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27 February 2017

Dear Sir or Madam,

Submission - Social Impact Investing

KPMG welcomes the opportunity to make a submission to Treasury in response to the January 2017 Discussion Paper on social impact investing (**Discussion Paper).**

From our work with governments, not-for-profits and investors over the last four years on six social impact bonds, we have found that barriers to social impact investment are lack of measurement, a sluggish market and complexity of the transaction. The Commonwealth can play a vital role in the market through developing the capacities of social services to measure their outcomes and impact, stimulating momentum to develop the scale and number of transactions for take-off and developing a broader range of transactions, including simpler transactions.

We have outlined a number of policy levers that the Commonwealth can draw on to develop and consolidate social impact investing in Australia which include championing the policy direction at senior levels of government with vertical and horizontal alignment behind the leadership. Specific transactions can encompass partnerships with State and Territory Governments on social impact bonds (SIBs) and Australian Government SIBs on appropriate areas within its responsibility such as young people not in education, training or employment (NEET), social and affordable housing, and primary health care.

Please note that we have interest from providers and investors in these areas and would be willing to discuss with you the development of bonds in these areas. We are also currently engaged in developing transactions that involve investors to develop solutions for social and affordable housing in several jurisdictions.

Please find in Appendix A our submission which concentrates on questions 1 to 11. We would be more than happy to discuss any of these directions with you further.

Yours faithfully,

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Appendix A – KPMG Response to Discussion Paper

KPMG has provided responses to questions 1 to 11 only.

1. What do you see as the main barriers to the growth of the social impact investing market in Australia? How do these barriers differ from the perspective of investors, service providers and intermediaries?

Overall, we consider the three major barriers to growth of the social impact investing market in Australia to be:

- Measurement: Social services do not consistently measure outcomes.
- Momentum: The relatively small number of impact investing deals in Australia and the slow take-up of impact investing mechanisms.
- Complexity: The need to simplify the complex impact investing mechanisms on offer.

Specific barriers for each key player in the impact investing market are considered below:

<u>Governments:</u>

- *The need for government leadership and policy on social impact investing*: State and territory responses to social impact investing have been varied across Australia:
  - In New South Wales, a clear policy statement has been released, backed up by a commitment of resources (an Impact Investing Unit funded jointly by the Department of Premier and Cabinet and NSW Treasury) and a yearly statement of policy priorities.
  - Queensland has also committed resources to developing social impact bonds.
  - In Victoria, the State Government has invested in the social enterprise sector, as reflected in the amount of social enterprise activity.

  In other states and territories, government activity in the social impact investing space has been less proactive. As a result, fewer social impact investing activities have eventuated.

- *The need for social impact investing champions in governments:* Social impact investing has thrived in states and territories where it has been 'championed', and where there has been both vertical and horizontal alignment behind these champions in the public service. For example, the NSW Treasurer and the then Premier of NSW have been champions of social impact investing, which has led to an alignment of public service agencies behind this policy goal. Conversely, in states and territories where policy objectives and implementation structures have not been aligned, the social impact investing market has not been established as strongly.
- *The complexity and speed of transactions:* The speed and volume of transactions is hindered by the complexity of social impact bonds. A public-private partnership (PPP) framework is not the correct framing of the transaction and leads to undue complexity. (The title of the transaction as 'bond' is also not helpful and leads to misunderstandings.) Simple contracting and framing is needed to speed up social impact investing transactions and mature the market.
- *Not using payment by result (PBR) mechanisms for every transaction:* While social impact investing can be framed within the context of a payment by result (PBR) regime, there is need for caution when attempting to use PBR for every government transaction. Different types of

specific mechanisms work in specific circumstances. Consideration could be given to the choice of different structures in different situations.

- *Government views on risk sharing:* A key 'sticking point' for negotiating social impact investment transactions has been the degree of risk sharing in which governments are willing to engage. Social impact bond deals are only successful when all three parties (non-government organisations, governments and investors) clearly benefit from the transaction. The degree of risk sharing and long term benefits for government needs to be re-examined.

- *The need for selection of the 'right' policy areas:* Governments may select policy areas for a social impact bond that are politically important, but that are not suitable for a bond in that there is insufficient relevant data or the bond does not "stack up" financially.

<u>Service providers:</u>

- *Limited ability to measure outcomes:* Depending on the policy area, service providers may have limited capacity or capability to collect, measure and analyse outcomes data.

