that paper was to be progressed through the legislation and enacted, it would be quite clearly to allow charitable not-for-profit organisations to run a business, and presuming that business would be run on commercial terms largely because the business itself is looking to generate income, it can choose to divert its profits back to its not-for-profit parent or partner agency after meeting the financial expectations of investors, be they debt or equity investors. On a discussion paper that has not passed through, that might provide a linkage mechanism whereby investments into the not-for-profit sector into business activities run as businesses are judged purely on financial terms by investors, and it is the not-for-profit business itself that determines how much of its surpluses it might divert into its social, charitable and not-for-profit activities or how much it might retain to grow its business activities for future diversion into the social or not-for-profit activities. That is quite speculative on material that is really only just discussion papers at the moment.

CHAIR: That also raises issues more generally. If the social capital market in a broader sense is developed in some shape or form, for example, if just a simple social bond—without necessarily government involvement—becomes a feature of the market and there are a lot of people investing in that, with not-for-profits then having to return at least to some extent a commercial return as well as maybe the social return, that means they are working in a way to pay off investors. For a DGR is that going to have any impact on the way the ATO would actually treat them?

Mr Hardy: As I understand the Treasury discussion paper around tax concessions, the business unit that might be established is a business and so it makes business decisions. It will no doubt need to repay debt or dividends to shareholders—however they might have financed themselves. But there is also nothing against that business, which is a business itself and not a DGR, diverting some of its money—

CHAIR: So, the business would be treated with normal taxation status, even if part of the return that it is providing or offering to investors is a social return?

Mr Hardy: That is right. Short of any other particular legislative changes that have a different tact outcome from that decision, just the conventional law at the moment, if the charitable, or the not-for-profit, entity that they were supporting was a gift deductible organisation, any donation of funds to that create a tax deduction for the business in the conventional sense as it happens now. If there was a distribution of franked dividends, say, the business had paid tax but distributes dividends that have tax paid on them, the not-for-profit would claim back the franking credits as is the case now.

CHAIR: What about a situation where you are a not-for-profit and do not have business activities per se that are supporting your activities, but you do go to the market seeking investment on the basis that you will at least be able to pay some commercial return back to them out of your activities—which might be independent living units or whatever it might be—that otherwise, if you relied on grants and philanthropic activity, would have been completely within the DGR? If you are actually going out and trying to actively get more capital into your activity through something like this, would that trigger what you are talking about?

Mr Hardy: In that situation you almost have a commercial activity being run inside a charitable or a not-for-profit organisation.

CHAIR: How is that different from seeking a loan from the bank, which you are then paying back?

Mr Hardy: It is not in fact. If you had an investor that is prepared to say, 'Yes, I think the return I can get from investing directly with you is an acceptable return', with the investor making their own choices, they can do that. We recognise that charities sometimes need to borrow from banks or otherwise secure funds from other parties, and quite properly they need to repay those amounts at normal arm's length rates. The only time that we would be concerned that there was a misuse in a charitable environment was if there appeared to be some manipulation or something that was not market driven in terms of the relationship, and so we might contemplate the business investor maybe was trying to extract the not-for-profit tax concessions out of the charity through the pricing structure. If a charity goes to a bank and says, 'We need to get a loan for this much to do something' and the bank says, 'Yes. Here's the loan and here's the interest rate.'

CHAIR: Similarly, if the charity went to the market and sold bonds, which were purely just investors putting money in and getting a commercial plus a social return—so maybe a discounted commercial return reflecting that they were doing social good as well, that would not necessarily trigger—

Mr Hardy: That is not fundamentally a problem from the tax point of view. I think some of the submissions that you have got say that if the not-for-profit is seen to have less assets or less reliability of income stream the financial return they need to offer is perhaps higher than maybe alternative investment options for the investor and they have trouble offering that higher return, but that is a financial consideration.

Senator STEPHENS: On that point, on Friday we also heard about an investor choosing to invest in this kind of investment, and that where they acknowledge the difference between the commercial return, say nine per cent, and a social investment return of, say six per cent, the investor—for example, a super fund—can actually claim the three per cent difference.

CHAIR: As one option.

Senator STEPHENS: Yes, as one of the options.

Mr Hardy: Does that presently exist in the legislation? Superannuation is not my strong point at all.

Senator STEPHENS: I do not mean to put you on the spot, particularly when I expressed it so badly. We will pursue that.

Mr Hardy: I could clarify the last question. If you had a DGR organisation that was effectively using public donations to the DGR to meet its debt repayments to a bank that may give some pause to donors and to public confidence in the DGR. I am assuming, in that example that we were talking about before, that the DGR organisation had some other mechanism or at least had agreement with the donors that they were going to be utilising donations made in that way. I think it was just a matter of diverting people's donations into perhaps a charitable organisation, which they assume were going to be used for some sort of charitable outcome, and the public was to then discover that they were just being used to service debt, that may cause some disquiet with the donor population.

Senator STEPHENS: Finally, to what extent do you think we need a social capital market?

Mr Hardy: I do not know that it is really my call to make. Perhaps these are more personal observations rather than anything the tax office would have to say. In working with the not-for-profit sector I have quite a deal of empathy for what they are trying to achieve. I see that they are often at the forefront of achieving what you might call good outcomes, which are sometimes beyond their actual particular charitable mission and that creates conflict for them. They are asked to do things which are good but which are not necessarily charitable. I think that some of the initiatives about trying to create explicit commercial or at least semi-commercial vehicles for them to operate without impeding their particular charitable status is probably to their advantage. The downside is if they get so preoccupied with their commercial activities and they forget their social or charitable mission, but I think that is unlikely given the people I encounter in the sector.

I think some elements of this are occurring in the Australian community. If anything, with some maturity—and these things take some time—they may find they are able to attract professional managers and professional business people to run their business operations almost independently of the charitable concerns. It is just that the business operations defer a proportion of their surplus, profits or whatever else to the charitable, not-for-profit arm to pursue its outcomes with some degree of certainty of independent funding. I think there is great potential, but people also need to be realistic that some of these things take some time to reach maturity and to find out what does and does not work.

Senator STEPHENS: Thank you.

CHAIR: Thank you for assisting us today.

CHARLTON, Ms Kylie, Impact Investment Professional

[09:34]

CHAIR: Would you care to make an opening statement?

Ms Charlton: Yes, I would. Thank you for the opportunity to address the committee and to be part of the contribution that this inquiry will make to the development of capital markets in the social economy organisations in Australia—a market that has potential to significantly increase the amount of capital available, and to identify and implement solutions that address social and environmental challenges facing our communities.

As a matter of background, I have actively worked in the area of impact investing since 2004 when I was recruited to establish a capital markets team for a US based non-profit organisation, Unitus, that focuses on building scale of microfinance in the developing world. In 2008 the team was spun out of the non-profit to become Unitus Capital, a private financial advisory firm that raises capital for microfinance institutions and social businesses in India and South-East Asia. Since its launch in 2008, Unitus Capital has advised on capital raisings of more than $600 million. We have a strong relationship with impact investors throughout the world seeking investment in the bottom of the pyramid.

On returning to Australia in 2009 I have divided my time between my role with Unitus Capital and developing the field of impact investing domestically. Currently I serve as the Social Investment Fellow at the Centre for Social Impact and I lead the social finance initiative of Ecotrust Australia. I was a member of the advisory committee for the Social Enterprise Development Investment Fund, SEDIF, as well as consulting to the team at DEEWR on the development of SEDIF. Prior to transitioning to the field of impact investing I spent 11 years working in commercial and investment banking in Sydney and New York. My comments to the committee, however, are made in my personal capacity, and I do not represent or speak on behalf of any of the organisations with which I am affiliated. My colleagues at CSI and Ecotrust have already had the opportunity to address the committee in prior hearings.

The terms of reference set forth by the committee are extremely broad, reflecting in some way nascent state of impact investing in Australia and the fact that there is much to be done to establish a robust market that meets the diverse capital requirements of social economy organisations and actively engages a range of private and institutional investors, a market that requires true cross-sectoral engagement, in order to garner the diverse skills set and expertise necessary to ensure delivery of financial, social and environmental returns. My comments to the committee are arranged across three overarching elements that I consider critical to development of a market for impact investing in Australia. Efficient intermediation is essential to unlock private capital, enabling industry infrastructure is needed to encourage investor engagement and confidence, and the absorptive capacity of social economy organisations must be developed to ensure high-quality deal flow.

A number of recent initiatives of the Australian government, such as SEDIF and the pilot for the community development financial institutions, CDFIs, along with the announcement by the New South Wales government to pilot social benefit bonds, served to commence the process of developing efficient intermediation. These initiatives will help to establish demonstrative funds, develop backable fund managers and create accessible investment product, and are commendable first steps. However, it is likely further similar or complementary initiatives will be needed effectively to address the challenge of intermediation. Well designed enabling infrastructure will serve to catalyse the industry and encourage scale. Necessary infrastructure includes some very practical items, such as common language platform, robust and accepted performance metrics and publicly available benchmarking data. It also extends to conducive policy and regulation that incentivises private sector capital into impact investing.

Tax incentives encouraging investors to put their money into underinvested or disadvantaged communities or sectors are recognised as the principal policy tool available to governments to incentivise investors. The New Markets Tax Credit in the US and the Community Investment Tax Relief in the UK are good examples of tax incentives used internationally to encourage investment in the social economy. The report by the Canadian Social Investment Taskforce released in late 2010 recommends consideration be given to similar incentives and also raised the possibility of tax supported debt instruments analogous to the tax-free municipal bonds in the US.

Beyond tax incentives, policies such as the Community Investment Re-enactment Act, CIRA, and program related investments in the US encourage financial institutions and charitable foundations to undertake investments in underinvested or disadvantaged communities and sectors. In Australia policy that facilitates the engagement of charitable foundations, including PAFs, in impact investing will I believe be important to catalyse the market.

Given the social purpose of foundations and PAFs they are indeed a natural first mover. A loan unlocking, say, 10 per cent of the estimated net assets of PAFs would release an estimated $200 million into the market, which I believe could have a significant catalysing effect. However, true scale is likely to be dependent on the engagement of superannuation funds, which from anecdotal evidence will require a rethink of the application of the sole purpose test or an introduction of a mechanism that effectively levels the financial return for such investors, recognising that the delivery of impact typically carries a cost.

A market no matter how good the intermediation and enabling infrastructure is will not, however, exist without quality deal flow. There is much education needed to develop the absorptive capacity of social economy organisations such that they may present themselves as investment ready. All too often in conversations with organisations it is clear that there is little knowledge and appreciation of the role of investment capital, the different forms of investment capital and the responsibility that comes from taking investment capital into an organisation. Investment capital ultimately needs to be returned to investors, requiring organisations to be confident of their revenue generation and financial sustainability. We are no longer just talking about grants.

Finally, as you have heard in a number of prior submissions throughout the hearings, I would like to conclude my comments by encouraging that consideration be given to the support of the establishment of a forum similar to the Social Investment Taskforce, as was undertaken in the UK in 2000 and more recently in Canada in 2010. In both these jurisdictions the respective taskforces were instrumental in galvanising stakeholders across the private, government and non-profit sectors around a common vision and strategy for the development of the capital markets. While there is an increasing level of conversation in Australia on the topic, it is largely uncoordinated and needs to be structured to ensure that we move forward in a considered manner that truly recognises success is dependent on cross-sectional engagement. Thank you for the opportunity to address the committee and I look forward to our discussion.

CHAIR: Would you be able to table that opening statement? I think you made a lot of good points that would be very good for future reference.

Ms Charlton: If you can read my handwritten notes I am happy to table it.

CHAIR: Thank you. Senator Stephens.

Senator STEPHENS: Thank you for a very succinct and fruitful statement. I would like to ask you about the point you made around the sector’s readiness. What is it that needs to be done in the sector to improve their understanding? You said that we are no longer talking about grants and that there has to be a return to the investors. Perhaps you could elaborate on what you think needs to be done to help that space. We have heard a lot about the intermediary space, but actually about the sector being enabled to deal with this.

Ms Charlton: I think a level of education is needed within the sector. That education needs to come from within the sector itself by recruitment of expertise into the sector. ‘Reticence’ may not be exactly the right word, but there has not necessarily been an open and welcoming approach to what I would call hard financial skill in the sector. Nor has there necessarily been the people with that hard financial skill at scale willing to enter into the sector. There are definitely some incredible people working with the sector with that skill, but I do not think it goes deep enough within the sector. You really need operational staff. You need financial staff who are there with that skill to recognise opportunities and how they are applied in their organisation on a day-to-day basis. There is a level of education within the organisations that can be applied externally from various forums and by having experts talk to the sector, but I ultimately believe that there needs to be a willingness to bring that expertise in house as well.

