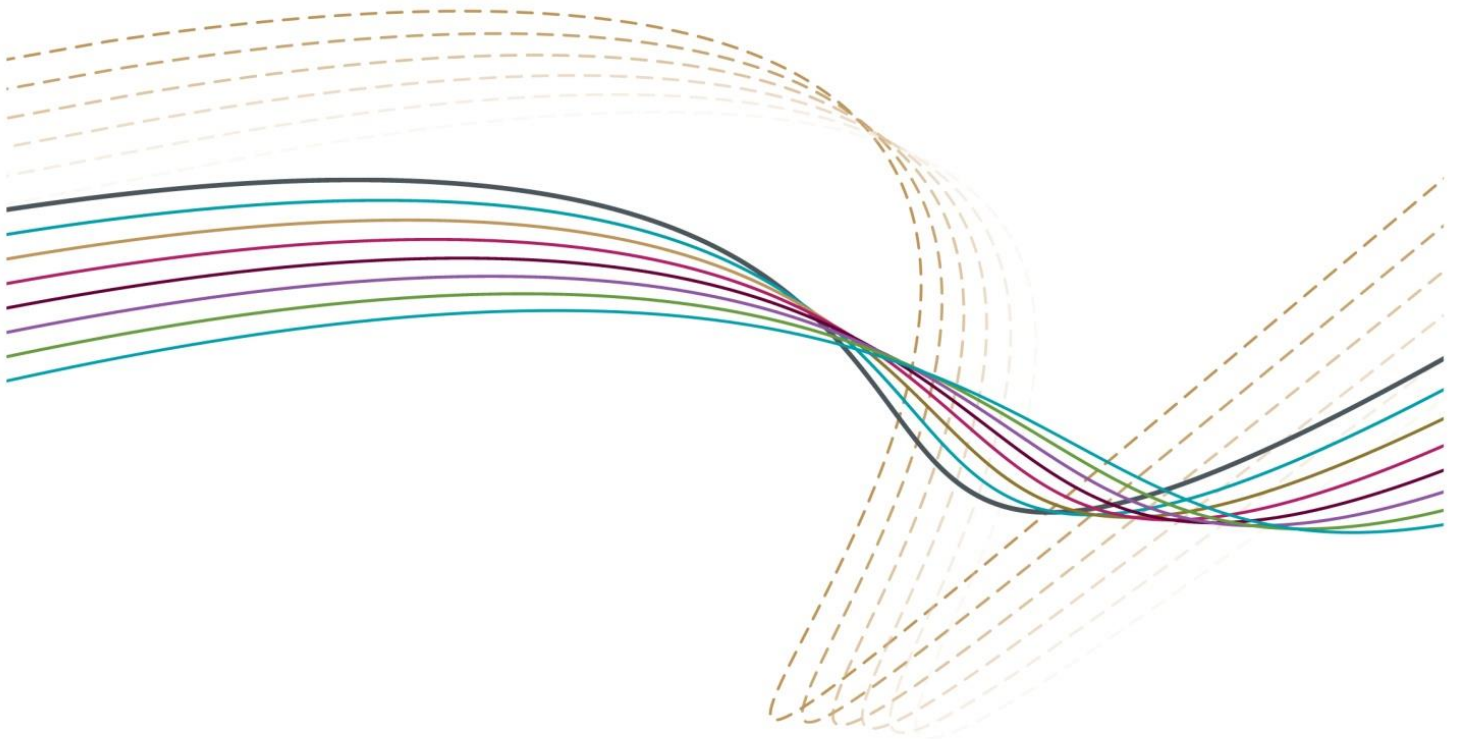


QUEENSLAND TREASURY

Submission on Impact Investment

Response to the Australian Government Social Impact
Investing Discussion Paper

March 2017

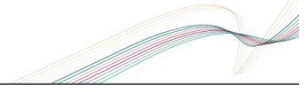






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1. Summary

Queensland Treasury welcomes the opportunity to respond to the Australian Government's *Social Impact Investing Discussion Paper*.