- *Lack of internal capacity/capability:* Non-government service providers, particularly those that are primarily reliant on government funding, may not have the resources to tender for, negotiate, develop and implement a social impact bond or social enterprise.

- *Understanding of social impact investing:* Some service providers are willing to trial innovative solutions, but in general, non-government organisations are unlikely to be able to develop a social impact investing product without the guidance of intermediaries. In particular, service providers need to ensure that their Boards have sufficient understanding and support for social impact investments before progressing with a social enterprise or social impact bond.
- *Lack of evidence base in many social programs:* The success rates for many social programs operated by service providers may not be known, and the programs may not have been evaluated.
- *Lack of solutions:* In some policy areas, the 'solution' to policy challenges has not yet been identified, and there are no known programs that achieve successful outcomes.

<u>Investors:</u>

- *Size of social impact bonds:* Social impact bonds in Australia are small relative to other investment opportunities, and are too small for some investors to consider, as there are high transaction costs relative to the size of the transaction.
- *Lack of sector knowledge:* Few investors have a strong understanding of social policy or programs, particularly of the challenges involved in measuring social programs. This may impede their willingness to fund social investments.
- *Range of interests:* The profile and needs of investors vary:
  - Some investors have indicated that they are more interested in nimble and flexible responses to social problems; social impact bonds are not suitable for this group, due to the lengthy process to establish bonds.
  - Some investors are interested in investing programs, and are less interested in the measurement of outcomes.

- Other investors are interested in pursuing outcome measurement that is tied to a payment mechanism.

- *Lack of clarity around success:* The social impact investing sector is relatively new to investors, and investors are unsure about what "success" looks like or what returns they seek from their investment.
- *Perceived higher levels of risk:* Before investing, investors seek assurance that outcomes are likely to be achieved and will hence generate returns. However, limitations in collecting data and measuring outcomes may undermine potential investor confidence.
- *Need for more diverse investment structures:* Investors have expressed frustration at the lack of diverse investment structures that would better support their participation in the social impact investing sector. For investors, there is no visible market place or agreed framework for due diligence for social impact transactions (including an agreed measurement framework for each type of transaction).

<u>Intermediaries:</u>

- *Ability to work with the social services sector:* Intermediaries, governments, service providers and investors all view social impact investing from different perspectives, and so use different language and frameworks when discussing social impact. Financial intermediaries will need to be "trusted advisors" to service providers. This means that they must have a strong understanding of social policy and programs, the 'value-oriented' mission of service providers and government, and means of measuring social programs.
- *Cost:* The cost of contracting intermediaries can make advice out of range for small service delivery providers. Some intermediaries offer support on a pro bono basis, but this may not be sustainable as the sector grows.
- *Value:* Service providers and government may underestimate the complexity of establishing a social impact investing transaction and may not understand the value that experienced intermediaries provide.

2. What do you see as the future for social impact investing in Australia: for example, can you foresee the development of new structures for social impact investing?

In future, key features of the social impact sector in Australia will include:

- An increasing emphasis on using social impact investing to solve intractable social problems. The key elements of social impact investing will include:
  - The development of a culture of tackling social problems across government and the service delivery sectors.
  - An increased focus on innovation to solve 'wicked problems'; the current Government's Try, Test and Learn fund is a good example of this.
  - A strengthened focus on value for money, and in examining which programs work and which programs do not work.
- The establishment of a large-scale social impact investing fund.
- A thriving marketplace with the following characteristics:
  - A burgeoning social enterprise sector.

- Outcomes data in the public domain, accessible datasets and known success rates for social programs.
- Greater investor awareness of approaches to social programs and how success is measured.
- More diverse structures for social enterprises with a range of commerciality arrangements, a range of impact investment structures and options for investment, and a broader range of approaches to transactions. The latter might include:
    - Payment by outcome structures (such as social impact bonds).
    - Innovative 'try, test and learn' approaches backed by investors.
    - Other impact investing structures that do not involve governments.

- Enabling mechanisms to support the features listed above, including:
    - Alignment of policy across the local, state and federal levels of government (and within governments).
    - Structural alignment within governments to progress and build the marketplace.
    - Support and capacity-building mechanisms available for service providers (both large and small) so that they can measure outcomes and participate in the marketplace.
    - Shared and agreed methods for measuring outcomes.

