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MEMORANDUM TO THE DEPUTY MINISTER OF EMPLOYMENT AND SOCIAL DEVELOPMENT

POTENTIAL ENGAGEMENT ON LEGAL AND REGULATORY BARRIERS TO SOCIAL FINANCE AND SOCIAL ENTERPRISE

(FOR INFORMATION)

SUMMARY

BACKGROUND

Context

The Government has committed to forging a “new relationship” with the charitable and non-profit sectors. This commitment is reflected in the tasking of the Minister of National Revenue to work with the Minister of Finance to develop a new legislative framework to support the charitable and non-profit sectors, which includes working with Minister Duclos specifically on social finance and social enterprise, and in the joint mandate letter commitment of Ministers Duclos and Mihychuk to develop a Social Innovation and Social Finance (SI/SF) Strategy.

Social finance has been a policy tool of interest to the Government of Canada for a number of years. Successive Budgets have underscored the Government's commitment to explore the potential of social finance, which included a specific undertaking in Budget 2014 to examine possible barriers to social finance in the Canadian context.

- On June 9, 2014, the Minister of Employment and Social Development brought key Cabinet colleagues together with his Ministerial Advisory Council on Social Innovation (MAC) to discuss these perceived barriers.

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- Subsequently, an Interdepartmental Task Force on Barriers to Social Finance which included Finance Canada, Canadian Revenue Agency (CRA), ESDC and Industry Canada was struck with a mandate to assess barriers identified by the MAC, resulting in a report that was not finalized due to a lack of consensus (Annex A).



Diagnostic

Community organizations have a critical role to play when it comes to maintaining a strong social safety net in Canada. They provide services and develop innovative ways of supporting individuals and families which are a key complement to universal social programs. The civil society sector is also an important component of the Canadian economy. It contributed 8.1 percent to GDP in 2008 and made up 13 percent of the total labour force in 2003. This is the result of a long history of government support for the civil society sector.

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However, the sector may be approaching an inflection point, with traditional sources of funding declining or stagnating (e.g. government grants and private donations) and necessitating a move toward more innovative, market-driven, non-governmental sources of financial sustainability (e.g., business activities and earned income). At the same time, an aging and more diverse society creates a greater demand for the services that civil society organizations provide.

As Imagine Canada has put it:

"Canada's charities are at a financial crossroads. With traditional revenue sources declining, charities are increasingly looking at ways to finance their non-profit activities through business income — both in areas directly related to their charitable missions, and in areas that are not."

In response, the not-for-profit sector is embracing socially innovative techniques and programs by:

- **Adopting more sustainable business models:** The Vancouver Native Housing Society has created a social enterprise – the Skwachàys Lodge – that combines a boutique hotel with an Aboriginal art gallery, providing the society with a flow of revenue and a place for local Indigenous artists to showcase and sell their work. Many not-for-profits have similarly pursued innovative programs that generate revenue for the organization while creating employment opportunities for the at-risk populations they serve.
- **Mobilizing new sources of capital:** The United Way, City of Toronto, and Government of Ontario created the Toronto Enterprise Fund to support social enterprises that focus on employing and helping persons at risk of homelessness. The Fund provides financial and business development supports so that innovative organizations can launch and grow impactful social enterprises.

Documentation of barriers

Perceived barriers to the development of the charitable and non-profit sectors and potential components of an enabling legal and regulatory environment have been highlighted in the 2014 report *"Mobilizing Private Capital for Public Good:*

Priorities for Canada" by Canada's National Advisory Board (NAB¹) to the G7-based Social Impact Investment Taskforce (Annex B) and the 2015 study *"Exploring the Potential of Social Finance in Canada"* by the House of Commons Standing Committee on Human Resources, Skills and Social Development and the Status of Persons with Disabilities (Annex C).

CURRENT STATUS



Canada compared with other countries

The legal and regulatory barriers often cited by stakeholders can be grouped into three types:

1. **Tax policy:** legislative restrictions on the kinds of investments that can be made by registered charities such as foundations, and the current taxation and regulatory framework for charities and NPOs more generally.
2. **Tax administration:** including barriers to and misunderstandings surrounding mission-related and program-related investment by charitable foundations. Charities are seeking more clarity and flexibility in how they invest monies both from their traditional investment pools (their endowments) and from funds set aside for granting, in hopes of creating financial and social returns using both pools of funds.

¹ The NAB (2014) included representation from the above organizations as well as: Centre for Social Innovation; Pierre Elliot Trudeau Foundation; KPMG Impact Ventures; Trico Charitable Foundation; BC Centre for Social Enterprise; Social Innovation Generation (SiG); Edmonton Community Foundation; Imagine Canada; Norton Rose Fulbright / Macquarie Capital Markets; Carleton University Centre for Community Innovation; Renaissance; Concordia University School for Community and Public Affairs; Renewal Funds; Strandberg Consulting; Desjardins Group; Native Commercial Credit Corporation; and Social Capital Partners.

3. **Corporate form and business development:** including lack of access to a hybrid corporate form for social enterprises and access to SME supports. A hybrid corporate form would be a new type of legal entity that could fill a gap between the existing non-profit and for-profit forms, and would provide social enterprises with more clarity and flexibility in how they operate. SME supports include a wide range of business development services and resources, including incubator and accelerator networks as well as business loans.