Senator STEPHENS: Are there any programs to train up CFOs and key staff that would take them to the environment in the not-For-profit space?

Ms Charlton: I have not seen anything specifically here in Australia in that light in terms of looking at new financial instruments. There are initiatives around common financial governance, but this goes beyond financial governance. This is how you use an investment instrument and what is the most appropriate investment instrument for your organisation. I have not seen anything in Australia and it is probably something that needs thinking about in terms of how to develop it. Have I seen stuff internationally? In the work that I have done with Unitus Capital, no. A lot of that is actually done by the intermediaries. People come to those intermediaries. They may not be investment ready, but they have good ideas in terms of social change and strong potential or business models, but it is often the intermediary who then engages and, for the want of a better phrase, cleans it up, makes it investment ready and takes them through that journey to the point where they are ready to actually approach investors.

Senator STEPHENS: Do we have enough intermediaries in Australia?

Ms Charlton: The market at this stage is really nascent. It is small. I think there is a number of intermediaries, such as Foresters or Social Ventures Australia. You may also look at the work that some of the more traditional firms have done in terms of Westpac, National Australia Bank or even JBWere. They are starting to play in this space. Do we need more? Yes. I think you need a broad range. Again, I go back to the point on diverse skill set. Diverse teams are really key as well. I would be the first—and I think I am qualified to say this as a former banker—to say that it is no use getting a whole table of bankers together to define what a social capital market is and how it will operate. It needs to be really diverse team sets that come together to deliver the social and financial outcomes that we want and which investors will have confidence in.

Senator STEPHENS: Can you tell us a little bit about the social impact bond pilot in New South Wales? I understand that you were involved in establishing the framework for that, and particularly the timeframe that is involved and how the impact is being measured?

Ms Charlton: My understanding is that the tender documents for that will come out late this week. This is the timeline being worked. Also, to accompany that, there is a tax paper the Centre for Social Impact has been working on, which will be interesting for the committee once it is made publicly available.

In terms of the timeframe of the bond, the initial discussions with investors and also with social economy organisations that may look to participate in that bond, really looks at a term of anywhere from five to eight years. You would probably need to go the longer term in order to be able to truly measure impact and provide people with confidence of that impact. You need to remember with the social impact bond or social benefit bonds as they are calling them in New South Wales that it is not only the investors that need confidence of the impact but also government, because government is essentially the purchaser of those outcomes through the outcome based agreement they will enter into with the social impact partner or the social benefit partner.

In terms of the measurement and the timeframe for measurement, that will depend a little on how the program is delivered. If we take the example of the Peterborough Social Impact Bond in the UK, which is obviously a live example in the market and probably one of the best ones to refer to because we do not know exactly what timelines we will see with the tenders when they come in from New South Wales, they work basically on a four-year cycle with two years of delivery of services. The first year is a cohort of 500 people and the second year is another cohort of 500. That basically gives 1,000 people within a program or services being delivered, which is then considered statistically valid in terms of the UK experience. The measurement or the outcome they are looking for in that pilot is a reduction in recidivism beyond 12 months. You have to wait at least 12 months to ensure that those prisoners have not returned back to prison. It really is not until the third year that you can start to measure the success of the first cohort and it is not until the third year that you can measure the success of the second cohort. It is actually not until the fourth year that you will have an outcome on which investors can be paid. There is this lag from the time the investors' money went in, in year one, and also successively because that bond facility is drawn down successively as money is needed by the program before the outcome will be measured, investors will have repayment and that the government will have had to have made those outcome payments.

Senator STEPHENS: How much has been issued in social benefit bonds for the Peterborough example?

Ms Charlton: The bond principal is $5 million. The UK government has also announced—I cannot remember when Minister Nick Hurd announced it, but it was only four to six weeks ago—another $40 million that they will be piloting, and obviously the US government has announced $100 million.

Senator STEPHENS: And in New South Wales?

Ms Charlton: The figure is $21 million to be divided between two pilots, of which that has been identified as recidivism and out-of-home care.

Senator STEPHENS: Have you had any input into the Lifehouse discussions around social investment bonds and the Benevolent Society?

Ms Charlton: Not directly. I am aware of those conversations. Just having heard the prior evidence given, I think the comment that you were referring to was actually the discussion with David Ward and Christopher Thorn from Philanthropy Australia at the prior hearing, and maybe not last Friday, because I was reading the evidence. That really relates to the differential between a market rate and a submarket rate and whether or not that would be applicable for the private ancillary funds—so for the PAF to claim back the differential and apply to their distributable amount. Say, a PAF needs to distribute five per cent, could that differential qualify as part of the five per cent? That is really the question. There are current guidelines for PAFs that indicate that would be the case. I think there probably needs to be clarification by the ATO that that will be allowed.

Senator STEPHENS: You would know that we have the superannuation funds association here later, but your second point was about the potential of unleashing the investment capacity of superannuation funds. Would you like to expand on that?

Ms Charlton: As you would be aware, our superannuation funds in Australia operate fundamentally under a sole purpose test, which is orientated towards a financial return for their members. The largest challenge—and I think you have heard through a number of other submissions—is that there is a cost in delivering impact. It is going to be very difficult for organisations to offer a fully commercial return in many instances. I am not saying that that is not going to be achievable, but for the want of a better term, it is somewhat a holy grail in the sector. Therefore, being able to engage superannuation funds that need to be able to measure their investments and benchmark them against something commercially acceptable is probably going to be very difficult under the current rules, the fiduciary duties and responsibilities they operate under. Therefore, there are a number of ways that could be considered to address that. You may look at going to something like a community reinvestment act, which applies to banks in the US. Could you apply it to superannuation funds in Australia? That may be one way. However, having said that, I know the superannuation review which was done last year specifically said in one of its last points that it would not mandate superannuation funds to go into a specific area of investment. My comment about saying a CRA applicable to superannuation funds contradicts the recommendations of the last review, and I am very conscious of that. The alternative would be to look at some form of compensation or incentive that can be offered to offset the differential between the commercial return and the subcommercial return given the social impact which is inherent.

Senator STEPHENS: We heard from Christian Super last Friday about the fact that they are investing in this area. They did not seem very concerned about it. It was quite a modest investment at six per cent.

CHAIR: They also had advice that, provided they advised investors of their intended investment, they were basically in compliance with the sole purpose test.

Ms Charlton: There is also one other point around superannuation funds. If you have gone out to your members and specifically allowed your members to mandate you to invest in this asset class—if we want to frame it that way—you would be allowed to do that. Christian Super obviously incorporates that within their mandate and their value statement with their members.

The other important aspect about the Christian Super fund investment into SEDIF, which is at $6 million, is the role that government money played was really fundamental in being able to allow them to determine that the return they were being offered was acceptable for the risk that was involved. In terms of that bid for SEDIF, the superannuation fund and the involvement of Christian Superannuation Fund was critical on that adjustment of the risk capital as well. The other thing that you should be aware of—and I do not know whether they talked about it on Friday when they were here—is that Christian Super fund has also invested in international microfinance as well.

CHAIR: Yes, they did mention that.

Senator STEPHENS: On the issue of SEDIF, we have $20 million of government funding supporting an additional $20 million. Do you think that $40 million is enough in the market at the current time? Does it provide the impetus for growing this market or is there more to be done?

Ms Charlton: SEDIF addresses one area of the market in terms that it is specifically set aside for social enterprises. If you look at the statements now being made by the two chosen fund managers, being SEFA and Foresters, it will be put out in the market for social enterprises, which are addressing either social, environmental or Indigenous issues. SEDIF will not address issues such as the social impact bonds or the social charitable bonds that other people are talking about. I think it is just one part when we look at social capital markets, but we need to be doing things in other areas as well. The other aspect of SEDIF is that it is obviously targeted at a specific level of social enterprises in terms of their development. There may be a need to look at other forms of support for developing the market around probably younger, earlier stage social enterprises.

Senator STEPHENS: With the Lifehouse and the Benevolent Society projects one goes to an investment in health infrastructure and the other goes to aged accommodation. We had evidence in Melbourne around NRAS. Do you have any knowledge of the NRAS scheme?

Ms Charlton: I would rather not comment on NRAS. My knowledge is rather peripheral, so I do not really feel at liberty to speak about it.

Senator STEPHENS: Thank you.

Senator MARK BISHOP: Thank you for your submission. Apart from the study and the suite of recommendations that came down from the Productivity Commission in more recent times, are there any structural impediments to the development of this market that the government is not addressing or should be addressing within its purview? I do not mean the desirability or lack of to change the sole purpose test and things of that nature, or the willingness or unwillingness of superannuation funds to come into this market in a big way. Are there particular things or actions that the government is able to do that it is not doing that inhibit the further development of this niche market?

Ms Charlton: Tax incentives could be a really valuable part of catalysing the market. I spoke about the Community Investment Tax Relief in the UK and also the New Markets Tax Credit in the US. I think they are things the Australian government could give consideration to, which would structurally encourage investors to engage. There has also been commentary throughout the hearings and submissions around whether we need new legal forms.

CHAIR: Before we go to that second point, there is clearly an opportunity cost to government in doing that. Do you mean something more than a subsidy for a defined or undefined period? Do you mean more than what is an effective subsidy to encourage investors to go into this area for a defined or undefined period when you talk of tax incentives?

Ms Charlton: If I understand your use of 'subsidy' correctly, my comment would be if you look to the UK and the US effectively what they are doing is providing a tax credit for the amount of investment going into disadvantage or underinvested communities. In the US it is 39 per cent and in the UK it is 25 per cent of the investment value. I think that would then qualify as a subsidy, but it is not something that goes beyond the value of the investment or beyond the term of that investment. I am not quite sure I have understood you correctly.

Senator MARK BISHOP: We often hear in inquiries of this nature and others the requirement for a tax incentive of some form to act as a catalyst to the growth of a niche product or market in a particular area. The response from government or executive government, as always, is that that is fine and that is a good idea, but if it is going to cost us $20 million, $50 million or $100 million per annum, you need to identify the social program, the industry program or the taxation program that needs to be offset and then we will seriously look at your good idea. I am not trying to be at all pejorative, but if you come up with a recommendation for a tax incentive or even a more specific one along the lines of the two countries that you have just outlined, the response from the minister will be either, 'That's good, Senator, but there is an opportunity cost' or, 'Show us where we will reduce outlays in other areas' or, 'Are you really requiring us to cut the subsidy that might be provided for social housing or whatever?' That is the ballpark. We need a real recommendation that we can take to government.

Ms Charlton: I understand that anything firm on a tax incentive would need to be framed within the cost to government.

Senator MARK BISHOP: So, your recommendation on the tax incentive comes within that overall constraint that I have identified?

Ms Charlton: Yes.

Senator MARK BISHOP: That is a value judgement for government at the appropriate time. Secondly, in your earlier remarks you referred to lack of skill and lack of education in the depth of people who work in this market. Is that a bit of a chicken and egg situation whereby people are not attracted to work there for a particular time or for a career because it is not sufficiently broad, like the finance market might be, or are there other reasons?

Ms Charlton: I think you are right. New ideas breed opportunity for people and that is what attracts new people into the market. However, I also think that fundamentally in Australia many of our non-profit organisations—and this does not just apply to Australia—really need to consider the compensation being paid to people in the sector as well. I am not talking about creating organisations that are paying completely market and unreasonable salaries to people, but they also need to recognise that they can compete for talent. That sometimes comes back to the willingness of philanthropic funders of organisations to actually accept the cost of staff within organisations as well.

Senator MARK BISHOP: People post university who go into the wider finance market for the first 10 or 15 years of their career, say, from mid-twenties through to 40, put in enormously long hours in this industry and its subsets. There are sometimes high rewards and sometimes not, but that is the trade for people who come to work in this industry—the potential for high reward at some time in exchange for the inordinate hours and contribution they make.

Ms Charlton: That is true if you are looking at young talent, but the other aspect of it is that there are many people who have been in the finance industry professionally for a number of years—I worked in it for 12 years—

who are then willing and able to say, ‘I’ll take that skill set and I will apply it across to social change and to social purpose.’ With most of them, in that case, they are making a philosophical decision to redirect their talent and decide what that level is. The best thing that someone told me is, ‘You need to make sure your staff are not looking over their heads wondering whether they can pay their mortgage or take their children to school.’

Senator MARK BISHOP: On that point, does the wage package and so on that is offered to people who enter into this type of work have to be reasonably similar to that which is available in the wider market, not perhaps as high but within the ballpark?