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

KPMG has not considered legislative or regulatory barriers in our response. However, we recommend that the legislative or regulatory barriers relevant to social enterprises are examined to grow the social impact investment market in this area.

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

We consider that the Australian Government has several primary roles in developing the social impact investing market:

- *COAG funding:* The Australian Government should consider financially rewarding states with a success fee for every $1 million of investment that investors provide for social investment transactions. This would act as an incentive payment for state and territory governments to develop their own impact investing markets.
- *Opportunities:* The Australian Government should work with state and territory governments, service providers and intermediaries to develop a pipeline of opportunities for social impact investments.
- *Market steward:* The Australian Government has a major role to play in establishing and developing the social impact investing market in Australia. This may include:
    - Determining national agenda of key policy priority areas for social impact investing, including:
        - Establishing a framework for determining which areas are suitable for social impact bonds.

- Working with the states and territories on joint initiatives/transactions.
- Establishing a range of possible investment mechanisms (which are not payment by outcomes) for other social areas in a way that aligns with the innovation/Try, Test and Learn approach.

- Establishing social impact investment as a policy priority and establishing a policy framework to support its development (e.g. principles, requirements/pre-conditions); establishing a governance structure to chorale support across different government agencies and different levels of government.
- Establishing a clear public position on leading and championing impact investing.

- *Funding:* The Australian Government should consider funding social enterprises as it did in the Social Enterprise Development and Investment Funds (SEDIF); while the implementation of SEDIF encountered some challenges, the model is fundamentally sound if some adjustments are made to account for the capacity and state of development of organisations.
- *Legislation:* The Standing Committee of Attorneys General (SCAG) should consider harmonising legislation pertaining to impact investment.
- *Facilitator of data collection and exchange:* The Australian Government holds a range of social datasets, including higher education, employment, housing and environmental data. There are clear opportunities to develop a data exchange mechanism with state and territory governments.

5. Do you see different roles for different levels of government in the Australian social impact investing market? For example, the Australian Government as co-funder with State and Territory Governments continuing to take the lead in developing social impact investment.

We see all levels of government as participating in the social impact sector, with overlapping roles:

- The Australian Government should co-develop social impact transactions (such as social impact bonds) with state and territory governments, in recognition of the shared savings in social policy areas such as education and employment. Co-development would also enable data sharing across different levels of government.
- All levels of government should support social enterprises through:
  - Providing 'connectors' (such as networking events, electronic hubs and mentoring) for initial establishment and development of individual enterprises
  - Providing on-the-ground specialist assistance and infrastructure to develop and scale the market
  - Financing the growth of social enterprises
  - Providing policy direction and raising the profile of social enterprises
  - Articulating and better measuring social value to assist market development
  - Using social procurement as a key lever to market development.

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

We believe there are multiple areas where funding through a social investment framework may generate more effective and efficient policy outcome than through direct grant funding. However, one of the findings in our work [evaluating the first Australian social benefit bonds]was a tension between innovation and having a strong evidence base in a payment-by-results transaction. Hence, the social investment framework needs to be flexible in order to accommodate innovation (with success as well as failure) as well as reward for outcomes in areas with known findings. These dual aims need to both be incorporated:

- If the aim is to solve an intractable social problem, for which there is not a current evidence base, *a Try, Test and Learn* approach with private investment could act as a catalyst for new solutions, with the procurement process designing innovation into the process.
- If the aim is to invest in programs so that *positive outcomes* are achieved in those programs, and a strong evidence base is in place, a social impact investing transaction could be appropriate. For example, early home nurse visiting is known to have effective results (although not all high risk Australian children in the early years are included in home nurse visiting programs).

To be effective, either transactions need to scale up in their second iteration, or transaction costs need to reduce in their second iteration so as to make the investment in the transaction worthwhile for investors and government.

We also have noted the flow-on effect that social impact investments, including SIBs, can have on capability building within non-government organisations. Hence, the primary place of outcomes in some social impact mechanisms can be more effective in developing value for money in social programs than direct grant funding.

7. What Australian Government policy or service delivery areas hold the most potential for social impact investing? Are there any specific opportunities you are aware of?