The Discussion Paper raises three key components for consultation:

1. the role the Australian Government should play in the social impact investment market;
2. the principles for social impact investing; and
3. potential regulatory barriers to the growth of the social impact investment market.

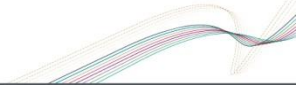
While there are 29 questions posed in the Discussion Paper, this submission focuses on Questions 1 to 11 which relate most directly to the role of the Australian Government and State and Territory governments, and the principles for impact investing. Particular emphasis is placed on social benefit bonds (SBBs) as one form of impact investing with which Queensland Treasury has recent experience.

The impact investment market in Australia has potential for strong growth. This is most likely to eventuate if the "right" conditions are in place which give market participants confidence to invest.

The Australian Government's regulatory and taxation responsibilities allow it to set the broader policy framework to facilitate the development of the market. However, the federal nature of the Australian system of government poses unique challenges for the development of the market. Harmonised policy frameworks across jurisdictions and the sharing of data will assist market creation and growth.

A principles-led approach to market development which sees its purpose as being the delivery of measurable improvements in challenging policy areas is critical. A comprehensive understanding of the concept of 'value for money' and a commitment to collaboration by all are key guiding principles.

Overall, a collaborative approach across all levels of government and between public and private sectors will best enable the benefits of impact investing to be realised across the nation, and, in particular, for individuals and communities to be positively impacted.



2. Growth Potential and Barriers to Impact Investment

Discussion Paper Questions:

1. What do you see as the main barriers to the growth of the social impact investing market in Australia? How do these barriers differ from the perspective of investors, service providers and intermediaries?
2. What do you see as the future for social impact investing in Australia: for example, can you foresee the development of new structures for social impact investing?
3. Are there any Australian Government legislative or regulatory barriers constraining the growth of the social impact investing market?

- The impact investment market in Australia has potential for strong growth. SBBs represent a developing segment of that market.
- While the limited experience of governments, social service providers and financial intermediaries is currently proving a barrier to the timely development of SBBs, market participants are gradually acquiring the necessary capabilities and capacities.
- Market participants will be more willing to invest in capacity building if they are confident that the impact investment market will experience strong growth in the future, facilitated by the support of governments.

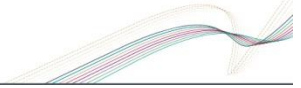
The impact investment market is expected to grow as investors seek out socially and environmentally responsible investments. According to one report, the Australian market for impact investing has the potential to grow to \$32 billion by 2022. A recent example of impact investment is the Queensland Treasurer's announcement in February 2017 of Queensland Treasury Corporation's planned issuance of certified and independently verified green bonds to domestic and international investors for use on projects funded entirely or in part by the Queensland Government.

A growing segment of the domestic market is represented by social benefit bonds (or social impact bonds) in which governments, social service providers, and private investors partner to address challenging social issues. An SBB transaction takes the form of a contract between the government and a service provider with payments to the service provider based on the achievement of measurable and verified outcomes, rather than inputs or outputs. The social service provider receives initial funding from private investors through the issuing of a bond, and the service provider returns the principal plus interest to the private investor from payments it receives from government.

While there have been over 60 SBBs implemented internationally, relatively few have been issued in Australia, on all of which State governments have taken the lead. The New South Wales Government contracted the first two SBBs in 2013 after three years in development. South Australia announced their first SBB earlier this year, also taking three years to develop. The Victorian Government is currently establishing a procurement process for its first SBB.

In the 2015-16 Queensland State Budget, the Queensland Government announced its intention to pilot three SBBs to tackle challenging social issues facing Queensland communities, with a focus on the areas of homelessness, reoffending and improving Indigenous outcomes. These SBBs will address complex social issues delivering new services to complement the extensive work already being undertaken by the Queensland Government and the social services sector.

In October 2016, the procurement process had narrowed the field to three proponents. The Queensland Government has been in joint development with proponents since late 2016 to negotiate and contract the three SBBs. Subject to these negotiations and the decisions of Government, services associated with the SBBs are expected to commence by the end of 2017.