Ms Charlton: I think it needs to be in the ballpark. If I look at the organisation that I worked for in the US, we largely benchmarked our salaries against the lower quartile of a similar finance field.

Senator MARK BISHOP: We often also hear in inquiries, correspondence and things like that where ideas are exchanged about the need for the superannuation industry to become more heavily involved in providing capital, but of course the superannuation industry has for profit, not-for-profit, retail and a whole range of different components. I have not been aware of great criticism out of the peak bodies of the superannuation industry of the sole purpose test. Is that a correct statement for me to make or do you think there is a widespread desire to get away from that restriction?

Ms Charlton: I have not heard that comment from the superannuation industry themselves. I cannot say that I have had enormous conversations with people within the superannuation industry. I think the issue is whether they know what other opportunities may potentially be available, and in Australia because it is such a nascent market for the social capital markets and there is a lack of product which can be taken to superannuation funds currently that we go back to whether it is a chicken and egg situation; superannuation funds are not asking for flexibility because there is not a product yet being presented. However, people designing product are saying, ‘We’ve got to design it to be able to fit that sole purpose test.’ Again, I go back to my comment that this is a cross-sectoral approach to developing the social capital markets and we really need to look at who needs to be engaged in the conversation to develop and determine how we move forward.

Senator MARK BISHOP: That is a good answer. Thank you.

CHAIR: In view of the time I will not ask any questions myself. Thank you for your time. I think you have a lot of relevant experience and invite you, if you are so inclined, to put in a late submission, because we would certainly be interested in your thoughts as a follow-up on what we have done here today.

NOBLE, Mr Gordon, Director, Government Relations and Strategy, Association of Superannuation Funds of Australia

[10:09]

CHAIR: Welcome, Mr Noble. If you would like to make an opening statement then please do so.

Mr Noble: I am the Director of Government Relations and Strategy with the Association of Superannuation Funds of Australia. Thank you for the invitation to provide the committee with evidence and to answer some questions. I will make a fairly brief, informal opening statement, but I would be very interested in the questioning, obviously after hearing the questions that have come from the evidence of previous witnesses.

ASFA is the peak body for the superannuation sector. As has been mentioned, the industry has a number of sectors, whether it is retail or not-For-profit. ASFA represents all of those. We have amongst our membership the industry super funds, the retail superannuation funds and also provide some support to the self-managed super fund sector and government super funds as well.

I will start with some additional personal background. Prior to coming to ASFA, I also worked for the United Nations Principles for Responsible Investment, and I will talk about why the PRI, as they are referred to, are relevant in terms of the superannuation work in this area. Firstly, I will give you a snapshot background of the debate around investment impacts. The debate about the way in which money can be used for positive purposes goes back to Wesley and the sermon on money. There is a long tradition of ethical investment that goes back particularly in the UK and the US for a couple of hundred years. In Australia the ethical investing side of the industry was always a small side of our industry and there were a number of reasons for that. Principally there were legal opinions that basically said that investors had a fiduciary duty to only invest on financial returns. Over the last five years there has been a lot of work done around this and it reflects the fact that we have a lot of change going on in society, including things like climate change. At a global level there were a number of legal opinions that looked at this, most principally the Freshfields opinion, which basically examined whether pension funds as we call them globally, or superannuation funds as we call them in Australia, were able to look at issues outside of their financial interests. The legal opinion coming forward was—and I am paraphrasing this—that it was a duty that pension funds and superannuation funds could do to effectively consider a range of other issues, say, things like climate change that are predicted to impact on investment portfolios. The more recent debate has been that it would almost be a dereliction of your duty as a trustee if you did not consider what these long-term issues might be.

The debate five years ago led to the establishment of the United Nations Principles for Responsible Investment, and a number of Australian funds were involved in the process of actually negotiating those principles. Just to summarise what those principles are, superannuation funds, pension funds and investment managers would commit to integrating environment, social and governance issues into their investment processes and becoming active owners of their investments. In the Australian market, the PRI, as it is referred to, has become quite significant, whether it is the retail sector, industry super funds or government funds. We have had strong support in terms of those organisations becoming signatories to the PRI. In fact, it would be estimated that more than half of our funds under management would have been committed to these principles.

Within the PRI community there is a debate going on around impact investment and what this may mean. There is a whole debate around the bottom of the pyramid in developing countries, say with clean energy and how you can make infrastructure, and of course the social side, which is obviously a particular focus of this inquiry.

I would like to come to a few challenges that we see in this area and hopefully that might lead into some questions. I will summarise the issues that we have from a industry perspective. Principles Responsible Investment would indicate that there is a strong support within the superannuation sector to understand that there is a social outcome of what the investment process is. There has been a lot of work done around how you may integrate environment, social and governance factors into your investment processes, and the engagement that would take place, whether that is in the equities part of your portfolio or other parts of your portfolio.

In terms of our superannuation sector, we have some areas where impact investments are moving forward at a greater rate of knots. Globally microfinance has become an asset class. We have at least one super fund, Christian Super, investing in that. One of the reasons something like that would become an asset class that is supported and invested in globally is to understand that there is a range of factors as to why a super fund would invest. Returns and fees are not just the issue. A key thing is to understand the way a portfolio is constructed, and in particular the essential principle around building an investment portfolio is diversification. In the context of microfinance, the benefit of something like microfinance is that within a fixed interest portfolio it can actually diversify that portfolio. This is all about correlation in our language. What that means is that the performance of a microfinance investment may have a different attribute and a different profile in the way it performs than other fixed interest investments. In simple terms that might mean that when one goes down another one goes up and, therefore, overall your portfolio is strengthened. Risk and return are fundamental, but it is important to understand that diversification is a way that superannuation funds invest.

As you would be aware, we have been going through a lengthy review of the superannuation sector and we have just had the announcement of stronger super legislation that will be coming through the parliament in the next months. This will effectively provide increased regulation over the fees and charges of superannuation funds. It is important to understand that super funds operate in a competitive environment so that the returns a super fund achieve are effectively benchmarked against other superannuation funds. If a fund was to underperform, that is an issue that not just attracts competitive pressure in terms of consumers but also government attention.

There has been a range of debate around the role that superannuation can play to address a number of social issues. I will list just a few. More recently there has been a whole discussion going on around the superannuation investment in infrastructure. Superannuation funds are large and significant investors in infrastructure and there is a significant role of government in that. The federal government is establishing a Clean Energy Finance Corporation and there is a discussion as to how superannuation funds might invest in clean energy investments, which super funds already do. There have been debates around superannuation funds and how they might support the wholesale funding issues of banks. There have been discussions as to whether superannuation funds could address housing affordability issues. Superannuation funds can and do do a lot of things that can contribute and have social impacts, but we cannot do it all. It is important to moderate what the expectations are in terms of potential for change and also to have an understanding as to how long things may take in order to build the confidence of investors.

There have obviously been proposals around a capital market for the social economy. From an institutional investment perspective, the sorts of issues that I suspect would be important come to the confidence of a market in general. If we look at our investment, say, in equities in markets, we have an expectation of the governance of those markets and the regulation around those markets, and so the creation of tax incentives may provide some assistance, but it really is critical that in any market there is actually the governance and the regulation. What that means is that investors need to have a confidence that what is said is actually done. That is what we expect of the companies that we invest in and we hold them to account through our active engagement in that.

There are a lot of examples of markets created globally. I particularly think of less developed countries where market structures can be created. Institutional investors do not come to those markets principally because there are governance concerns in those countries. I think a critical element in creating a market, if it is to have support from institutional investments, is the question around what is the disclosure, and building the confidence of the investors.

We start here with a lack of knowledge. I think it is fair to say that there has not been a strong degree of engagement with the superannuation sector around these issues. The superannuation industry has shown that they have an interest in these broader issues, and I would suggest that there would be an appetite for engagement, but we start from a perspective in the industry that there has not been to this date a great deal of engagement with our sector.

Senator STEPHENS: Thank you for your opening statement. I think your messages are quite salutary. How do we develop a market in Australia? As you said, there are a lot of factors to consider and you have made the point that the market needs to be shaped and regulated. We had Mr Saunders from the Triodos Bank tell the committee that he expects between two to four per cent of superannuation funds investments will be made into the social investment area within the next decade. Triodos is one of the partners in one of the SEDIF funds, and so they have come into the Australian market in a way that is interesting. You warned about the overexpectation of super funds, but do you think that there is potential for superannuation funds to invest in these areas?

Mr Noble: Certainly. If I look at the global debate, Australian investors are tuned in to what is happening globally. In fact, Mr Saunders, as a New Zealander, is on the PRI board and we have an engagement with him around some of these issues. Investors are grappling with how to do these things and what investments make sense. Not all investments will make sense. A key thing to understand is the transaction cost for a super fund. A super fund has to do its own due diligence about the particular investment and decide that it actually makes sense. One of the things that makes sense from a super fund’s perspective is economies of scale. If you are going to do a whole lot of work to make sure that the investment makes sense, then in the end it makes sense to put a lot more money than, say, $5 million. You could put $200 million into the same investment, because you carry that due diligence across the whole investment.

I think the question is: in what areas? Microfinance has been a good example where there has been a maturing of that sector. Microfinance is many decades old. It takes time to have that support, but certainly pension funds in Europe are strong investors in microfinance. I would agree with Mr Saunders that the potential is there, but how you get from potential to reality involves quite a few steps.

Senator STEPHENS: Is this something that your association is actively doing research on?

Mr Noble: That probably rests with me at the moment. I have a certain level of knowledge base. It is fair to say that we are challenged resource wise with a number of other things that are happening in terms of the restructuring of the industry. It is an area that we have an interest in, but we are a small industry association that has many challenges at the moment.

Senator STEPHENS: Several submitters have made the point that for wholesale investors to get involved there needs to be a track record developed of successful deals and a solid pipeline of investment opportunities with an accurate forecast of financial returns. That is a challenge in the current economic environment. It would be helpful if you could assist the committee with understanding what type of financial returns and risk profile wholesale investors would require to invest in these kinds of products.

Mr Noble: If you think about a superannuation fund as a pie, that pie is split up into different assets on the basis that those assets build overall into a diversified portfolio. You have a equities component, a property component, sometimes an infrastructure component and a fixed interest component. The issue as to where the investment goes depends on what pie we are going to put it in. For instance, you can do investments in the property side that have a social element. You can do investments in the fixed interest side of your portfolio that have social impacts. Even in the equity side, whether that is private equity or in the equity markets, you can have investments that contribute socially and environmentally as well. The question is where the focus is in terms of these different options.

There are different return expectations in different parts of the portfolio. In the fixed interest part of the portfolio you have an expectation of low volatile investments, steady returns—government bonds, corporate bonds and those kinds of things. That is the part of the portfolio where microfinance sits. It is the part where you are able to diversify your portfolio and there are expectations of lower returns. With infrastructure, depending on the infrastructure you can have higher rates of returns. It all depends on what risk you expect the investors to bear. When investors are bearing things like construction risk they expect to be compensated for that risk, otherwise they will not take that risk. That is the question.

It is a $1.3 trillion pot overall, which continues to grow due to compulsory superannuation funds and voluntary contributions. In each one of those subpots, if you like, there are areas for investment. The question has not been that there is a shortage of capital in Australia, it is how you construct your investments. Long-term investments are critical for the industry.

Senator MARK BISHOP: There are four issues that I would like to raise with you. Firstly, I should probably declare an interest here. I am both a long-term member and former director of an industry superannuation fund, and so I come from that particular perspective.

Firstly, in terms of the sole purpose test, I am not aware of any great criticism by the disparate elements within the superannuation fund industry of the application of the sole purpose test. Indeed, my own experience from when I was around the game was that people were comfortable with it. I have not heard any criticism since from either industry funds, retail funds or for-profit organisations. I say that because often in committees we receive advice that there is such a multitrillion-dollar pool of money around that some of it should be mandated for worthwhile social causes. Can you update the committee on whether there is an across-the-board attitude in that context to the application of the sole purpose test?

Mr Noble: I agree that there is universal support for the sole purpose test, and there certainly has not been any support for mandating the asset allocation of superannuation funds in any shape. I think there would be some concern about mandating asset allocation and that it would in fact conflict with the duty of a trustee to determine the overall strategy of the investment portfolio.

Senator MARK BISHOP: Going down the same path, you mentioned really just in passing the utility of the microfinance industry, in terms of fixed interest returns, subparts of an overall portfolio. That is really an argument about products that goes to the discussion that I had with Ms Charlton about where some of the shortcomings might be. Is there sufficient new product around social movements being offered to significant organisations like yourselves so that they can avail themselves of new and innovative products that might be designed to have one, two or three per cent less return because of a greater good argument? Is there sufficient coming on board?