Our views on suitable policy and service delivery areas are set out below:

Issue	**Potential for impact investing**
Early education and childcare	Suitable
Employment, education and training	Highly suitable, particularly following on from similar social impact bonds in the UK and Europe
Social and affordable housing	Suitable – already working in this area
Aged care	Suitable
Financial exclusion	In order for this area to be suitable, Government would need to be able to clearly define the population and determine access to the population.
Health services	The suitability of this area would depend on the particular health issue that is selected for a transaction, the quality of the evidence base, access to the target population and the data available.
National Disability Insurance Scheme (NDIS)	The suitability of this area would be dependent on the timing. However, initially a housing component for individuals on the NDIS could be suitable.

Other policy areas that may be considered are federally-funded programs for Aboriginal and Torres Strait Islander communities and social services delivered through Centrelink.

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

Yes. As above, the Australian Government should consider collaborating with state and territory governments to develop joint social impact investments, as the benefits and potential cost savings occur across multiple tiers of governments.

Several state governments are currently developing SIBs for young people leaving out of home care – this is also an area in which savings are generated for the Australian Government.

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

The Public Data Policy Statement has the potential to '*optimise the use and reuse of public data; to release non sensitive data as open by default and to … extend the value of public data*' (Australian Government 2015 p 1).

These changes noted in the Public Data Policy Statement are welcomed and have the potential to assist in the development of the social impact investing market. The specific challenges that are faced regarding data and development of the market are as follows:

- *Payment by results transactions including SIBs, rely on measurement of outcomes* - Administrative data is often limited to inputs and outputs. Consideration should be given to inclusion of outcomes in administrative data sets within the current regulatory framework.
- *There is a need for improved sophistication with outcome measurement* – This could include capacity building in human services, and social enterprises, to improve measurement capability.
- *Measurement of impact and analysis of cost savings for government rely on cost data* – Business cases for social impact investment, including SIBs, rely on assessment of government costs and savings. Release of government cost data, as has been undertaken in some SIB RFT processes, would assist in standardising cost and saving assumptions and would assist in development of these transactions and the market.
- *The need for a 'safe to fail' culture around the Try, Test and Learn fund*. Development of new approaches to policy issues involve both successes as well as failures. Social impact transactions and social enterprises trialled under the fund should not utilise a payment by results mechanism but another social investment transaction structure.

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

Yes. As discussed above, data sharing partnerships should be developed with each social impact bond transaction, as well as other social impact investing transactions. It is critical that the Australian Government form data sharing partnerships with state and territory governments and service providers in order to be able to effectively use data to track the trajectory of the client. The advent of new technologies means that data can be linked in a relatively cost effective manner; the major barrier is encouraging governments to take up these technologies.

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

Our feedback on the four proposed Principles for social impact investing is as below:

Value for money	This is an appropriate principle of social impact investing; however, the implementation of this principle is not entirely straightforward. For example, the time horizon for value for money is not always agreed, nor is the question of whether indirect costs, intergenerational costs or indirect savings are included.
Robust outcome-based measurement and evaluation	We acknowledge and agree with the emphasis on robust outcomes-based measurement and evaluation. For transactions where a payment by results mechanism is used, it is entirely appropriate. For other social investment transactions, where the cohort is more difficult to track or define, then other types of measurement need to be considered. We also note from our work with social enterprises that impact measurement in social enterprises is under-developed. We suggest that investment in measurement should be proportional to the size of the expenditure/investment, so that small programs undertake relatively simple measurement and larger scale investments with more complex transactions (such as SIBs) utilise more sophisticated measurement methodologies (such as a randomised controlled trial).
Fair sharing of risk and return	This is an appropriate principle; however, the standing charge and other kickstarters/catalysts to the market need to be considered according to the stage of development, and the maturity of the policy area.
A deliverable and relevant social outcome	This is an appropriate principle; however, it is dependent on the outcome being sought. As previously noted, in KPMG's evaluation of the Joint Development Phase, the emphasis on evidence-base policy often contradicts efforts to be innovative in identifying new solutions to wicked problems. The principle of delivering social outcomes should consider the below: • Where social problems do not have a known evidence base, governments and service providers should be innovative in developing new approaches to the social problem. In these instances, a new impact investing mechanism may be appropriate. • Where social problems do have a known evidence base, a social impact bond may be a suitable mechanism to implement a program with a measurable social outcome.

Proposed 5th principle:	
Include the 'client voice'	We propose that the client voice should be included in social impact transactions including social enterprises; clients, for example, could be involved in the design of programs/services, and should give feedback on their experience of the program in the evaluation of programs or service offerings developed as a social investment.