The lengthy development timeframes for SBB transactions reflects the complexity of the transactions and the current immaturity in the capabilities and capacities of SBB participants (i.e., governments, non-government organisations and financial intermediaries).

Outcomes-based contracts require a greater level of expertise and willingness on the part of service providers and investors to accept risk. For many service providers accustomed to grant programs for the delivery of a service or product (based on inputs and outputs), shifting to an outcomes-based funding model is a paradigm shift. This new approach requires stronger commercial capability and greater responsibility for achieving measurable outcomes. Governments, social service providers and their financial intermediaries are gradually learning as the focus shifts to more of these impact investment transactions.

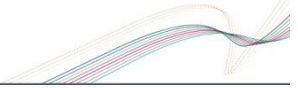
The Queensland Government has sought to support all stakeholders to engage in market development and direct participation through:

- market sounding processes to identify the opportunities and engage key players;
- education of the market through targeted briefings and forums;
- de-briefing sessions to proponents after each major phase of procurement;
- sharing lessons learnt with other jurisdictions;
- engaging with proponents through a joint development phase of negotiations, where the service delivery organisation works with government to develop their proposal in order to come to an agreement on contract terms;
- offering access to a \$1M Readiness Fund for service providers to support proponents to procure commercial and legal expertise in recognition of the novel nature of these types of transactions; and
- improving access to information to support accountability and transparency of performance through monitoring and reporting against agreed outcomes linked to a financial outcome.

A lack of capability in outcomes-based service delivery is not just reflected in the skills and expertise of market participants, but also the limited availability of outcomes-based data and systems support. Access to reliable data is a critical requirement in determining cohort and outcome measures in an SBB transaction.

The initial development of impact investment in Australia, as in the United Kingdom, has begun with the trialling of SBBs, which are possibly the most complex transaction type in the suite of payment-by-outcomes arrangements. Given relatively high transaction costs incurred in developing SBBs, it remains an open question whether they can be scaled up over time to make them a more attractive and mainstream investment proposition.

The sophistication of participants and data systems in relation to SBBs will undoubtedly develop over time. Participants are more likely to invest in capacity building if they are confident of an impact investment market in Australia which is experiencing strong growth with the support of committed governments. Continued and growing engagement of market participants, in turn, will provide its own impetus for the growth of SBBs as a viable asset class within the broader impact investment context.



3. Roles and Responsibilities

Discussion Paper Questions

4. What do you see as the role of the Australian Government in developing the social impact investing market?
5. Do you see different roles for different levels of government in the Australian social impact investing market? For example, the Australian Government as co-funder with State and Territory Governments continuing to take the lead in developing social impact investments?
6. Are there areas where funding through a social investment framework may generate more effective and efficient policy outcomes than direct grant funding?
7. What Australian Government policy or service delivery areas hold the most potential for social impact investing? Are there any specific opportunities you are aware of?
8. Are there opportunities for the Australian Government to collaborate with State and Territory Governments to develop or support joint social impact investments?

- The Australian Government's regulatory and taxation responsibilities will allow it to set the broader policy framework to facilitate the development of the impact investment market.
- The federal nature of the Australian system of government poses unique challenges for the development of the impact investment market. Benefits may spill over across jurisdictions (distorting value for money assessments) and access to data may be difficult when data is not shared across jurisdictions.
- Collaboration across governments to facilitate a harmonised policy framework and the sharing of data will assist to create an environment that will allow the market to develop.

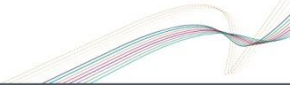
State and Territory Governments have direct policy responsibility for many service areas, and therefore, its main role in impact investment can be expected to involve direct participation in impact investment transactions, including an informative role communicating to the market potential areas of development.