Mr Noble: There seems to be a consistent number of innovative ideas that come to the market. The challenge when an innovative idea comes to the superannuation sector is around the capacity of that superannuation fund to understand what that idea is. My view would be that when you have 10 different ideas coming to a superannuation fund, all having different risk and return characteristics, it is very difficult for a superannuation fund to work out whether that is in fact a good investment and to look through to see where the risks are, given that the superannuation fund probably does not have the expertise around the particular social impact that the investment is trying to address.

Senator MARK BISHOP: For those who articulate that particular cause are there two or three identifiable shortcomings, for want of a better description, in their approach to the funds that you deal with that we can identify and perhaps make some recommendations to overcome?

Mr Noble: It is a case-by-case situation. From the super fund perspective, the financial return and the risk and return aspect is the predominant one, with the impacts being secondary. If a product comes to the market promoting the impacts first and not addressing the financial side to the extent that we expect, it will struggle in the market. From a due diligence perspective, the expectation is that you need to be able to tick the boxes on all the risk and return, the financial side. It is not just about the projection of what the return would be. It would be the governance around the investment and those types of issues.

Senator MARK BISHOP: So, this has to be identified, costed, priced and solved upfront?

Mr Noble: It does.

Senator MARK BISHOP: If you are requesting investment that has a degree of social purpose attached to it and it is going to a bunch of financiers at the investment committee level, those issues need to be clearly sold and explained upfront?

Mr Noble: Yes.

Senator MARK BISHOP: Going to my third point, you would have seen as I have the recent spate of ads on the TV by industry funds stating that less fees gives higher return over time. That is essentially an argument about competition based around price for the market share, and it is at the root of the same thing that Minister Shorten is about with his forthcoming legislation about price, getting a higher long-term return. That tells me, in terms of that market where people are going to put their retirement monies—either into an industry fund, a company fund, for profit fund, a retail fund or whatever it might be—this issue of long-term return and price, if it is the central feature upon which funds sell themselves to the market, it is not just a matter of predominant interest, the cost and the long-term return are critical and just cannot be wished away.

Mr Noble: Absolutely. The challenge for an investment that may have a payoff in four or five years time, particularly if it is a new and innovative investment where there is uncertainty around that, presents difficulties for superannuation funds that have to be focused on the annual returns achieved. We have a big debate in our industry about longer term investments and how we can effectively ensure that the superannuation sector, which has been set up for the longer term purpose of retirement, has that. We are conscious of the short termism in equity markets trading and so on. If you look at some of the investments, for instance the industry super funds, in properties and infrastructure investments that they hold for many decades, there is good evidence—the retail funds do this, too, in terms of their investments in infrastructure and property—that the industry is a long-term investor. It is not perfect and we have issues in terms of the short termism in markets, but these are the challenges that we deal with. Certainly the key one is that we operate in a competitive environment and there is a justifiable focus on cost within the industry. We are doing a lot of work right across the industry to ensure that we improve the efficiency of the superannuation sector to deliver on our prime purpose, which is retirement incomes for Australians.

Senator MARK BISHOP: I have one final question arising out of some of the comments that you made. I was lobbied heavily by property developers in Western Australia on the issue of funds for NRAS, social housing. At one stage I was extensively briefed on the delays in taxation, finance and also superannuation in getting together appropriate legislation and regulation that facilitated the government's identified purpose to have 50,000 or 100,000 social housing units. You made some comments that there was an appetite for engagement with government. I presume you meant on the part of your organisation on behalf of members?

Mr Noble: Yes.

Senator MARK BISHOP: Can you identify for us the shortcomings in terms of current levels of engagement? Secondly, does there need to be some sort of permanent liaison unit established both at your level and government level to give effect to reasonably quick identification of issues that require legislative or regulatory solution when they are an impediment to progress and, thirdly, if not some form of interchange via establishing subunits, what would be an appropriate mechanism to achieve that end when government says that it wants to have 100,000 or 150,000 social housing units built in the next three years, but two years and nine months from that three years we still do not have the regulations such that it is attractive to your members? Can you address those concerns for us?

Mr Noble: Yes. An opinion that we have expressed in other forums is that when there is a desire to have superannuation involved in an issue, then the superannuation sector needs to be at the table. We have said this around the issue of infrastructure, and there is an active dialogue going on around infrastructure investment at the moment.

Senator MARK BISHOP: Is that through Infrastructure Australia?

Mr Noble: Yes, through Infrastructure Australia. They have established an infrastructure finance working group, which is bringing the superannuation sector together with other experts, including different government departments—Treasury and the department of transport and logistics. We need those sorts of dialogues. When we operate in our silos making an assumption about what superannuation may do—and this was the early issue with infrastructure, that we could invest trillions; we cannot—we need to have an informed debate that involves us transferring knowledge as to the way we invest, which means that we need to be active in our dialogue with government. We need government to be active and having a dialogue with us to understand what the constraints are in reality. I am not sure how do you do this and what kind of mechanism to use, whether it is a committee, a forum and so on. I am not sure, but I am certain that what is needed is continued engagement around these issues that gets into a lot of the technical detail.

If we understand that super funds have a commitment around these environment and social governance issues, and then we have an objective around something like impact investment, how do we then get from here to there? How do we get any investment in this area? We will not get anywhere without an engagement and I think how you have that engagement is key.

The challenge for us as an industry is that we are resource constrained in a sense. A good example would be infrastructure investment. Investment super funds cannot spend all their time and resources on putting a tender in for a deal, because our costs have to go back to the investor and the member. We have to report back. We cannot just spend money if the money does not lead to a return. The developmental work is a challenge for individual super funds because of that resource constraint. I think it sits with the industry associations. How we do it I do not know, but I think there is a need to do this across not just these impact investments, but infrastructure, clean technology and other areas where superannuation funds might contribute to society and the environment.

Senator MARK BISHOP: What I am hearing you say is that if government identifies a particular social purpose or other purpose that is going to require heavy investments by superannuation funds, firstly, you need to be consulted upfront; secondly, there needs to be ongoing dialogue; thirdly, government needs to understand that there is huge cost on the developmental side of products that may or may not be suitable for your members to invest in. Fourthly, that requires ongoing education both ways, in Treasury, Finance, the relevant line departments and you and your members who may want to go in. That developmental work is important.

I was struck by two things when I was lobbied extensively by the property developers. One was the lack of knowledge of the market by Treasury and Finance and the second was the number of ring backed folders they brought into my office. I thought to myself that someone had spent a small fortune doing this sort of heavy technical work, which government officials did not understand. How critical is that cost associated to the developmental work when you are essentially putting together a new product that government wants you to fund?

Mr Noble: It is critical. It is cost and time. Even if we get the right framework through work that was done, we then need to have a dialogue with what is a very extensive industry with many participants. You need to build the knowledge base around the trustees of a superannuation fund, investment managers and all of the people who will need to make the decisions around that. The challenge at the moment is that there will not be a knowledge base. You have to do the work, but you then need to work out how you are going to take that through to build the knowledge to give the investors the confidence to make decisions.

Senator MARK BISHOP: And give the Treasury and Finance officials the knowledge that they can make recommendations as opposed to putting up roadblocks all the time.

Mr Noble: Yes.

Senator MARK BISHOP: Thank you.

CHAIR: With the nature of the superannuation industry, with $1.3 trillion and growing, everybody eyes it as a fantastic source of funds for all sorts of things. About 10 months ago when we were conducting an inquiry into banking competition we had issues raised that if we get super funds to invest in the smaller financial institutions that would solve all the world's problems. It has been set up for a purpose and that purpose is to provide retirement income for members right across-the-board. Ultimately that purpose has to be balanced against the potential social and economic good it can do in other ways. I think you would probably not disagree with that.

Mr Noble: I think that is right, and to acknowledge the work that superannuation funds are doing to understand a range of difficult risks—environment, social, governance risks—and the engagement around those. Impact can be achieved in different ways. It can be achieved through the social economy, but it can also be achieved through the companies that we invest in. There is a lot of engagement that our super funds do around the practices of companies.

I will finish with an area that there has not been a focus on. A lot of the companies that we invest in will contribute one per cent of their pre-tax profits into a philanthropic fund. A good example of that would be BHP Billiton. That is approximately $200 million each year that they make a contribution on. That is an area of capital where I would encourage engagement with the corporate sector, that is, the money it puts into the philanthropic community. That area of fund may be able to do a lot of the developmental work around some of these innovative ideas that come forward.

CHAIR: Thank you for your assistance.

FITZGERALD, Mr Robert, Commissioner, Productivity Commission

[10:46]

CHAIR: Good morning, Mr Fitzgerald. Thank you for making yourself available to assist us this morning. Would you care to make an opening statement?

Mr Fitzgerald: Firstly, the commission welcomes the opportunity to make a presentation and, more importantly, to be able to answer questions that you might have. We are aware that this comes at the conclusion of the committee receiving submissions and holding hearings, so I am sure you have more questions than I have comments.

Secondly, you would be aware that the Productivity Commission's report went to government in January of 2010. We want to acknowledge the significant work that has been done since that report went to government. You would be aware of the establishment of the Office for the Not-for-Profit Sector within the Department of Prime Minister and Cabinet, the development of the Reform Council, the establishment of the implementation taskforce for the new regulator of the Australian Charities and Not For Profit Commission, and also the extensive work being undertaken by Treasury, the Department of Finance and Deregulation and Prime Minister and Cabinet in relation to a number of the recommendations from the commission. We are very mindful of that and acknowledge the work that is being done.

As you are aware, our report was substantially done in 2009 and the commission has not done further work on these issues. As a consequence, the comments that I can give you today are based on the work at that time, but we are aware that there has been considerable work undertaken both within government and the sector around some of these issues.

Fourthly, you are aware that in the report we made a number of recommendations that go to the funding and finance of the not-for-profit sector, not only in relation to capital and debt financing but also in relation to philanthropy generally, and some of those are important to reiterate. We made recommendations, for example, that over time organisations that are deemed to be a charity should in fact receive automatic DGR status. That is a matter that has some considerable implications for the financial bottom line but we believe would increase the philanthropic contribution to the sector. We also made recommendations in relation to enhancing payroll giving, both within governments and more generally. We also made recommendations in relation to social innovation funding and acknowledge that some government agencies, in particular DEEWR, have established some social innovation funding arrangements, in that case to the tune of $40 million. We raised the issues that are central to your committee's concerns, and that is in relation to debt financing and capital raising for the not-for-profit sector.

By now you are well aware of the issues in relation to the sector and why that is a central concern. I will just reiterate why we made some recommendations around this issue. Clearly the lack of access to capital and debt financing affects a number of organisations in the sector more than others, because of the different risk profiles that organisations have, but more importantly the collateral that they can provide. There are issues around lack of collateral to guarantee loans, lack of reliable revenue streams to service debt, large transaction costs relative to the amount of capital required, lack of experience by non-profit operators, and lack of suitable organisational structures are part of that.

Our recommendations acknowledge that some organisations in the not-for-profit sector are able to access capital and debt financing relatively well, but others struggle. The recommendations that you no doubt want to talk through today really go to addressing those issues, but there is a fundamental theme to our recommendations, and that is that wherever possible the market should be able to be developed to provide some of these financial inputs. We have not taken an approach where the government should be the principal funder of the sector. We have certainly been very clear that the sector must be the controller of its own destiny and, thirdly, that wherever possible emerging market responses should be encouraged, but in so doing we recognise that there may be a role for government.

Lastly, we were not prescriptive about a number of these measures because we were not sure, and where we are not sure then we do not pretend to be. We were certain that this was an area that required much greater exploration. Hence we recommended to the government the establishment of an advisory panel chaired by Treasury to explore some of these issues more fully. Of course your own committee's terms of reference would give weight to that. I will leave it there and open it up for questions, comments and thoughts. I am happy to discuss those issues with you.

Senator STEPHENS: Thank you for your opening statement and reminding us of why we are here. One of the recommendations was about developing a social capital market and so here we are trying to figure out how to do that. Your last point was about the recommendation of an advisory panel, which you recommend to be chaired by Treasury. The committee has heard evidence about the UK Social Investment Task Force and its work over a decade, which has made significant progress and recommendations, but in a different economic time, and secondly the Canadian Task Force on Social Finance. Given that we have the advantage of that work, is that the role that you perceive an advisory panel here in Australia could play?