Measures to date

In keeping with the Government's platform commitment to forge a new relationship with the charitable sector and an earlier Budget 2015 proposal resulting from the work of the Interdepartmental Task Force on Barriers to Social Finance, the Budget Implementation Act (Bill C-15) introduced on April 20, 2016, includes an amendment to the *Income Tax Act* that will permit registered charities and registered Canadian amateur athletic associations to hold limited partnership interests. Limited partnerships are the most common legal vehicle for raising share capital and the form being taken by many social finance initiatives. They consist of a general partner with direction and control of the venture and assorted shareholders with limited legal liability for its activities.

This change will help charities diversify their investment portfolios, thereby allowing them to reduce risk and increase returns, and to unlock new capital to be invested in innovative community projects.

As such, the measure can be seen as a "down payment" on the Social Innovation and Social Finance Strategy. While the measure has been welcomed by the sector, stakeholders have indicated that more fundamental reforms to the legislative framework are needed.

Some social finance stakeholders have pointed to policies in other jurisdictions as potential remedies for some of the regulatory barriers they describe, from least to most ambitious:

1. **Unrelated business income tax (UBIT)** – The American UBIT allows tax-exempt organizations to carry on business activities that are not related to their tax exemption (e.g., a university running a restaurant) by taxing the income generated from those unrelated business activities, while identifying a set of public benefit activities on which they will not be taxed (e.g., hiring and training at-risk youth).
2. **Destination of profits test** – Used in the UK, New Zealand and Australia, the destination of profits test allows charities to generate unlimited tax-exempt revenue so long as the profits are reinvested in their operations and used to further their charitable purposes.
3. **Independent charities regulators** – Several jurisdictions, including Australia (Australian Charity and Not-for-Profit Commission), the UK (Charity Commission), and New Zealand (Charities Services) have dedicated charities regulators with varying degrees of independence from their respective tax regulators, allowing for more extensive study and responsive treatment of the sector's activities.
4. **Redefinition of charitable purpose** – Some stakeholders have argued that the laws governing Canada's charitable sector may require updating and that more expansive "heads of charity," such as those introduced in the UK, could create more space for organizations on the demand side of social finance to proliferate.
5. **Tax credits** – Several jurisdictions such as the UK and Nova Scotia have begun using tax credits and other forms of positive tax relief to incentivize impact investing and social finance.

Recent stakeholder proposals

The legal and regulatory barriers outlined here, identified in the reports of Interdepartmental Task Force and the NAB, have recently been reinforced by:

- Pre-Budget submissions by the National Impact Investors Practitioners Table (NIIPT)² and other stakeholders (e.g., Philanthropic Foundations Canada, Canadian Community Economic Development Network, Ontario Non-Profit Network); and
- Stakeholder statements made at a roundtable on social finance in Toronto on April 7, 2016, hosted by Minister Duclos.

² The NIIPT coordinating committee consists of representation from: Vancity Credit Union; Chantier de l'économie sociale; Community Forward Fund; Social Enterprise Fund of Edmonton; New Market Funds of Vancouver; MaRS Centre for Impact Investing; and Nova Scotia Co-operative Council.

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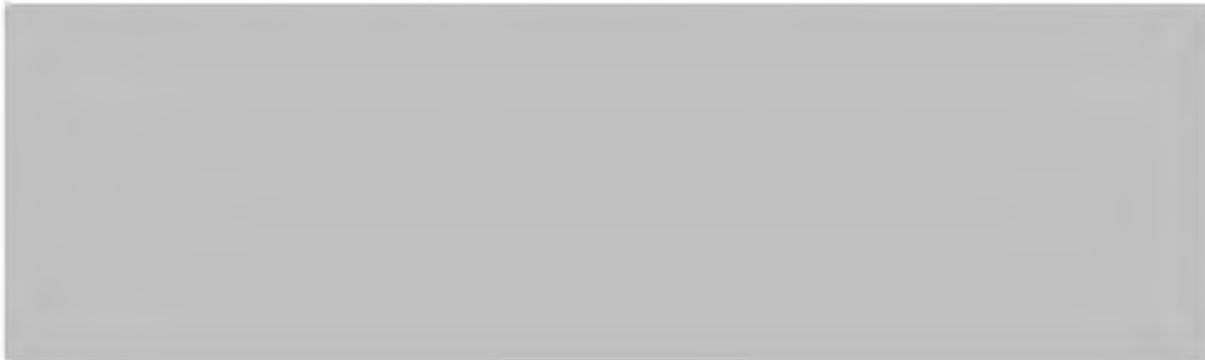
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These include calls for a comprehensive review of charitable and non-profit sector regulations; an enabling environment that permits revenue generation by charities and non-profits which they can reinvest to support public benefit work; and access for non-profit social enterprises and cooperatives to business supports available to traditional SMEs.

Annex D provides specific examples of recent stakeholder requests.