The Discussion Paper emphasises the potential role of the Australian Government in developing the market. With responsibility for the broader regulatory, taxation and legislative frameworks which influence the attractiveness of investment from domestic and international financiers, the Australian Government has the opportunity to remove regulatory barriers and tax disincentives to "level the playing field". Tax concessions which reflect the positive externalities generated by many impact investments may be considered appropriate. The development of a secondary market for impact investments may also require oversight from Commonwealth authorities such as the Australian Securities and Investments Commission and the Australian Prudential Regulation Authority.

Key elements of impact investment are its focus on outcomes and evaluation, and the generation of benefits (including avoided service costs) for governments through improved social outcomes; however, the federal nature of the Australian system of government presents unique challenges for impact investment in Australia.

- Benefits generated from impact investment in one jurisdiction may spill over to other jurisdictions. Therefore, in assessing value for money, a focus on costs and benefits affecting a single jurisdiction may lead to underinvestment in social projects that would otherwise be beneficial from a broader national perspective.
- Socially relevant data for a particular geographic region can be owned and controlled by different levels of government. Each government can have different rules and protocols for the sharing of data which can restrict access to data that may be critical for the development of an outcomes-based transaction. Such data limitations can also lead to underinvestment in socially beneficial projects.

Intergovernmental collaboration has the potential to address social issues that are interjurisdictional. The Australian Government has an important role to play in facilitating intergovernmental collaboration, such as opening up investment opportunities in policy areas where the benefits of investment span multiple jurisdictions is desirable.



The growing reach of SBBs and other impact investments suggests that investment opportunities exist across a wide range of social, environmental, and other policy areas. It would be undesirable for this potential to be hindered by a lack of collaboration across jurisdictions.

It is important that policy frameworks adopted by separate governments be harmonised where possible. Investors and service providers are more likely to invest their resources and efforts across multiple jurisdictions if there is consistency in policy frameworks, standards and terminology. In developing this consistency, the foundational work of existing institutions such as the Global Impact Investment Network (GIIN) in establishing conventions and taxonomies which can be drawn upon to ensure what we are developing in Australia is consistent with global convention. Further, domestic institutions such as the Social Impact Investment Interjurisdictional Network (SIIN) can be leveraged; through the SIIN, Australian governments are already learning from each other and developing a common understanding of impact investment.

The Discussion Paper (p. 5) recognises that “State and Territory Governments are leading on social impact investing, consistent with their responsibility for the delivery of many services which could be delivered through social impact investing, including justice, homelessness, and out of home care services.” However, the Australian Government has an integral role in building a collaborative partnership with State and Territory governments to develop the impact investment market, including the movement towards harmonisation. Through collaboration, sharing of data, and harmonising policy frameworks, Australian governments can create an environment conducive to a thriving impact investment market and ultimately a respected place in the global impact investment movement.

4. Data

Discussion Paper Questions

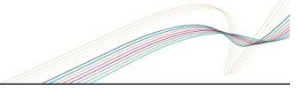
9. What are the biggest challenges for the implementing the Australian Government’s public data policy in the social impact investing market? What can do the Australian Government do to address these challenges?
10. Are there opportunities for the Australian Government to form data sharing partnerships with State and Territory Governments, intermediaries and/or service providers?

- Access to high quality data is a key prerequisite for creating and sustaining a vibrant impact investment market in Australia.
- The Australian Government can play a leadership role in generating and sharing data with other governments and non-government organisations to help drive policy innovation.

Data is typically used through a social impact investing transaction. In the first instance, data is used as evidence to prove and define the complex social issue to be addressed. Through the procurement and negotiation phases, data is used to demonstrate that the service or intervention proposed could deliver the promised change and in turn deliver value for the State (i.e., avoided demand outweighs the cost of the SBB). Ultimately, when the transaction ‘goes live’, the data is used to validate that the proposed change in the social issue has been delivered by the intervention or service.

In piloting SBBs, a key learning from the experience of other jurisdictions is that data is a significant program risk for both government and non-government entities alike. Identifying, accessing and interpreting data is a key input into defining the outcomes and measures used in the SBBs (and ultimately drive when and if payments are made). These outcomes and the associated data drive the measures and modelling that underpin the commercial arrangements of SBBs.