Mr Fitzgerald: Yes, you are quite right. Work has been done, particularly in North America and Britain, in relation to this area and we would imagine one would want to draw from those experiences. Secondly, we believe that Treasury and Finance, but in particular Treasury, has a central role to play in this particular discussion, and so it seemed logical at the time that Treasury would be the group to chair the panel. We were not prescriptive as to the nature of that panel and they could in fact reflect the various approaches that you have referred to. We were concerned that this was a matter that required government, at the heart of the considerations, largely because many of the recommendations that people put forward had substantial hits to the bottom line and required fairly careful consideration in terms of tax arrangements. When we looked at it, we simply wanted to say that this was a matter that needed government and sector consideration. We believe in the centrality of Treasury in those considerations, but we were not prescriptive about the actual model that could be used.

Senator STEPHENS: You said that the Productivity Commission has not revisited this issue per se, but with the work that you have done in terms of aged care and the national disability scheme, do those significant pieces of work highlight the importance of getting on and doing work in this sector?

Mr Fitzgerald: The commission has been privileged to have done a number of inquiries in recent times in areas where the not-for-profit sector are very significant providers. I was a commissioner on the aged care inquiry and, as you have rightly said, the commission has recently released the National Disability Insurance Scheme inquiry. Both of those highlight what was already in the not-for-profit report. The first is that the not-for-profit sector is now, in many parts of the human service area, in an open market competing directly with for-profit operators, both in the aged care area and the disability sector to a lesser degree, in early childhood development and in health—all areas where the not-for-profit sector is significant, all of which are open to for-profit competition and market pressures. Should the government accept the recommendations in the aged care report and the National Disability Insurance Scheme, that will continue and in fact increase because those arrangements place the choice and control with the consumer. The entitlement to services will be with the consumer and, therefore, the budget holding and they will be able to take those to approved providers, who may be for-profit, not-for-profit or indeed government operators.

Secondly, one of the reasons why some not-for-profits will struggle in that marketplace is that they will have insufficient capital or insufficient access to debt finance to be able to develop and maintain their infrastructure relative to for-profit operators that can obtain that more readily and particularly those that are publicly listed companies. You would be aware in the aged care area in particular there are very substantial for-profit operators, both nationally and internationally, so this issue will be critical going forward. As I said, this is now across most of the human service areas. In fact, there are almost no human service areas that are carved out exclusively for the not-for-profit sector. All of them are competitive, with some having more attraction to the private market than others. The issues identified in those reports replicated and strengthened the needs of the recommendations that we put in the not-for-profit report.

Senator STEPHENS: That report went to the importance of CDFIs in intermediary organisations. We have had quite a lot of evidence throughout this inquiry about the work of intermediaries being very difficult to finance. It is not just CDFIs, but also other advisory services that are about building capability within the sector. In the UK the government has provided ongoing support. Can you explain to us why your report took the view that any support for the CDFI sector should only be for a limited time?

Mr Fitzgerald: Yes, I can. The CDFIs are an emerging and exceptionally important financing source for the sector. We believe the government should encourage their growth and development. We believe that the work done so far in Australia but also overseas gives us confidence that this particular area, CDFIs, can be a very significant contributor to the financing of the sector. There are a number of ways to approach that in terms of government support. The view of the commission, as I indicated, was that wherever the market is responding then the role of government is not to overly intervene in that. We identified that CDFIs could be provided with access to capital by the government in their establishment or developmental phases, but that would be a short-term arrangement. In other words, we did not see government as an ongoing or permanent pool of funding for the CDFIs. You can do that. Both in North America and in Britain we have seen various models. The difficulty is one of principle and risk to the government. To what extent should in fact the government be a funder of these CDFIs? What are the risk inherent in that? Are there issues around moral hazards and so on? Our view was to say the government should be supportive. One of those could be short-term funding, particularly in the development phase. We were less convinced that long-term funding of the CDFIs was appropriate. Nevertheless, other countries have done so and, as I have indicated to you, there may be evidence that warrants a rethinking of that particular issue, but that was our view at the time.

Senator STEPHENS: Do you have a comment about other intermediary services? We heard this morning from the tax office that PAFs, the private ancillary funds, now hold around $2 billion and yet we have heard consistently through the hearings that there does not seem to be much capability of PAFs to understand how they can engage in the market or how they can be leveraged. Is there a role for government in supporting the building of that knowledge base?

Mr Fitzgerald: One of the recommendations that we made in this report was to encourage governments to be actively supporting what we might call this intermediary layer—professional support and business planning for the sector itself. Again, we were not prescriptive, but we certainly think there is a role in developing this intermediary layer, both advice and support for the sector.

I will make a couple of comments about the funds more generally. The public and private ancillary funds are a hugely important source of finance for the sector, and anything at all that can happen to encourage them to be a more effective provider of financing should be encouraged. The issue that they have often raised is whether they should be compelled to provide a certain amount of money, which is a contentious issue that they have been engaged in with the government for some time. One of the things that is of interest is that clearly the vehicle has become an attractive vehicle for high-wealth individuals, and we believe that, whilst at the present time the distributions from those funds are modest relative to their total capital, that will increase.

The second thing that we recommended was that there needed to be an examination of the use of the corpus, the principal amounts that are held within foundations and trusts more generally. The PAFs can in fact make loans on non-commercial rates already, but there are issues around fiduciary duties in other trusts and foundations. One of the things that we are very clear about is that even a small releasing of the corpus by way of loans to non-profit organisations at favourable terms and conditions would have a significant impact. We believe there needs to be serious consideration of amendments to the fiduciary duties that would allow philanthropic foundations and trusts, more generally, to be able to lend at favourable terms a portion of the corpus. In the report we said that even if only five per cent were made available this would be significant, without in any way posing a risk to those particular funds. We see that as hugely important.

I can just round that out with superannuation funds. I heard some of the presentation of the industry previously. One of the significant issues that people fail to understand is that currently members of funds are able to in fact invest in products that provide less than a commercial return through a superannuation fund. The issue here is the choices with the member, but of course the fund has to actually provide the product. So, whilst there is debate about whether or not superannuation funds should be required to invest any portion of their activities in social purpose investments, what is clear is that there should be a much greater activity on the part of superannuation funds in finding products, including in the non-profit space, and offering that to members who may choose to invest part of their superannuation funds in that product. That is an attractive way. Again, it does not in any way conflict with the fiduciary duties of the trustees, because the decision is with the members. The members are currently able to choose a whole range of investments from very high risk to very low risk. We think that avenue is also available. With a freeing up of some of the corpus in trusts more generally, with a new product mix in superannuation funds, you start to get potential sources from a number of different areas without in any way conflicting trustees of these sorts of instruments.

Senator STEPHENS: Chair, I have questions about the commission, but others may have questions on this.

CHAIR: Do you have more questions in this area?

Senator STEPHENS: About the financing issues.

Senator MARK BISHOP: I have questions on financing issues. Welcome, Mr Fitzgerald. We heard some evidence from ASFA just prior to your coming where they identified a number of issues: firstly, product development cost; secondly, developmental cost; and, thirdly, early engagement/interaction with government. They were in the context where if government identifies a particular social purpose that might require significant funding from the superannuation industry those three issues need to be addressed. The discussion we had was in the context of the social housing argument. It does not matter; it is the principle that I am talking about. The three matters they identified were high-cost developmental work, interaction with Treasury, Finance and government agencies at inception, and product development cost. They made some very strong comments. Do you share those comments or do you have a different view?

Mr Fitzgerald: I did not hear all of their comments. Establishing a particular product and who bears the cost of those are relevant issues. My view is that you make an assessment based on the nature of the product itself. There are some products that it would be in the interest of government to have developed and, therefore, they would bear the greater proportion of the costs of the establishment of that product and offer it into a superannuation fund. For example, social housing may well be one of those. There are other products where it may be in the interest of the members of the superannuation fund to be given the opportunity to invest and therefore the costs of that product development would remain with the superannuation fund. There is probably quite a substantial number of those if they chose to look. Then there are those where it might be in the interests of the not-for-profit organisation to actually spend money on establishing the product and offer that into the particular fund.

The answer, like always, is that it is about recognising the costs, but it is then about asking who bears the particular costs. That is a decision that you have to make on a case-by-case basis. It is relative to the public interest. So, where there is a very high public interest, the government would be expected to pay a higher percentage of those costs. Where there is a private interest that includes the desirability of somebody being able to put money into an ethically sound investment, one which they feel is appropriate, the costs are probably borne elsewhere. Nevertheless, they are correct.

Putting that on the table in relation to non-profits, one of the things that we did hear from the superannuation industry was that they were quite prepared to promote to their members these particular products, but they just were not available, and that raises your question. On the other hand, the not-for-profits are not investing in developing these products and offering them to the superannuation, so perhaps there needs to be a much greater discussion between the superannuation industry and the not-for-profit sector about how these products can be developed and offered to the superannuation fund and to their members. That is a longwinded way of saying that they are important issues, but who bears the cost is a case-by-case matter.

Senator MARK BISHOP: So, what I have heard you say is that it sounds like they have some merit, but it needs further work?

Mr Fitzgerald: They have great merit. The superannuation industry needs to step up to the plate. If we are not going to go down the route of requiring superannuation funds to invest a set percentage in social investments—and I think there are strong arguments why we do not require that—there are in fact other things they can do. The finding of appropriate products, social purpose products, which can be offered to their members at slightly less favourable rates than other investments needs a great deal of work done.

Senator MARK BISHOP: We are hearing different approaches to solving this issue of appropriate products for social investment. Who is best charged with doing that type of work?

Mr Fitzgerald: We saw that the first step in that was this advisory panel by Treasury, which would bring together the various parties and then, having identified the opportunities, work out a pathway by which you could actually turn the opportunities into reality. I suppose that is the only place we can start. This is why government is so essential. It can bring the relevant parties together, identify the appropriate opportunities and then work out those implementation pathways. I cannot give you advice as to how that will happen. The fact that it has not happened today indicates that simply leaving the superannuation industry and the not-for-profit sector there is not delivery.

Senator MARK BISHOP: That is right.

Mr Fitzgerald: I believe the government has a role. But having said that, you would have been aware that groups like Social Ventures Australia and a number of other organisations are much more active in this financing space, including the development of so-called social bonds. The not-for-profit sector has not been completely dormant in this area, but if you really want to get movement my suggestion is that a proposal that involves at least the Commonwealth government is the first step.

Senator MARK BISHOP: I think you are probably right on that. I have just been struck even at this late stage by how far apart the sets of parties are on this issue. No-one is bringing them together, sticking them in a room and forcing them to talk. They all identify somewhat similar outcomes that they desire. We need to give some thought to that. When one reads the terms of reference here, they are about social capital organisations, social business organisations and social business products, and a lot of discussion has been about the interests of those types of organisations however defined. It reminds me of a lot of the debate in the eighties and nineties about the interests of producer organisations, and how producer organisations capture movements for their own interests. I am often struck by the interests of large building companies, property developers and the like—Grocon in Melbourne and similar companies in other states, which are huge and always have projects willing to go—and their inability for a range of reasons to translate their desire for work to the social purpose that the government might identify, particularly in the housing sector, the aged care area and those sorts of areas. They say that they simply do not have the time or that the cost is too much to have heavy engagement with government when government identifies social purpose; or if the cost is not too high, often the time involved from beginning to end in dealing with government agencies in Canberra is too prohibitive. They almost say, but do not say, that it is like having to go to Germany and speak Italian; it just cannot be done. Do you think those sorts of complaints or criticisms, being private or public companies for profit, in terms of trying to get into projects that the government identifies as having high priority social purpose, are legitimate criticisms or are they just the bitching of people who cannot get in the door?