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Attachment(s): 4

Report of the Interdepartmental Task Force on Barriers to Social Finance

March 2015

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Executive Summary

“The Government will continue to work with leaders in the not-for-profit and private sectors to explore the potential for social finance initiatives and examine whether there are barriers to their success.” – Budget 2014

Social finance has been a policy tool of interest to the Government of Canada for a number of years. Successive Budgets and the 2013 Speech from the Throne have underscored the Government’s commitment to explore the potential of social finance, with the most recent Budget undertaking to examine possible barriers to social finance in the Canadian context. A process was launched on June 9, 2014 with the Minister of Employment and Social Development bringing key Cabinet colleagues together with his Ministerial Advisory Council on Social Innovation (MAC) for an “Engagement Day” to discuss these perceived barriers. Following Engagement Day, a working group was struck, with a mandate to assess barriers identified by the MAC. Issues identified through parallel and related initiatives, such as the work of the Canadian National Advisory Board to the G7-based Social Impact Investment Taskforce and recent Industry Canada consultations on the *Canada Business Corporations Act*, were also assessed insofar as the schedule and workload of the Task Force permitted. The complete Terms of Reference of the Task Force can be found at Annex A.

Chapter 1: Introduction to Social Finance

Chapter prepared by Employment and Social Development Canada

Social finance is both a type of, and a funding source for, social innovation.

Social innovation refers to ideas (products, processes) that seek to address pressing unmet social needs by applying new learning and strategies to achieve better results and outcomes. Social innovation takes place across boundaries between the public, private, and not-for-profit sectors.

Social finance makes up one component of a continuum of funding available for social innovation. Social finance is the management of money so as to create both a financial return and a positive social or environmental impact that is actively measured. Social finance provides opportunities to leverage additional investments to scale up proven or promising approaches that address social and environmental challenges. It also creates opportunities for investors to finance projects that benefit society and for community organizations to access new sources of funds.

There are multiple forces driving government interest in social finance.

Despite Canada's strong safety net and community-specific programs, some groups continue to face complex social challenges (e.g., new Canadians, Aboriginal people, at-risk youth, persons facing multiple barriers to employment).

Recognizing that governments at all levels and across jurisdictions cannot tackle these challenges on their own, there is a desire to find new ways to address social challenges that have proven resistant to current interventions and to work with new partners from a variety of sectors.

Governments are seeking new ideas and new partners in order to maximize existing resources, and to ensure value for taxpayers' dollars while delivering on specific commitments to help vulnerable populations. Social finance mobilizes a variety of sources of capital to provide access to new financing streams, to leverage limited government funds to scale up proven or promising innovations and to finance preventative interventions. Social finance also introduces

a level of market discipline to the social sector, which creates a new push for outcome or impact measurement and for social returns on investments. By creating a new stream of financing, separate from philanthropy and government grants, social finance can help community organizations achieve greater self-reliance and sustainability. Many governments are also interested in extending outcomes funding to complex service delivery areas where costs are rising and entrenched problems persist, with a view to enhancing accountability, achieving greater social impact and redirecting funds to high-performing service providers who can demonstrate outcomes and impacts, not just short term outputs. More broadly, social finance reflects a general push toward public sector innovation, which seeks solutions to intractable social problems while driving productivity and growth.

Social finance requires supply, demand, intermediary actors and innovative tools.

The social finance marketplace is made up of actors on the supply side (those providing capital) and the demand side (those using the capital for social good and to generate revenue).

On the supply side, there exist traditional funders of social services (e.g., governments, foundations, community loan funds, credit unions) but also new, private-sector actors (e.g., high-net-worth individuals, venture philanthropists) looking to make investments that pay a return and make a positive social impact. Investments from other private-sector segments, such as pension funds, banks, and retail investors, have started to grow and represent billions of dollars in potential funding¹.

On the demand side exist non-profit organizations and charities looking to raise capital for a variety of purposes. These social finance-seeking organizations can often take the form of social enterprises – businesses explicitly designed to generate both revenue and social impact. Social enterprises incorporated as for-profit organizations, sometimes referred to as social-purpose businesses, can also be end-users of social finance. Innovative charities are also adopting revenue-generation strategies from the sale of goods and services while addressing complex social challenges. Imagine Canada has called these and other types of earned-income activities opportunities “...for experimentation and innovation, to forge paths toward greater independence and long-term sustainability, and to further enhance the organizational mission and impact.”² Social enterprises and social-purpose businesses are active in a variety of policy spheres, often focusing on addressing entrenched social issues from a prevention-oriented

¹ *Expanding Social Finance in Canada*, Public Policy Forum, p. 4,
http://www.ppforum.ca/sites/default/files/Social%20Finance%20Consultation%202010_0.pdf

² *Earned Income Framework*, Imagine Canada, p. 2
http://www.imaginecanada.ca/sites/default/files/www/en/publicpolicy/earned_income_framework_2013.pdf