During the Request for Proposals phase of procurement, the Social Benefit Bond Pilot Program established a web-based platform to present structured analysis or visualisations of data, helping proponents identify feasible cohorts, factors to be considered in service design, and potential referral points. The Hub, as the platform was



called, enabled the State to bring together data from across a range of government agencies at a transactional level. The Hub platform enabled users to interact with the visualisations or analytical dashboards to explore the data to inform its service proposal. From the State's perspective, this was achieved without the need to release sensitive transactional data to a third party and to be able to present the data in the context of inherent limitations.

While The Hub aimed to address presentation and supply of data to proponents, this did and could not address the underlying issue of ensuring and accessing sufficient data to develop and implement a rigorous SBB transaction. Data to support the transaction needs to provide a narrative on the trajectory of the individuals involved, such as the frequency, duration and intensity of episodes of care and the mix of services being accessed over time. As a single jurisdiction, inadequate available data imposes limits on analysis that can be done and, in turn, the type and quality of transactions. Linking of data within a single jurisdiction and across jurisdictions is needed to demonstrate the service consumptions and risk factors around the individual. Restrictions in data sharing between governments in a federation can impose another hurdle to the acquisition of data and limit the development of market maturity.

The Australian Government is a major repository of social and other data, beyond that collected and published by the Australian Bureau of Statistics. Recent developments suggest a greater willingness by the Australian Government to share data (while observing privacy protocols). For example, the Australian Government's *Try, Test and Learn Fund* initiative represents a novel approach to driving policy innovation through the sharing of data. Similarly, the sharing of Australian Government data with other jurisdictions could support the development of outcome-based transactions where data is a major requirement, and, in turn, help drive policy innovation. Sharing of data across jurisdictions could also leverage off advances in web based and secured platforms as well as analytical tools.

Maintaining the privacy of those whose personal information underpins the data sets remains paramount and is embedded in the related privacy legislation and regulations across jurisdictions. A key impediment to data sharing both within a jurisdiction and across jurisdictions is the interpretation of privacy standards. There may be benefit in opening a conversation across jurisdictions involved in any data linkage as to how this work could be delivered without comprising the privacy of individuals.

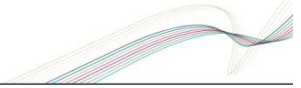
While supportive of opportunities to increase the linkage of data, it is also recognised that this often intensive work will need to be guided by clear and agreed research or investment questions to ensure that the resulting data set can achieve its objects. Representation from across government will be important, with co-ordination of activities across government enabling access to and understanding of the various data sets to inform and support the impact investment market.

5. Principles

Discussion Paper Questions

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

- The appropriate assessment of value for money requires acknowledging non-financial and qualitative benefits as well as financial, recognising that benefits can accrue over a longer period of time than the investment, and working across agencies and governments to account for all the benefits of an investment.
- Risk sharing arrangements will necessarily affect the value for money assessment. Ideally, risks should be allocated to those best placed to manage and absorb them.
- A further principle concerns commitment and collaboration. The effective management of impact investments and associated risks requires a clear commitment throughout a negotiation process by all transacting parties (including investors, service providers and government).



The Discussion Paper proposes principles to “guide the Australian Government’s participation in the social impact investment market,” with the aims of guiding “actions across the Australian Government related to the development of the social impact investing market” and encouraging “involvement of the community and private sector.”

The four principles proposed in the Discussion Paper are:

- Value for money
- Robust outcomes-based measurement and evaluation
- Deliverable and relevant social outcome
- Fair sharing of risk and return.

These principles appear to be narrowly focused on the optimal design or assessment of feasibility of social impact investments, rather than on the stated purpose of developing the impact investing market and encouraging the involvement of various stakeholders. The principles mirror key elements of an SBB: a focus on measurable outcomes; the generation of a value for money proposition; and the sharing of risk and return with the private sector. The discussion below focuses on the latter two elements.