Mr Fitzgerald: Government is not easy to deal with generally, and that should never be underestimated, but many in private business replicate the difficulties of government itself; they internalise the cost. Going forward, if we look at things like social housing, it is absolutely clear that the involvement of the private sector, the non-profit sector and the government are essential. Those three players are critical if we are going to move forward in relation to substantial social housing initiatives. We looked at a case study in the not-for-profit report on social housing, not necessarily on that but picking up a whole range of issues. It is in one of the appendices in the draft report. The point that we make here is that, to the extent that it is difficult to deal with government or cost may be an issue, nevertheless the coming together of those three parts of the three sectors is critical if we are going to advance those. We have to find ways by which the three can come together. Again, you cannot be prescriptive. Trying to come up with a social housing model is very different from a social investment model around children and so on. What we have noticed through the states—and the states are a significant player in this area—is that there have been a number of attempts, particularly in school education, where we have seen the involvement of private sector developers, the government and sometimes not-for-profit school operators. We have seen that in that space. We see it in early childhood and the health system as well. There have been numerous attempts to ensure that the costs of building hospitals are borne by the private sector. The running of the hospital might be by the government or by a not-for-profit operator. There are models out there, but the question is: can it be done? Yes. Are there costs associated with dealing with government? Yes, there are. Should they be excessive? No, they should not. But I cannot be prescriptive as to how you deal with that particular issue. I can make a couple of other comments. Also in our report we talked about the way in which government contracts and funds not-for-profits. We had a couple of chapters that were very significant. For example, one of the issues that has been raised that inhibits funding to not-for-profits is the uncertain funding arrangements with government—short-term funding. Those sorts of issues need to be fixed up. At the moment I understand the Department of Finance and Deregulation is looking at grant making, funding arrangements and contracting, as are nearly all the states that I am aware of. There are issues around the funding of not-for-profits, which if we improve that would enable some of those organisations to be able to access finance from other sources or enter into ventures with the private sector that would be more certain and quite favourable to all parties. Again, we enter this space from a number of different aspects, but just getting contracting of funding arrangements correct by the nine governments with the not-for-profit sector would have a flow-on effect. It may well be that the Office of the Not-for-Profit Sector in Prime Minister and Cabinet is looking at some of those issues more broadly. For example, the Victorian government is at the moment looking at streamlined funding arrangements for the not-for-profit sector. All of those seem very small and modest, but they all add up.

Senator MARK BISHOP: I have one further question, and again it is in the context of social housing, which takes so long. If the government identified it needed or wanted 100,000 units built, we are still walking down that path. There seems to have been a long logjam of working through portfolios—the regulatory regime and the taxation regime—to have it, firstly, correct and, secondly, sufficiently attractive for capital to move in there. When government identifies a big social purpose or a big social program—and I think 100,000 units by any stretch fits that test—is it necessary also for it then to almost direct itself to properly and fully engage with relevant sectors that might be seeking to participate? For example, if they want to build 100,000 units and they want the superannuation funds to provide a significant part of that capital, they need to be engaged with that at a very early stage so that both sides understand what the problems might be. Is that lack of early and ongoing engagement a problem in your mind?

Mr Fitzgerald: The early and ongoing engagement is central to whether or not the project will actually get up and its success, and so there is no question about that in relation to that particular area. Social housing or the lack thereof has long vexed all governments and remains a serious social problem. Early engagement by all parties is critical.

Another element in the report that we talked about was evaluation. I will just explain how critical this is. One of the things that we have stressed in the report is the need for much better evaluation in all areas of government activity where it is involved with the not-for-profit sector. One of the reasons for that is that evaluation helps you to design the actual program. If you have good-quality evaluation at the beginning—

Senator MARK BISHOP: Are you saying 'valuation' or 'evaluation'?

Mr Fitzgerald: Evaluation. If you spend time and effort coming up with an evaluation framework before the program has in fact been fully designed, it will inform the design features. This is critical.

The second thing is evaluation has to be seen as part of a quality improvement framework, not a measure of success or failure. So often in government programs, both at the Commonwealth and other levels, we see that evaluation is not developed until the program has been established, and often not done until the program is in failure mode. We have seen that in many of the Indigenous programs. Thirdly, we see it used as a success or failure mechanism. That is not good evaluation.

In programs like social housing and others where they are long term we need to have good evaluation processes that allow you to adapt the program as the evidence warrants the adaptation. One of the difficulties when you have the private sector involved is that they want certainly. One of the issues with social policy is that often you have to adapt as you learn. Not only do you need early intervention by the government in terms of bringing the right parties together, you need good-quality evaluation frameworks designed at the beginning. You need them to be used to inform and then you need an ability to adapt as you go forward.

If we look at the Indigenous social policy area—and you are aware that the commission convenes the working group that produced the *Overcoming Indigenous disadvantage* report—we see over and over again a lack of good-quality evaluation, and evaluations used once the program has already started to fail, and no capacity to use them for quality improvement. That is a micro example of a much greater issue. Again, our commentary in the report about evaluation is very important. It is not just about program evaluation; it can be applied to a much broader concept than just very small programs. It can be looking across a range of programs or initiatives.

Senator MARK BISHOP: I take it from your comments on the centrality and necessity of establishing proper evaluation processes that you see them as qualitatively different to KPIs or success or failure mechanisms?

Mr Fitzgerald: Success and failure is rarely helpful in public policy, because at the end of the day these are what we might call wicked problems—long-term, intractable issues. For example, child protection, overcoming Indigenous disadvantage and social housing—all of these are long-term issues. Program success or failure is not a helpful construct. Examining why a program is working or not working and determining whether or not it needs to be adapted substantially or modestly is very critical. One of the issues in our report was how government restructures their relationship with the not-for-profit sector for that to occur. It does not have to occur in every area, but it is absolutely central to some of our recommendations that there be a new relationship between government, including the Commonwealth government and the not-for-profit sector, which allows a new relationship for intractable or long-term social problems. That is part of another set of very important recommendations.

In fact, the work of the Office for the Not-for-Profit Sector in the Department of Prime Minister and Cabinet, I would imagine over time, would be very much targeted to that particular issue. If you then involve the private sector into that it becomes even more critical that we have good-quality mechanisms that allow for not only evaluation but also flexibility, which is difficult, because the private sector actually likes clear, certain, unchangeable frameworks. Unfortunately in social policy that is very difficult.

Senator MARK BISHOP: Thank you.

Senator STEPHENS: Are you the chair of the advisory board of the ACNC?

Mr Fitzgerald: Prospective chair, when it is established on 1 July 2012.

Senator STEPHENS: So the advisory board is not—

Mr Fitzgerald: No. Just to clarify, the government has announced that I will be appointed as the chair of the advisory board for the Australian Charities and Not For Profit Commission when it is established on 1 July 2012, and in the interim I have been seconded as a member of the Not-for-Profit Sector Reform Council to provide some advice during that period.

Senator STEPHENS: Thank you for clarifying that. In your opening remarks you made the point that the Productivity Commission recommended that the government should progressively widen the scope of gift deductibility to include all endorsed charitable institutions and charitable funds.

Mr Fitzgerald: Yes.

Senator STEPHENS: I know it is early days in the taskforce in trying to shape up the enabling legislation for the regulator and so on, but what role do you think the ACNC could have in helping determine potential changes to the DGR eligibility rules?

Mr Fitzgerald: The policy in relation to tax matters, including those, will remain with Treasury and not with the commission. The commission will be a regulator. As such it will simply administer the law, and policy will be determined elsewhere. Having said that, all regulators provide substantial input into policy considerations, based on their experience. Secondly, the reason the commission is so important, and the notion of a one-stop shop regulator is so important, is that it will be the first time that we can actually look at regulation from taxation, corporate governance and perhaps potentially fundraising in a holistic way. At the moment all of these areas are looked at separately and, of course, across the nine governments. I think the regulator will play a role in helping to consolidate consideration of these issues. At the end of the day, at the Commonwealth level, Treasury and Prime Minister and Cabinet will have central responsibility for policy, not the commission itself, but I would imagine it would be a significant imputer into those policy considerations.

Senator STEPHENS: The Productivity Commission report, and indeed the draft report, go to the issue of establishing the basic infrastructure for change. Is there anything missing in the suite of measures that the government has put in place to date or is in the process of putting in place that you think needs to be there?

Mr Fitzgerald: I am not completely aware of all that the government is doing. I understand that you have a presentation by Paul Ronalds shortly, who may be able to indicate what they are doing. So far I have to say that the commission is pleased that many of the recommendations are in fact not only being adopted but are being rolled out. However, there is a very large number of recommendations in our report and we have not yet received advice from the government in relation to all of those recommendations. All I can say at the moment is that, in terms of those things that have been announced, we are pleased that they are being implemented, but I am not able to advise you what the gap is, because I am not absolutely certain what is in train and what is likely to be in train.

CHAIR: I have a couple of questions before we finish up. Some of the submitters have contended—and we even had a small discussion about it this morning—that the government could provide a top-up payment or tax concessions to make the financial return on social investment more attractive and viable. Is the concept of, say, a not-for-profit going to market with some social bonds of some sort, with the government topping that up—either in an impact bond-type situation where it is dependent on outcomes or even in situations where it is not, but the government may otherwise have been spending money and it is seen as a less expensive way of dealing with it—something that you have considered in your report?

Mr Fitzgerald: It is a case-by-case scenario, but let me make a couple of comments. We would imagine that if a particular activity or program was in the public interest it may well be that on a cost-benefit analysis the government were to determine that it would be more cost effective for it to top up the initiatives of another party, that is, for example, social bonds being offered by the not-for-profit sector, than if it were to bear the whole cost of that particular initiative. There may well be an exceptionally sound economic reason the top up by the government might be the appropriate strategy. You can think of a number of instances where unless the government is prepared to do that then in fact that particular initiative will not be undertaken by any other source, but that initiative might be undertaken by a partnership between for profits, not-for-profits and philanthropy if the government were to provide an additional input into that.

What we are starting to see around philanthropy—and you will see this in Australia at the moment—is that a number of philanthropists are saying, ‘We are prepared to put in $2 for the project provided government puts in $1 and the not-for-profit organisation puts in X’, which might be in-kind or other. Those sorts of arrangements are very exciting. Again, there is certainly no reason why the government could not and should not look at the opportunities to provide some sort of support. However, there is one caveat on that. We think the government has to be very careful about not crowding out other initiatives. This is a term that people use very dangerously, so let me be very careful. If it is the case that people believe that the government will intervene and take all of the risk, then human nature says that is exactly what they will allow to happen. We would not be supportive of that in these initiatives. We believe that genuine collaboration between government, philanthropists, for profit and not-for-profit is a very appropriate way forward, each of those playing a discrete and important part. What part that is will depend on the actual circumstances. Our report is open. It does not say that you should and it does not say that you should not. It says that you should look at it on a case-by-case basis.

CHAIR: Did you consider at all how you might avoid that crowding out impact and what criteria you would put in place?

Mr Fitzgerald: That is exactly what I have just indicated. You look at the particular public interest involved in it. You can look at what is available from the not-for-profit sector or the philanthropic sector, and then you do a cost-benefit analysis as to what that measure might be. Having said that, there are people that believe that the government should have a standing pool of funds available to support certain initiatives, and that is possible. Some people would believe that there should be a whole-of-government approach in relation to social bonds, which may well have merit. Our approach is much more tailored to the particular purpose for which you are trying to engage and shape a set of measures around that particular purpose.

This also is in the social innovation section, which you will have seen. We did not favour the establishment of a social innovation fund at the Commonwealth level that could be available to all non-profits. What we did favour was with programs that had an expenditure of more than $10 million a year a certain portion would be made available in addition for social innovation in that particular area. We have a view that is more tailored. All that aside, in America and the UK there has been the establishment of these fairly substantial funds. They have merit. The question is whether they are the most appropriate way to go.

CHAIR: Did you examine social impact bonds in the report?

Mr Fitzgerald: Only peripherally. We talked about social bonds and what have you, but we did not do a detailed analysis.

CHAIR: So, you have not considered in any detail the challenges of measuring outcomes?

Mr Fitzgerald: In terms of measurement, yes, absolutely. You may be aware that a substantial part of the report, two chapters, goes to the measurement of the contribution of the not-for-profit sector. The commission has recommended a new measurement framework to be adopted by the nine Australian governments. That framework has the measurement of inputs, outputs, outcomes and impacts. We drew from international research on wellbeing and we looked at all of the current techniques being used, including social return on investment, results based accounting and a number of other processes. There is an appendix in the final report specifically on that. Yes, we have made a very substantial contribution to improving the way in which you measure the impact for organisations and the sector.

There are a couple of very quick things about that. As you move down, going from inputs, outputs, outcomes and down to impacts, the measurement techniques become less and less robust. As a consequence of that, when you are looking at impacts you need to use a range of measures. You need to use both quantitative and qualitative approaches, which draws off good evaluation, good case studies and other evidence, but absolutely measuring impacts, both at an organisational and sectoral level is where we want to get to. There is work being done on that internationally and I think we have made a significant contribution to that.

CHAIR: In some areas the ability to measure impacts would be more mature than in other areas, depending on the social benefit you are trying to deliver.

Mr Fitzgerald: Absolutely. Since this report has come out—and I am still involved in the sector in a number of ways—one of the good things is that there has been a real desire by the sector, including the philanthropic part of the sector, to move to looking at impacts and trying to design ways by which that can be measured in the broad sense. I think that is an area where there has been great progress. The point I make is that we should not fall into the trap of trying to turn everything into a number. The point that we have made in the report is that where it is measurable you can measure it, but where it is not measurable you can still in fact try to ascertain its value through other processes and other techniques. I think that in the social policy area that is an appropriate way to go.