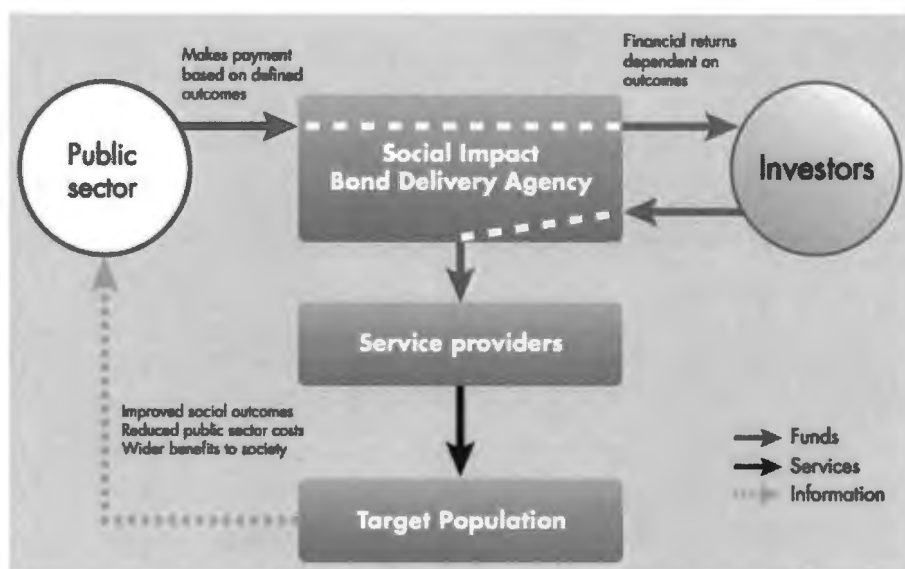
perspective: persistent unemployment, housing and homelessness, public health, Aboriginal issues, immigrant settlement issues, and at-risk youth. Impact investors are largely making use of repayable financing tools such as loans, which represents an opportunity for social enterprises that want to expand and grow, but are frequently ineligible for traditional financing instruments. Some studies have shown that, while the demand for social finance is growing in Canada, there is a shortage of funding and this shortage is creating an inefficient and uncoordinated market.³ Social finance has also played a role in incenting new grant-based funding, as new players such as corporations see an opportunity to direct donations to innovative organizations achieving social or environmental impact. While more research needs to be conducted on Canadians' views regarding the tax privileges enjoyed by charities and the impact that increased business activities would have on donations, Canadians seem to support charitable social enterprises and business activities, with 86% agreeing that "running a business is a good way for a charity to raise money they can otherwise get via donations or grants."⁴

Intermediaries exist in the social finance space, as they do in most capital markets, aggregating deals into funds, providing advice and due diligence services to investors, and offering business development services to organizations seeking financing. Intermediaries can take the form of for-profits, non-profits, or charitable organizations, depending on their role and target clientele.

Emerging social finance investments include a wide range of outcome-based tools, launched by governments, such as social impact bonds (SIBs). The SIB tool provides a good illustration of how the elements of the market – supply, demand, intermediary – come together. SIBs are agreements between a commissioner (someone who wants to improve social outcomes – usually government or the public sector) and investors or an intermediary agency (as in the diagram which follows) in which the commissioner will pay a fixed amount to the investors if certain social outcomes can be demonstrated to have been achieved. In general, if investors can achieve the outcome for less than the government will pay for it, they have the opportunity to recover their principal investment and make a return. SIBs combine a pay-for-performance element with an investment-based approach: private investors provide up-front capital to fund interventions, and can expect to get back their principal investments and a financial return only if the results are achieved. In calculating the amount it will pay, government will notionally consider the costs a particular social ill creates, thus creating theoretical cost savings if the outcomes are achieved.

³ *Redefining Returns*, Purpose Capital, p. 32 <http://purposecap.com/wp-content/uploads/Redefining-Returns.pdf>

⁴ *Talking about Charities*, Muttart Foundation, p. 76
<http://www.muttart.org/sites/default/files/survey/3.Talking%20About%20Charities%202013.pdf>



One newer application of the SIB model is in the field of international development. Development impact bonds (DIBs) apply the SIB model by using donor money (possibly combined with funds from the host country) to pay for outcomes. Initial DIB work has focused on sleeping sickness in Uganda.⁶ Grand Challenges Canada, an organization currently making impact investments in social enterprise in developing nations, is also exploring the SIB model for development financing.⁷

Overview of domestic and international markets and government actions to date

Estimates of the size of the social finance market in Canada vary widely, due to varying definitions of social finance and/or impact investing. Analysts value the current Canadian social finance market between \$2B and \$5B, with the potential to grow to \$30B in future within 10 years.⁸ Most analysts agree, however, that the market is in its nascent stage and, while it is growing, it still faces barriers, including but not limited to regulation and legislation.⁹

Globally, the social finance market is at various stages of development, with strong foundations and steady growth now established in the UK (the world leader) and rapidly emerging markets in the US, Australia, and across the EU. JP Morgan estimates the size of the global market to be

⁵ Source: *Towards a New Social Economy*, Social Finance UK, p. 30 <http://www.socialfinance.org.uk/wp-content/uploads/2014/07/Towards-A-New-Social-Economy-web.pdf>

⁶ <http://www.socialfinance.org.uk/impact/international-development/>

⁷ <http://www.grandchallenges.ca/2014-annual-letter/>

⁸ *Mobilizing Private Capital for Public Good*, Canadian Task Force on Social Finance, p. 5 <http://www.marsdd.com/wp-content/uploads/2011/02/MaRSReport-socialfinance-taskforce.pdf>

⁹ *Mobilizing Private Capital for Public Good: Priorities for Canada*, Canada's National Advisory Board to the Social Impact Investment Taskforce, for example.

