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Submission to Social Impact Investing Discussion Paper

The Responsible Investment Association Australasia (RIAA) welcomes the opportunity to make this submission in response to the Discussion Paper on Social Impact Investing.

RIAA is the industry body representing responsible and ethical investors across Australia and New Zealand. RIAA has 165 members who manage well in excess of \$1 trillion AUM globally. Our membership comprises superannuation funds, asset consultants, fund managers, financial advisers, dealer groups, researchers and analysts, and others involved in the industry, across the full value chain of institutional to retail investors.

Many of our members are involved directly as impact investors or have an active interest in impact investing, primarily as providers of capital into impact investments, but also as advisers to providers of capital (whether institutional or wholesale) as well as intermediaries structuring impact investment products. The interest in impact investment comes from across our membership, from the largest of superannuation funds through to independent financial advisers.

RIAA works to see more capital being invested more responsibly, working to shift capital into sustainable assets and enterprises, and shape responsible financial markets, to underpin strong investment returns and a healthier economy, society and environment. As such we see impact investment as one core strategy of unlocking capital to flow into the types of enterprises and assets that are needed to build a stronger, more socially equitable and environmentally sustainable nation, that will underpin strong, long term investment returns for beneficiaries.

Fundamentally, we see that additional private capital is required to be deployed to augment public capital in order to sufficiently respond to some of the biggest and most complex social and environmental challenges we are confronting. Impact investing provides a means whereby this private capital can be harnessed and put to work to complement and augment strong investments that deliver measurable social and/or environmental returns in addition to financial returns.

As such, RIAA is strongly supportive of the work of government – both at a Federal and State level – to continue to develop and mature a more consistent and reliable impact investment market, and see an important role for government to unlock the full potential of private capital to be deployed in impact investing.

This submission will focus primarily on the view of the institutional investor in impact investing, presenting a view on the role of the Australian government in catalysing this sector.

High level responses:

Broadly, RIAA sees the discussion paper as a strong summary of the social impact investing market, its challenges, its definition, the principles and the main forms of impact investments. Furthermore, the summary of challenges for impact investing (page 11 and 12) are well articulated and cover off many challenges frequently raised by the RIAA membership, in particular: small scale, illiquid, high due diligence costs, high transaction costs, lack of data, the challenge of measuring and articulating social impact in a quantifiable manner.

In terms of the main forms of impact investing (question 2), there is little doubt that innovation in financial structure will occur very rapidly in this space as investors seek out ways to get exposure to impact investment products and strategies across all parts of a balanced portfolio. As a result, we see the list of three styles of impact investments in the discussion paper as a fairly limited description of the structures that will become available. We are already beginning to see impact investing opportunities being presented across all asset classes (from private equity, listed equities, fixed income, venture capital, infrastructure, property and beyond), and believe the government should remain focused less on structures and more on the principles of what constitute impact – ie “the intention of generating measureable social and/or environmental outcomes in addition to financial returns”.

The role of the government in social impact investing:

Importantly, there is an increasing desire by investors to allocate capital to investments that generate both social and financial returns. However, the more important reason for supporting the growth of impact investing is that there remain many seriously underfunded social and environmental challenges that will require a significant step up in capital if we are to solve these problems. Impact investment provides an avenue to catalyse private capital to do some of the heavy lifting to solve these challenges, and augment the amount of public funding that is available (not replace public capital).

Through this lens, there is strong justification for governments to step in to both hasten the development of the impact investment market and grow the amount of private capital flowing into impact investment to support public policy objectives. Without supportive government policies, clear guidance, government co-investment, and adequate risk sharing, an inadequate amount of capital will flow into these important social and environmental areas.

From this point of view, RIAA has focused our submission primarily on the regulatory barriers constraining the flow of institutional capital into impact investments.

Superannuation law and social impact investing – question 23:

A key focus for our submission relates to the current superannuation law and how it relates to impact investing. RIAA agrees with the summary in the Discussion Paper that under current legislation and regulation - including both the Superannuation Industry (Supervision) Act 1993 as well as APRA’s Prudential Practice Guidance (specifically SPG530) – it is consistent for superannuation fund trustees to

consider and allocate capital to impact investments and that this can form a part of a balanced investment strategy.

RIAA has many superannuation fund members who have made investments in impact strategies and products consistent with the best interests of members.

However, RIAA is of the view that the current wording provided by APRA under Prudential Practice Guidance SPG530 Investment Governance in its current form is causing confusion for some superannuation fund trustees, and thereby acting as an impediment for the flow of institutional capital into impact investments.

Specifically, the current wording in sections 34 – 36 conflates environmental, social and governance issues as non-financial investment issues alongside ethical investment issues. The wording is such that it lumps all forms of “responsible investment” as non-financial, or purely “values” based styles of investment.

What we know to be clear today is that the vast majority of Australian institutional investors are engaged with responsible investing because they see these factors as entirely material to investment outcomes. Similarly, no institutional investors in Australia are making impact investment decisions without the dual purpose of delivering risk adjusted financial returns as well as social (or environmental) returns.

Due to a confusing use of terms relating to responsible investment in the SPG530, the APRA Guidance is currently being interpreted narrowly by some trustees as limiting the ability of trustees to undertake ESG investing, ethical investing and/or impact investing.

It is our view that it is time that APRA updated the wording in SPG530 to better clarify the duties of trustees around the issues of impact investing, ethical investing and ESG investing, and as a minimum remove the current confusion in the use of these terms in this Prudential Practice Guidance.

By providing additional clarity, this will remove current confusion and ensure trustees have clearer guidance as to what conditions must be met in consideration of impact investments within broader superannuation investment asset allocation.

It’s worth noting that both the US and UK have recently provided additional guidance to fiduciaries around responsible investment issues, to reflect the rapidly changing understanding of investment approaches, and how ESG, ethical and impact investment issues are being considered by trustees.

Most noteworthy is the updated guidance issued by US Department of Labor to pension plan trustees clarifying that they may invest in socially responsible, ESG and/or impact investments so long as this is appropriate for the plan and economically and financially equivalent with respect to the plan’s investment objectives, return, risk and other financial attributes (see <http://www.dol.gov/ebsa/newsroom/fsetis.html>). By specifically naming these investment approaches, this guidance established very clearly the position of the government on these matters, giving trustees much more comfort in how they should approach such investments.

The UK Law Commission reviewed the fiduciary duties of investment intermediaries in 2014. Usefully, the Commission concluded with a clear two test process for trustees around decisions that would relate to ethical or impact investments (without naming the term “impact investment”). Specifically, the commission concluded that the law permits trustees to act on non-financial factors providing that they have good reason to think beneficiaries share those concerns and that there is no risk of significant financial detriment (see <http://www.lawcom.gov.uk/project/fiduciary-duties-of-investment-intermediaries/>).

RIAA believes the key regulatory change that would unlock more private capital from institutional investors toward impact investing would be for APRA to clarify its guidance on responsible investment strategies, specifically ESG investment, ethical investment and impact investments, in a manner consistent with the US and UK.

Other responses:

RIAA also supports and commends the submission by Impact Investing Australia, and will not aim to duplicate their work in this submission. Rather, RIAA supports the recommendations proposed by Impact Investing Australia.

Furthermore, RIAA also supports the submission by B Lab in regards to the suggested ‘Benefit Company’ amendments to the Corporations Act. It is our view that these amendments are beneficial in helping to identify potential businesses that are deeply committed to the dual purpose of generating social and financial returns, and would provide assurances to investors that companies are accountable to their mission to deliver these dual returns.

RIAA would welcome the chance to discuss this submission further with the Treasury.



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