CHAIR: Thank you for your time today.

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

[11:35]

CHAIR: Mr Ronalds, welcome back. Please feel free to make an opening statement.

Mr Ronalds: Once again, thank you for the opportunity to appear before you today. The department has been watching the work of this committee with real interest and we have certainly noted the wide variety of issues that the committee has canvassed, including social impact bonds, the role of the Australian Charities and Not For Profit Commission, regulatory settings, the Social Enterprise Development and Investment Fund, the National Rental Affordability Scheme, the better targeting of tax concessions and the like.

Perhaps as a broad comment to begin with, in our view the issues that have been canvassed by this committee highlight the way that government policy making must change to reflect the fundamental way technology, globalisation and the relative decline in the power of governments has changed our society. Responding to today's policy challenges can no longer just be the role of government or even bureaucrats such as myself. This is particularly the case in a constrained fiscal environment. Instead it must be much more of a collaborative effort involving the public, private and not-for-profit sectors working together to bring their respective strengths and resources to the table.

In this context, government must become much better at using its convening power to catalyse, promote and to encourage the private and not-for-profit sectors as well as individual citizens to become active agents of a change that we would like to see in our society. In our view, the work of this committee can play a very significant role in assisting this change. A policy environment that encourages more collaboration, like that achieved in the establishment of initiatives such as the GoodStart Childcare initiative, the Social Enterprise Development Investment Fund and the National Rental Affordability Scheme are all very welcome beginnings to this.

The Office for the Not-for-Profit Sector in Prime Minister and Cabinet has been continuing to work on many of the issues that have come before this committee, and we believe three initiatives in particular have significant merit. The first is a social investment taskforce that could lead a national dialogue, report on developments in social investment both here and internationally, advise on steps to support the emergence of an effective social impact investment market, oversee the development of initiatives to encourage the emergence of new social enterprises, and build new collaborations to support the role of social investment.

Secondly, given the pioneering work in the UK and more recently here in New South Wales, we believe there is merit in considering the potential of social impact bonds. The groundwork has been done in other jurisdictions and they provide useful foundations for broader action in Australia. As a new financing vehicle, social impact bonds appear to provide promising community benefits.

We suggest that there are six characteristics that are important for successful social impact bonds, and they are as follows. Firstly, they bring new resources to the table. Secondly, they harness social innovation by both the not-for-profit sector and social investors more broadly. Thirdly, they support participation and community based action to help solve problems. Fourthly, they share risk between government and the private social investors. Fifthly, they have clear and measureable outcomes as the basis for incentive payments to investors. Sixthly, they focus on interventions that prevent consequential social problems and their associated costs to government.

The third area that we think has significant merit would be the absolutely crucial importance of measuring return on investment. The previous speaker has given significant evidence in relation to the Productivity Commission's work in this area. Better measurement of social return on investment is critical for establishing the transparency and accountability of social initiatives for building credibility with investors, funders, donors and the like.

However, before concluding my opening statement, there is one other issue that I would like to emphasise to this committee. I think that it would be important in developing recommendations that promote increased collaboration and social investment across the public, private and not-for-profit sectors that there is a strong emphasis placed on empowering local communities to engage in this type of activity. Increasingly, local solutions are needed if we are to effectively meet many of the policy challenges that we face. To do this local communities need sustainable and flexible sources of funding. An example, in my opinion, that is a useful starting point and worthy of the committee's consideration are models like the Victorian Community Foundation Initiative. You are probably aware that these are community run foundations that raise money from a range of different sources to invest in a wide range of projects and programs locally, particularly in the most disadvantaged communities, and over time such foundations could actually emerge into more sophisticated community development financial institutions. Let me leave my opening comments at that. I look forward to responding to what I am sure will be a range of questions.

Senator STEPHENS: What did you think about the Productivity Commission's recommendation about an advisory group or a taskforce? It is very clear that you think that is something that is needed to advance this whole debate. Is the office currently doing work on such a proposition?

Mr Ronalds: It is. Over recent times it has certainly been thinking quite deeply about the value of it, what the potential scope of it could be, its composition and some of the other parameters around that sort of advisory committee.

Senator STEPHENS: So, scoping is beyond just access to debt products and some of the other issues around measurement perhaps?

Mr Ronalds: Yes. Broadly speaking, there are probably four different areas that an advisory committee or taskforce could look at. Obviously the supply side of social investment is an important aspect. A second one could be the demand side of social investment. The third one could be the intermediation issue. I know there has been lots of discussion at this committee in relation to those issues. The fourth one could be the reporting and evaluation platforms. So, looking at a broad scope that might be built off those four different aspects.

Senator STEPHENS: Are you able to provide us with an update on the commission taskforce's work, in terms of the taskforce that is charged with establishing the commission by 2012?

Mr Ronalds: Not in any detail. Obviously Treasury is taking the lead with that. I get periodic reports on progress. I am broadly aware of its progress, but perhaps not in the detail that this committee would like. Is there anything specific?

Senator STEPHENS: One of the things that we have heard a lot about is capacity building of the sector to understand investment products or to understand a regulatory environment for financing. My real interest is whether or not the commission might have a role beyond just education, the technical matters and the regulatory matters, to more broadly some of the discussion that we have been having?

Mr Ronalds: No. As far as I am aware, the commission itself has not done any thinking about that. It obviously has a fairly ambitious time agenda just to get itself established, and to be thinking through things like the proposed information portal and a range of those other things. If it was going to look at these issues they are probably some time away. It has really been the Office for the Not-for-Profit Sector that has done any early thinking about that. I would say we are still only in the very early stages as well.

Senator STEPHENS: In terms of the measurement and metrics issues, JBWere's submission suggested that the government could fund an independent not-for-profit rating agency. Do you have a view about whether or not you think that would work?

Mr Ronalds: We have not looked at it in detail. Personally I am a little sceptical about, firstly, a review mechanism, given the enormous breadth and variety of the sector. I think that with the commission there is a real opportunity to allow not-for-profits themselves to put their best foot forward in terms of promoting the impact that they say they have and the evidence for that impact to people who perhaps are looking to give money to that particular cause. At least initially I see some of the greatest steps forward perhaps in the facilitation role that the commission can have in that regard, and this information portal with what could be part of that.

Senator STEPHENS: Finally, I have a question on your appendix 2, 'Factors in Capital Market Development', which goes to the issue of the four pillars and four second-order needs critical to the development of a social impact investment market, which were identified by the Charities Aid Foundation. Can you comment on where your thinking is now, given the discussion that we have been having and how far we have moved along. Confident and informed demand from the sector—investee readiness—efficient matching of supply with demand and the role of intermediaries, a variety of investment mechanisms and resilient supply of finance. You make those six points in terms of social impact bonds, which come into play in some respect, but do you have any comments to make in terms of your perspective or the perspective of the office around how much the debate and the conversation has changed since the Productivity Commission's report that came out and the recommendations that started to engage with the sector and with organisations such as investment groups and super funds? It would be helpful for us to know how far along we have moved since the PC report and whether it catalysed activity and thinking.

Mr Ronalds: That is an excellent question. In relation to those four pillars, I would say that the most progress has been made in relation to pillar No. 1. I certainly believe that the Productivity Commission and the government's adoption of some of those key initiatives, particularly as part of its election platform, in terms of the Office for the Not-for-Profit Sector and those sorts of things, have given a real spur along to the not-for-profit sector itself together with perhaps some of more leading financial intermediaries to get together and to be exploring the potential. If I think just in the last six months about the number of meetings, workshops and those sorts of things that have been convened by a range of different players across that sector, it is a very significant step up on what was previously the case. I think that the Productivity Commission's report and the government's response to that report have certainly done a good job of facilitating that. That is the good news.

On the other side of the ledger, it is still very early days and most of the work is still in the discussion/exploratory stage. 'What sorts of things should we do? Where are the greatest opportunities?'—those sorts of questions—rather than perhaps moving on to what you might hope to be the next stage, which is running concrete pilots that gather a much more robust evidence base on which you then build a long-term market platform.

So, it is a good start. It is still less than 12 months since the Office for the Not-for-Profit Sector was created. I think significant progress has been made, but this is a long-term endeavour. We have seen it with the UK's taskforce. They were established in 2000. Over 10 years they saw the sorts of changes begin to bear fruit, but we are only at the very beginnings of that.

Senator STEPHENS: If we were to be establishing a similar taskforce in Australia do you think we could have a more ambitious timeframe than 10 years?

Mr Ronalds: Definitely, because we should be building off and leveraging the work that has been done in other jurisdictions. We have mentioned the UK and Canada. There is work being done on social impact bonds in the UK, the USA and in New South Wales. There is a lot more on which to make progress than there was 10 years ago when the UK entered this market. Yes, I think we should.

Senator STEPHENS: With respect to these four second-order needs, the one that I am interested in is No. 2. We have had quite a lot of discussion through the submissions around definitions, terms, impact measurement, standardisation of measurement and so on. As you would have heard from the discussion with the Superannuation Association, it is the issue of how you develop product and the need for consistency and understanding. The super funds suggest that they are unclear of what the product is that comes in a social capital market and how to create something for their investors to consider. To what extent do you see that this is the challenge for us in Australia? Is it about common terminology and common understanding? The work of the Standard Chart of Accounts is a very small project in that space, but to what extent do we need a taxonomy of terminology?

Mr Ronalds: I am cautious about, for example, government moving very quickly into this space. If we think about analogies in the private sector, this sort of standardisation and understanding of terminology has evolved over a long period. Even that evolution has had a range of twists, turn and things like that. There are some areas where government has a clear role to play, and one of those is doing work around the better measurement of social return on investment. That is a foundation on which products and other things would be built.

Again, I am very cautious about government presuming to have a broad enough perspective to understand all the innovation that could potentially occur in this space, so I would be much more interested in creating the sort of environment where that innovation is able to flourish. That is where some of my opening comments were going to. The government has very significant convening power to get different sectors to the table. You have heard evidence from a range of different speakers about the need for these complex policy problems that we face to have all three sectors there working them through. You essentially get policy failure when any one sector, particularly government, thinks that they have the full understanding and puts in train a solution without sufficient consultation and engagement to get the perspective that it needs. I think that is the case with this. The foundation is good and should be a priority for government, and creating the right sort of environment, but do not move too quickly to prescribing in any sort of way the sorts of products that should evolve, because we are in too early a stage.

Senator STEPHENS: Can you elaborate on what progress has been made on a measurement framework? Has any work been done out of the Productivity Commission's recommendations?

Mr Ronalds: Work has started, particularly with the ABS, on the measurement framework. That is one part. Another part, which has come up a few times in the evidence given to this committee, is addressing what I might describe as the systematic underinvestment around measurement and evaluation. Mr Fitzgerald alluded to this as well. The Office for the Not-for-Profit Sector has given significant thought as to how we can change that. That is a cultural issue as much as anything, although in the current fiscal environment there is a range of very real limitations as well. It is about saying that if we are going to make progress in the long term we actually need to make some of the early investments in the data gathering and in good evaluations to make sure that we have the robust evidence base on which to make future decisions.

Senator STEPHENS: I suppose it is cheeky to ask whether the office is resourced well enough to undertake some of this fundamental stuff?

Mr Ronalds: It is a small office. We have around 12 staff for this agenda. The agenda, as you are probably aware, is progressing under three broad strands. The first strand is improving the relationship between the not-for-profit sector and government. Issues like the compact and where the compact might go, the possibility of having some codes that might sit underneath the compact that bring to life and really operationalise some of the principles that are in the compact, getting departments to appoint compact advocates at the deputy secretary level, which is now being done. There are things like the establishment of the office itself and the Not-for-Profit Sector Reform Council, and improving grants and contracts. All of that is about building a better basis for a relationship between the government and the not-for-profit sector. There are some staff who are very much focused on that, and that is something that the office is leading a whole-of-government effort around, working with the Department of Finance and Deregulation and others.

The second strand is around the regulatory environment and improving that. That goes to issues like the new commission, tax reform, definition of ‘charity’ and those sorts of things. The office is very involved in that, because it needs to be a whole-of-government effort, but most of those initiatives are being led by Treasury.

The third area, which is still at the earlier stage, and possibly of the most interest to this committee, is building the sustainability of the sector. We are doing thinking around volunteering and philanthropy. Obviously we are involved in many of the issues that this committee is looking at around social investment and those sorts of things. There are issues around workforce and capability. Again, we only have a couple of staff that can look at all of those issues, and there is a very broad range of issues. It is a far-reaching agenda with limited staff, which means we need to carefully prioritise and sequence the work.