\$12.7B in 2014, up 19% from 2013.¹⁰ Analysts point to the rapid growth of the related socially responsible investment market¹¹ in the US, from \$639B in 1995 to \$3.75T in 2012, as a harbinger for the potential expansion of social finance.¹²

Recently, governments at multiple levels have introduced programs explicitly supporting social finance. As the lead federal department, Employment and Social Development Canada (ESDC) has taken several steps to advance social finance activity in Canada:

- The **National Call for Concepts for Social Finance**, launched in November 2012, helped popularize the concept of social finance and encouraged Canadians to develop innovative ideas. A final report on the Call for Concepts was made public in early 2013 and proposed four next steps the Government would take to support social finance: further the social finance conversation, connect interested social finance partners, help to sharpen promising social finance ideas, and develop ways to test social finance tools using existing program funds;¹³
- In 2012, an interdepartmental working group led by ESDC and including Finance and CRA prepared a report for Ministers on the **Legal and Administrative Barriers to Social Impact Bonds and Similar Social Finance Tools**, to better understand how these new tools would fit within existing government funding instruments, tax law, budget and accounting processes, and intellectual property law;
- ESDC is developing a **SIB-like pilot** in the area of literacy and essential skills;¹⁴
- The **Ministerial Advisory Council on Social Innovation**, which includes social finance in its purview, has been renewed and expanded;
- ESDC has developed a **Social Enterprise Plan of Action** to increase the sustainability and self-sufficiency of community organizations by creating the conditions for social enterprises to thrive;
- The Minister attended and delivered a keynote address to the **Social Enterprise World Forum** hosted in Canada in 2013 and expressed his support for the social enterprise model, while noting that barriers such as regulatory restrictions could be alleviated by government action;¹⁵

¹⁰ *Spotlight on the Market: Impact Investor Survey*, JP Morgan, p. 5

http://www.jporganchase.com/corporate/socialfinance/document/140502_Spotlight_on_the_Market.pdf

¹¹ Socially responsible investing involves making investments that create a return but also encourage environment stewardship, social justice, and corporate governance. In contrast to social finance or impact investing, socially responsible investing places a larger emphasis on monetary returns, and more of an emphasis on reducing the social or environmental harm an investment does, rather than on creating positive social or environmental impact.

¹² *Financing Social Good*, RBC, p. 6 <http://www.rbc.com/community-sustainability/assets-custom/pdf/Financing-Social-Good.pdf>

¹³ http://www.esdc.gc.ca/eng/consultations/social_finance/report/index.shtml

¹⁴ <http://news.gc.ca/web/article-en.do?nid=778049>

¹⁵ <http://news.gc.ca/web/article-en.do?nid=778049>

- ESDC is working with a network of **Social Finance Investment Funds** (SFIFs) to develop a compendium of best practices to support the emergence and growth of these vehicles; and
- ESDC is represented on the **international Social Impact Investment Taskforce**, created in 2013 under the UK presidency of the G8 to explore the growth of the global impact investment marketplace and make recommendations to G7 leaders.¹⁶

Across Canada, several provinces have begun to explore this policy space as well:

- British Columbia has created a new **corporate form** for social enterprises, called Community Contribution Companies,¹⁷ and has redirected some **unclaimed assets** to community foundations;
- Saskatchewan has launched Canada's first **SIB**, to provide supportive housing for at-risk single mothers;¹⁸
- Ontario has launched a **call for SIB ideas** in the area of housing and homelessness, youth at risk, and persons with multiple barriers to employment, along with a social enterprise strategy;¹⁹
- Québec has provided longstanding support to the social economy in that province, including the funding of the Chantier de l'économie sociale, a large non-profit organization that makes **social finance investments**,²⁰ as well as adopting recent **framework legislation bill**²¹ that established ongoing support for the social economy and has created a supportive infrastructure for the social finance ecosystem on the supply side, demand side and for intermediaries;
- Nova Scotia has developed a **tax credit** (the Equity Tax Credit)²² in order to incentivize local community investment, as well as a **new corporate form**²³ for social enterprises (called Community Interest Companies), and provides first-loss capital to a social enterprise loan fund for not-for-profit organizations through credit unions across the province; and

¹⁶ <http://www.socialimpactinvestment.org>

¹⁷ <http://www.fin.gov.bc.ca/prs/ccf/>

¹⁸ <https://www.saskatchewan.ca/government/news-and-media/2014/may/12/social-impact-bond>

¹⁹ <https://www.ontario.ca/business-and-economy/social-impact-bonds>

²⁰ <http://www.chantier.qc.ca/>

²¹ http://www.gouv.qc.ca/portail/quebec/pgs/commun/actualites/actualite/actualites_131010_economie-sociale/?lang=en

²² <http://www.novascotia.ca/finance/en/home/taxation/tax101/personalincometax/equitytaxcredit/default.aspx>

²³ <http://novascotia.ca/news/release/?id=20121128010>

- Manitoba has a corporate tax credit to encourage corporations to start social enterprises (Neighbourhoods Alive! Tax Credit)²⁴ and recently published a social enterprise strategy developed in collaboration with community-sector organizations.²⁵

Potential program tools and government investments to support social finance (complementary to action on regulatory barriers)

As can be seen in the examples from other jurisdictions, in addition to addressing regulatory barriers, government can take other policy actions to strengthen the social finance marketplace, including:

- **Direct Investing:** Government can invest (directly or through intermediaries) in social finance opportunities, using its money catalytically. Early investments seek to help build investors' confidence, develop market norms and build market infrastructure (e.g., financial products and metrics). The investments are also used to signal clear and strong government support (e.g., dedicated fund) to ensure the long-term success of the market. Generally, governments invest or direct investment through local and regional investment funds, helping to build an intermediary market and reduce transaction costs. Examples of this type of policy exist in the UK (Big Society Capital, a wholesale social finance lender) and Australia (Social Enterprise Development and Investment Funds, which flows investment through intermediary investment funds).
- **Outcome Procuring:**²⁶ Similarly, government can act as a purchaser of outcomes, setting prices on social outcomes, creating funds to pay for them, and negotiating with investors, intermediaries and service delivery organizations to create social impact bonds or similar outcome-based contracts. Examples of this include the US Workforce Innovation Fund²⁷ (which funds pay-for-success projects across the country) and multiple SIBs in the UK (targeting recidivism, at-risk youth, and a host of other issues²⁸) and in Australia (at-risk families²⁹). Outcome procurement in Canada is at a nascent

²⁴ <http://www.gov.mb.ca/finance/cccredits.html#alive>

²⁵ http://www.gov.mb.ca/housing/pubs/mb_social_enterprise_strategy_2015.pdf

²⁶ Outcome procuring should not be confused with "social procurement," which uses the procurement of traditional goods and services to also create a social value (hiring a social enterprise to cater a meeting, for example) as opposed to outcome procuring wherein the social outcome itself is what is being procured.

²⁷ http://www.doleta.gov/workforce_innovation/success.cfm

²⁸ <http://www.socialfinance.org.uk/wp-content/uploads/2014/08/Social-Impact-Bonds-Snapshot.pdf>

²⁹ See Government of New South Wales backgrounder:

http://www.treasury.nsw.gov.au/site_plan/social_benefit_bonds/social_benefit_bonds_trial_in_nsw_FAQs#faq10

stage, with only the Saskatchewan SIB project and the federal government's SIB-like literacy and essential skills pilot currently in progress.

- **Developmental Support:** Finally, government can help build the capacity of organizations engaged in the social finance marketplace, to help incubate ideas, accelerate projects and improve their readiness to participate in the market. Examples of this type of government support exist mainly in the UK (the Social Incubator Fund³⁰ and the Investment and Contract Readiness Fund³¹), though social innovation and social finance accelerators exist world-wide (e.g., Australia's TACSI³² and MaRS' Impact8³³ in Toronto).

While several non-regulatory options are available to governments to support social finance, all of these measures would interact with the legal and regulatory systems discussed in this report. For example, an outcomes fund may be more effective if investment issues for foundations have been resolved. Similarly, allowing organizations to more easily operate as social enterprises may create more demand for social finance investments and thus increase the quality of projects available for direct government investment. It should also be noted that while many of these non-legal measures could be enacted by other jurisdictions or entities (e.g., provinces could procure for outcomes, foundations could help build capacity), potentially making changes to the tax-related legal and regulatory systems cited in this report would be an exclusive role for the federal government. Some social finance stakeholders view targeted federal actions in this regard as necessary to unlocking the full potential of social finance in the Canadian context.

³⁰ <http://www.biglotteryfund.org.uk/socialincubatorfund>

³¹ <http://www.beinvestmentready.org.uk/>

³² <http://tacsi.org.au/>

³³ <http://impactinvesting.marsdd.com/strategic-initiatives/impact-8/>

Chapter 2: Barriers and Stakeholder Examples

Chapter prepared by Employment and Social Development Canada

While Canada's social finance marketplace is growing, stakeholders including MAC members have identified a number of barriers that could be holding the market back.

The regulatory barriers often cited by stakeholders can be grouped into three types:

1. **Tax policy:** restrictions on investments in limited partnerships by registered charities, and the current taxation and regulatory framework for charities and non-profit organizations more generally.
2. **Tax administration:** including barriers to and misunderstandings surrounding program-related investment (specifically with regard to interaction with the disbursement quota).
3. **Corporate form and business development:** including lack of access to hybrid corporate form(s) for social enterprises and to small and medium-sized enterprise supports..

Non-regulatory barriers include low levels of awareness and opportunities for supply-side actors, high transaction costs and imperfect information for intermediaries, and low levels of capacity and investment readiness for demand-side actors.

Below are specific examples outlining some of the regulatory barriers as they are perceived by specific social finance stakeholders. These anecdotes are meant only to shed light on the way in which some stakeholders understand and experience current regulations; the individual case studies have not been analyzed or verified by regulatory experts.

Challenges with investment in limited partnerships

Colleges and Institutes Canada (C&I Canada – formerly the Association of Canadian Community Colleges), a registered charity, is leading a project as part of a pilot launched by the Government in October 2013, designed to test elements of a social impact bond (SIB) model in the area of literacy and essential skills. C&I Canada wishes to act as a financial intermediary for the SIB-like arrangement proposed between a number of college-based training providers and the Office of Literacy and Essential Skills at ESDC, which would involve C&I Canada raising upfront capital to fund literacy and essential skills training to help unemployed and underemployed Canadians develop their skills to better connect to available jobs.