Value for Money and Risk Sharing

The concept of value for money is critical in relation to impact investment strategies. Ultimately, the success of an impact investment should be measured by how effectively and efficiently the service makes a measurable difference for recipients, rather than the cash savings generated for government and the financial returns for an investor. Big Society Capital, an independent financial institution set up to help grow social investment in the United Kingdom, describes its core purpose as social impact: “If you ask any charity or social enterprise, they would say their purpose is to help their beneficiaries – social impact is their purpose and it must be ours”.¹

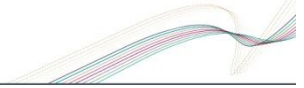
Impact investments seek to create both financial returns and positive social/environmental impacts which can be measured and evaluated. However, while some benefits may be readily quantified, others may be best described in qualitative terms and should be factored into a value for money assessment in some way. Further, impact investments should complement and enhance existing grant funding programs. A funding bias towards measurable outcomes may be at the detriment of existing areas of social responsibility in which measurement is impractical or inappropriate.

Impact investments are likely to be more effective when they target prevention and early intervention services, as evidence suggests these interventions are more effective in addressing social issues.² Addressing social issues early on or at their root cause can avoid demand for costly crisis and acute services in the medium to long term, which provides opportunities to direct savings into other social priorities.

However, the pursuit of prevention and early intervention service solutions may create a mismatch between the timing of benefits and costs (i.e., some benefits may have long tails which accrue well beyond the maturity of an investment). These longer term benefits should be accounted for in a value for money assessment. While the existence of benefits that accrue in the long term may impede a strategy of using avoided costs to fund the payments for an SBB, it should not, by itself, result in the rejection of the SBB if it represents value for money. In general, the financing decision (i.e., how to fund an investment) should not drive the investment decision (i.e., whether the investment represents value for money).

¹ “Our Strategic Direction”, Big Society Capital, <https://www.bigsocietycapital.com/latest/type/blog/our-strategic-direction>, 2 March 2017.

² *The Potential and Limitations of Impact Bonds: Lessons from the First Five Years of Experience Worldwide*, Gustafsson, Emily; Gardiner, Sophie; Putcha, Vidya. Brookings, July 2015.



As noted earlier, a focus on the value for money case for a single agency or government could result in some impact investments being rejected when, if a broader perspective were taken, the investment may actually represent value for money. This can occur because some of the benefits spill over to other agencies or governments who are not party to the transaction. In these circumstances, consideration should be given to cross-government or intergovernmental partnerships to ensure that investments that are in the community's interest are appropriately developed (and funded appropriately).

The risk sharing arrangement between government, service provider, and investor will necessarily affect the value for money assessment of an impact investment. Each participant will have a unique risk-return profile that it will apply when deciding whether to proceed with an investment. Ideally, risks should be allocated to those best placed to manage and absorb them in order to maximise the value for money of the investment.

Commitment and Collaboration

Commitment and collaboration could be added as a fifth principle. The effective management of impact investments and associated risks requires a clear commitment throughout a negotiation process by all transacting parties (including governments, service providers and financial intermediaries). Further, the success of impact investments depends on the ability and capacity of all parties to work in collaboration. Demonstrated commitment and collaboration from government will encourage the involvement of the community and private sector in the impact investment market.

While the intention and commitment to collaborate is fundamental, they will not be enough to create success if they are not supported by workable governance, operational and reporting frameworks. From an operational perspective, there needs to be clarity as to the expected role of key players. For example, the proposed level of government involvement in providing support functions for delivering the service, in terms of referral processes, policy, measurement, returns, data sharing and reporting frameworks must be determined.

Collaboration does have the potential to support improved community sector capacity and capability and increase investor confidence in the developing market. Currently, there is limited capacity across governments to capitalise on cross boundary collaboration to support the future growth and sustainability of the social impact market. Cross-government collaboration in social areas such as employment and health leveraging investment in the delivery of improved social outcomes is an example where a sustained impact within the community could be achieved.