Senator MARK BISHOP: Thank you for your introductory comments. I would like to go to three or four issues. In your introductory remarks on social bonds you made reference to ‘community based outcome’ and after that ‘local community involvement’. Can you define what you mean by the word ‘community’?

Mr Ronalds: What is meant by that will depend on the context. In my view, it is going to be defined by the range of people who are interested in the particular issue, and if that issue is economic development it will be by necessity something that is a much broader or larger community than it would be about a local piece of open space, which will have a much tighter group of people.

Senator MARK BISHOP: So, it is inherently flexible dependent upon the social good sought to be achieved?

Mr Ronalds: Yes.

Senator MARK BISHOP: In terms of the discussion we have had with ASFA, the superannuation funds people, Mr Noble made the point that there was a lot of time and cost attached to developmental work. He made that comment particularly in the context of the NRAS scheme and some of the hoo-hah that went on there, but he was making it more broadly. Is the government or your department in particular doing any work at all at this stage to raise the profile of that necessary developmental work or to make it a higher priority issue?

Mr Ronalds: Often government is not aware of the complexity and potential impacts on other actors. The world is so complex that it cannot possibly know that. One of the cultural things that needs to change around government is a much better appreciation for that and, therefore, an appreciation of the importance of improved engagement and collaboration across sectors. What follows from that is a much greater investment in developing the skills to be able to do that collaboration and cooperation across sectors. Again, because of the way the world has changed over the last couple of decades, I would say government is still catching up in terms of that recognition, that cultural change and then building the skills necessary to do that. Some of the frustrations that you see in stakeholders such as ASFA can be attributed to that. That is only part of the story, though. I think that in the same way as government is catching up many for profit and not-for-profit organisations also need to appreciate the interconnectedness of so many of the issues that they are dealing with and the need for each of them to build skills in understanding of the other sectors as well.

Senator MARK BISHOP: I will pull you up there, because there is a fundamental philosophical point here. ASFA was saying that, if they do not understand, if they are not consulted, if they are not contacted, if their views are not incorporated, they just will not participate. It is not ‘he said’, ‘she said’, it is, listen to what they are saying. It is not a matter of collaboration. They are sitting over there with trillions of dollars. A lot of people have argued for many years that they want to access the funds, and these people over here, ASFA, say, ‘No-one talks to us.’ That has been going on for 20 years. It is not just collaboration. That is what I am trying to drill down to.

Mr Ronalds: I agree with that issue. The point I was making was that I do not think it is necessarily a one-way issue. In my experience, often when you reach out to stakeholders—and I am not talking about this stakeholder in particular—they themselves do not actually have the capacity to engage back, and so it is actually a matter of capacity on all sides rather than just on the side of government. Again, I concede the point that government often fails. It often does not even know what it does not know and does not go anywhere near sufficiently seeking that advice and input.

Senator MARK BISHOP: In that discussion, when government identifies a particular social purpose that is going to involve hundreds of millions in outlays over a period, in the context of NRAS but not particularly that, have you identified shortcomings or deficiencies or perhaps different ways of doing things? Three years after the government has made the policy announcement they are still engaged in discussions with Finance and Treasury on the appropriate regulatory or taxation regime that should apply. Does that strike you as being somewhat incongruous?

Mr Ronalds: There is a general point and a specific point to be made around NRAS. The general point: have we been doing work? Yes. If you look at the national compact—and I am now talking about the Office for the Not-for-Profit Sector—it talks about the principles of collaboration. Many of those are in the APS reform document *Ahead of the game*, which is also very consistent with many of these directions. What we are doing in a co-productive way at the moment with the not-for-profit sector is developing a best practice guide to what that collaboration and engagement looks like, and trying to gather real-life examples of good and bad practice to then build an evidence base that we can share with other departments and with the sector about how to do this in a very expert way. We are working on that very broad general issue that you go to.

In relation to NRAS itself, I was not involved in the early days of it. I have a broad awareness of its function. I can imagine that the tax and the regulatory issues associated with it are very complex and something as significant as this could take a number of years to land effectively.

Senator MARK BISHOP: Let us assume you are right there. Let us assume that the taxation regime has a degree of complexity about it. To sell the eventual product to superannuation funds and their members, the cost and the risk has to be identified, which takes time. You say that it might take some years to develop the eventual scheme, but the government announced four years ago, for example, that it wanted to have 100,000 or 150,000 social housing units built, sold and established in the community across Australia. Four years down the track there has been some progress made. Some of the reasons for the delay are properly attributed to the respective portfolios that have been involved since inception. Do you think it is just not good enough that four years after the government announces a purpose you can say to a committee like this that it is technically difficult, complex, takes a long time and it might take many years? In terms of not attributing blame, why are these issues still being discussed four years after the event? Why were they not identified and acted upon six months after the relevant minister or Prime Minister made the announcement? That is what I am driving at.

Mr Ronalds: One of the issues is the general issue about the skill and capacity of the APS. That is something that is known to government. As I said, it was part of the *Ahead of the game* recommendations, but it is a very real issue. The world is much more complex, and because of the way that we now need to tackle these sorts of problems, such as social housing, by bringing the for profit, the not-for-profit and government sectors all together, those skills and capacities are actually quite rare. Quite rightly you could say that we perhaps have not done anywhere near enough work to make sure that we have the knowledge and expertise within government to be able to understand those complexities and to push along the agenda quickly enough. That would be one thing.

Secondly, my limited experience of NRAS does point to the change that has had to happen in the sector around understanding this new opportunity. Boards of not-for-profits are often very conservative. They have had to think about it. Not-for-profits themselves often have not had the breadth of experience in their management teams to deal with the sorts of complex financing arrangements that would make the most value out of an NRAS-type initiative. That is all changing, but it takes some time. I do not think it is unreasonable to expect that sort of change in capacity and thinking to take a couple of years to work through before you start getting a really significant ramp-up of the actual outcomes. When we are designing policies we need to be realistic about the implementation time, and that is often a very difficult thing in a political cycle, which is often quite short.

Senator MARK BISHOP: I take that point. In terms of the NRAS, though, it is not just the issues relating to the not-for-profit sector, say, skills, capacity and so on. I accept that. But do you think government has an adequate understanding of the needs, demands and limitations of the for profit sector? That program of 100,000 or 150,000 social housing units, by its very nature, was never going to raise the type of capital required for not-for-profit organisations. This is just by its very nature. Home units in Perth cost half a million dollars. That is probably less than over here. But if you multiply that by 100,000, those sorts of monies are not available in not-for-profits, so you are going to have to involve the private sector early and often, simply just to provide capital, organisation and so on. Is that level of awareness sufficient in the line departments?

Mr Ronalds: I do not think it necessarily is. Often when the policy is being developed there are assumptions made that a market will exist, but that is not always the case.

Senator MARK BISHOP: Where government decides that it wants to go heavy into a particular social program, which could be aged care, funding for schools or wherever there is a significant amount of capital involved that needs to be raised to fund it, and government is going to rely on capital markets or the private sector, what is the role of catalyst in that? You used that word earlier.

Mr Ronalds: This is a key role that government has. I mentioned what I would describe as government’s convening power. If in particular the federal government, which has an enormous degree of convening power, calls together a meeting of superannuation funds, business leaders, construction experts and not-for-profit leaders, generally they will come together and government can really create the agenda. Provided that government has the skills and expertise to be able to facilitate that, out of that something really terrific can blossom. We have spoken already about government not always doing that, but that to me is the opportunity and particularly in the space that this committee is looking at it is an absolute necessity if we are going to make the sort of progress that we want.

Senator MARK BISHOP: So, to translate that into a practical recommendation, you say that if the government is going to go into a particular social purpose activity that could involve the expenditure of significant amounts of capital—which we both understand is probably going to come out of the private markets—the critical role of catalyst needs to be identified at the outset and possibly attached to the policy statements and the progress of work for implementation right from the beginning, budget statement level?

Mr Ronalds: I do not know as to where it needs to best fit. It probably needs to happen in a range of different levels. Even creating the Office for the Not-for-Profit Sector is creating an institution within government whose very remit is to bring that whole-of-government perspective and to catalyse that sort of thing. We need to make sure that is replicated in other departments that have the responsibilities for the particular programs that might be the case that you are referring to.

The implementation issues that you raise are very real implementation issues, and as part of developing the policy in the first place we need to be very focused on how it actually gets implemented and the skills and expertise necessary to do that implementation. We are talking in the abstract so it is a little difficult to give you a precise example.

Senator MARK BISHOP: We are talking in the abstract at one level, but governments are elected from time to time with a particular policy outlook and a particular social capital area of wanting to do work in areas they identify as having deficiencies or shortcomings, and so the implementation timeline is not something that is not inconsequential in my mind, particularly four years after the event. I will leave it there.

CHAIR: In terms of the six characteristics for success that you went through for the social impact bonds, what work is being done by the office to develop how to identify and assess those characteristics?

Mr Ronalds: We are only at the very early days. Government has made no decision about a social impact bond per se. We are thinking about what those characteristics should be, being able to map them out so that if government decided that it did want to go forward then we would have done some of the preliminary thinking and work, to go to Senator Bishop’s points around implementation. We would be able to go there reasonably quickly and know the sorts of expertise, resources and things that we needed to get in house to be able to drive it forward.

CHAIR: So, at this stage you have identified them, but you have not really gone beyond that point?

Mr Ronalds: Yes.

CHAIR: As to the governments that have already involved themselves with social impact bonds, say, the UK and New South Wales, are they consistent with the characteristics they are also looking at?

Mr Ronalds: They are drawn from their learnings in the couple of cases where the evaluations are already in, and some of the issues that came up in those. So, yes, it is based on the still limited examples that we have.

CHAIR: But do not necessarily reflect the same characteristics those governments have put in place?

Mr Ronalds: No. It is a space that is quickly evolving. We are looking at the evaluations and saying, ‘What did they miss that would have actually led to a better outcome?’

CHAIR: You also noted the crucial importance of measuring the social return on investment. I think that comment was made in a broader sense. Have you been working on taking a lead from the Productivity Commission's recommendations and other lessons elsewhere in working on how you actually measure that?

Mr Ronalds: As I mentioned earlier, we are only at the early stages of that. We have begun work with the Australian Bureau of Statistics around that issue and framing out what the Productivity Commission recommended. Over time we will see the fruits of that.

Senator STEPHENS: I would like to go back to the Productivity Commission report, because it provided an incredible roadmap for reform. Last week we had evidence from several cooperatives, the cooperative movement in Australia, including employee share ownership schemes and others. As to your interdepartmental taskforce around cooperatives, share ownership social enterprise development, has there been much focus on the role of cooperatives, which were highlighted in the PC report?

Mr Ronalds: No work to speak of as yet. We are certainly aware of it as an issue. It is on the list, but it is certainly not something that we have yet had time to invest any real thought into.

Senator STEPHENS: Would you be aware of any initiatives that are planned to promote the work of cooperatives for the United Nations Year of Cooperatives, which is next year?

Mr Ronalds: There have been some early discussions about what might be done around that, but as far as I am aware there are no concrete proposals to help celebrate that year.

Senator STEPHENS: Another piece of evidence that we received on Friday was around the employee share buyout group that were funded under the jobs fund out of Western Sydney. The evidence provided to us was the extent to which that organisation had gained quite a lot of recognition. Recently in Victoria when a fruit cannery was proposed to close, that group was brought in to see whether they could orchestrate an employee buyout, but it was far too late. That is another kind of intermediary service. Has the government been thinking about that in terms of the manufacturing industry and what is happening there, and whether or not that might be an opportunity to strengthen that kind of local participation and local solution?

Mr Ronalds: I am not aware of any work that has been done around that issue. Cooperatives went out of fashion a little and, like in many parts of society, you have lost some of the richness of that. We are starting to see that they can be a useful vehicle in some very particular but important cases. Beyond that, I do not think there is any work.

Senator STEPHENS: I have one more question that goes to the scoping paper for the not-for-profit regulator. Were you involved in working up that scoping paper?

Mr Ronalds: The office certainly was involved.

Senator STEPHENS: Recommendation 37 states, 'Government contracts should no longer mandate organisational governance requirements for not-for-profits.' Do you have any insights into that recommendation, how that came about and whether it is a recognition of hybrid systems like the GoodStart arrangement or whether is it for profit business with social purpose?

Mr Ronalds: I would have to take that question on notice. I am very happy to do some research on what the thinking behind that one was and come back to the committee.

Senator STEPHENS: If you have any insights it would be helpful. We will go back to the scoping paper as well to see whether there are some pointers to that. Thank you.

CHAIR: Thank you for assisting us today. With that I declare this committee adjourned.

Committee adjourned at 12:19