Based on in-house legal advice and with a view to reassuring its board of directors, C&I Canada has retained KPMG to advise on issues related to accountabilities under its legal structure and tax status considerations relating to the upfront capital investment model. KPMG has advised that the most natural structure in terms of familiarity to investors – and the most common practice in other jurisdictions where SIBs are found – would be a limited partnership (LP), which would provide the easiest and most transparent flow-through of income and losses while preventing any co-mingling of investment monies with C&I Canada assets. Other structures such as income trusts and corporations would likely be less attractive to investors, in KPMG's view, for reasons of complicated deal-flow and less favourable tax treatment.

Pursuing an LP structure would, however, severely complicate investment in the SIB-like pilot by registered charities (including C&I Canada itself) – notably by private foundations, which are largely explicitly prevented from investing in LPs as this is considered to be carrying on a for-profit or business activity.

The Community Foundation of Ottawa (CFO) has set for itself a goal of investing fully 10 per cent of its assets in line with its mission. However, due to the rules surrounding foundation investment, it has decided against making a number of impact investments – notably in a sustainable fund established by the global consulting firm Mercer, due to its taking the form of a limited partnership (LP).

CFO has explored setting up an income trust to give it more flexibility in investing, but the drawbacks to this approach, as they understand them, include:

- Cost – setting up the trust could involve between \$10,000 and \$25,000 in legal fees;
- Governance – CFO would need to create a separate board for the trust, not including any CFO board members;
- Accountability – separate audits and tax statements would be required for the trust, increasing the reporting burden; and
- Liability – CFO is uncertain that even establishing a trust would prevent it from being assessed by CRA as carrying on a business activity.

The cost and administrative demands of establishing a trust or other work-around are burdensome for a large foundation, and likely prohibitive for a mid-sized or smaller foundation.

La Fondation Lucie et André Chagnon (the Fondation) is one of the largest private foundations in Canada with an interest in preventing poverty and contributing to the educational success of children. As part of its mission to support children and their families, the Fondation has explored making investments in affordable housing projects in the Montréal-Nord

neighbourhood. They have identified an investment opportunity offered by Fonds d'investissement de Montréal (FIM), an investment fund that provides mortgage loans, and the Société d'habitation populaire de l'Est de Montréal, a non-profit that borrows money, buys buildings and manages the affordable housing project. The Fondation was interested in investing in this project as it aligned with its mission and provided a financial return. However, the FIM is structured as an LP and thus the Fondation was unable to invest in it, barring costly work-arounds they felt used resources (for legal and accounting services) that were better put towards its mission.

Challenges with profit-making / revenue generation / earned income

Habitat for Humanity's ReStore³⁴ is a successful social enterprise that has generated millions for Habitat's charitable work. The organization has encountered barriers in attempting to generate income and keep in line with the *Income Tax Act* (ITA). Habitat has operated to date on the understanding that it has been earning allowable income under the category of fundraising. It was recently informed that its activities are no longer considered fundraising, and that it now meet the requirements associated with a related business. Specific issues include the requirement that 90% of staff be volunteers, that the stores not generate more than 50% of Habitat's revenues, and that the stores should not accept donations of surplus housing materials specifically for re-sale. None of the possible remedies considered (creating a for-profit organization, creating a separate non-profit, and creating a separate charity) would be optimal in terms of the stores' sustainability and efficiency. Habitat claims to have spent thousands of dollars and significant staff and board time on this issue, and the uncertainty around ITA compliance may limit its future plans for growth and discourage other charities from adopting a similar model. Habitat officials argue that their model is successful mainly because it has found an underdeveloped market niche and does not compete with the private sector as large competitors such as Rona and Home Depot do not see reselling as a viable business line).

The BC Centre for Social Enterprise (CSE), a leading social enterprise intermediary, is of the view that due to current interpretation of rules surrounding non-profits and profit-making (specifically, that non-profits may only generate incidental profit, regardless of how the profit is used), a large number of non-profits in Canada may be unknowingly operating offside. CSE estimates that as many as 75% of existing non-profits are operating offside.³⁵ Non-profits were, until recently, thought to be an appropriate corporate form for social enterprises that want to

³⁴ More detail on Habitat's Restore / ITA issues can be found on p. 20 of the Canadian National Advisory Board's final report: http://www.socialimpactinvestment.org/reports/MaRS-National_Advisory_Board_Report_EN.pdf

³⁵ *Empowering Non-profits to unleash maximum impact: the destination of profits test in Canada*, BC Centre for Social Enterprise, p. 3.
http://www.centreforsocialenterprise.com/f/Destination_test_in_Canada_BCCSE_Sept_2012.pdf

generate revenue and have a social or environmental impact. Recent CRA rulings suggest that this may likely not be the case, which will complicate the maintenance of existing social enterprises and the launching of new ones. Based on the new rulings, CSE itself recently relinquished its tax-exempt status for fear that it was operating offside. CSE suggests the adaptation of a “destination test” to alleviate some of the confusion and barriers created by the current regulations (see chapter 6).

During the course of the Task Force’s work, meetings with stakeholders have uncovered additional observations on barriers to social finance:

- In a meeting with public and private foundations regarding LP investing, stakeholders reaffirmed the potential benefits of LP investing for foundations generally (LPs provide diversification and a way to invest in illiquid assets) and with regard to impact investing specifically (can aggregate many smaller impact investments, of varying risk profiles, while relying on a general partner with specific expertise).
 - Stakeholders emphasized that LPs are not equivalent to running a business, as LP agreements clearly bar limited partners from running the day-to-day operations of the partnership.
 - Several foundations reiterated that the current interpretation of the LP rules has forced them to pass on impact investments they would otherwise make, or to use costly work-arounds (including establishing a trust) that took time, money and expertise and ultimately decreased any potential return they might have made.
- In a subsequent meeting on profit-making, stakeholders laid out basic reasons that charities and non-profits engage in social finance, including alignment with mission (finding a way to advance their core goals), financial sustainability (diversifying their funding streams), and financial flexibility (creating a consistent financing stream without any preconditions or limitations on spending).
 - Stakeholders pointed out that, while demand for the sector’s services is likely to grow, two main sources of funding for the sector (government grants and donations) had little potential for growth. That left, they argued, the third source of funding (earned income) as the one that could potentially support future growth of the sector.
 - Several organizations had wanted to engage in social finance, but were told not to do so by CRA. Stakeholders argued that the work-around for these organizations would be to spin the revenue-generating activity out as its own

for-profit business, something that the organizations lacked the capacity and risk tolerance to do. Stakeholders cited the cost of setting up a new for-profit social enterprise, including finding a new board, holding separate board meetings, hiring new staff, and keeping separate books, as too onerous to justify when contemplating small-scale social finance activities.

- One stakeholder recounted the story of a small SPCA that had wanted to sell dog food to earn additional income. The organization was advised by CRA to spin the dog-food sales out as a private enterprise, which the organization lacked the capacity to do and the cost of which would have quickly overwhelmed any positive returns that the relatively modest activity (dog-food sales) might create.
 - Several stakeholders also voiced a fear that once established, subsidiary for-profit organizations would have no explicit, locked-in mission to support the charity that had founded them, and could in future be sold to entities that could abandon their social mission and instead focus solely on profit.
 - Stakeholders described the “tone” of CRA guidance as being overly negative, focusing on what cannot be done instead of what can be done in the current regulatory environment. They argued that this created a chill in the social finance sector as organizations fear potential repercussions from engaging in social finance and accidentally straying off side of the regulations.
- Meetings with Canada Mortgage and Housing Corporation (CMHC) identified another illustrative case study. The Government of Canada, through CMHC, provides \$1.7 billion annually for social housing based on long-term agreements of 25 to 50 years. These agreements have begun to mature and the majority will reach term between 2015-2025, with all ending by 2038. When agreements mature, federal funding comes to an end as planned. Many housing providers are mission-driven, aiming to provide affordable housing for low-income Canadians, including seniors. Some providers may not be financially self-sufficient without revenue to replace federal subsidies, and therefore unable to continue offering affordable housing. One innovative approach for housing providers to become more self-sufficient is through revenue-generating activities, as also encouraged by the Canadian Housing and Renewal Association (CHRA). Supplemental income from ancillary activities such as renting out commercial space or developing other amenities could help keep rents affordable and address building repairs. But non-profit housing providers face barriers in pursuing these types of activities. As the Co-operative Housing Federation of Canada (CHFC) has asserted, if housing providers engage in revenue-generating activities for affordable housing missions, CRA could find them to be carrying on commercial activities that constitute a

for-profit purpose, and put their tax-exempt status at risk under paragraph 149 (1) (I) of the *Income Tax Act*. An alternative option for non-profit housing providers is to incorporate a for-profit business with the mission of supporting affordable housing. But many providers are small organizations, often managing only a small portfolio of projects and lacking the financial and human capacity to expand their operations.

- Finally, in separate meetings, stakeholders have cited specific barriers to Aboriginal social finance, especially on reserve.
 - Specifically, many bands and on-reserve members lack access to affordable main stream credit and finance for a number of reasons, including the complexity of the *Indian Act*, the higher cost of borrowing on reserve, and the perceived higher risk of lending on reserve.
 - Additionally, many bands lack the capacity to create municipal legal authorities and cannot themselves obtain corporate status (as other municipalities might), which further impedes their ability to access affordable commercial finance and credit.

Chapter 3: Analysis of Tax Policy Barriers

Chapter prepared by Finance Canada

SECTION 1:

Background:

1. Objectives of the income tax system

The principal function of the tax system is to raise the revenues necessary to fund government expenditures. This function is fundamental to the way government operates in Canada.

Ensuring fairness, neutrality and equity among taxpayers is integral to a well-functioning tax system. In particular, the principle of neutrality ensures that the tax system does not distort decision-making and promotes fairness between taxpayers.

In some instances, however, the tax system may be used to achieve public policy objectives through the application of special measures such as low tax rates, exemptions, deductions, deferrals and credits. These measures are known as “tax expenditures” because they achieve policy objectives at the cost of lower tax revenue.

Certain entities, such as registered charities and non-profit organizations (NPOs) that fulfil specific social purposes, are exempt from taxation on their income.³⁶ This exemption is in recognition of the invaluable role that registered charities and NPOs play in Canadian society.

In addition to the tax exemption, registered charities benefit from the ability of their donors to receive tax assistance on charitable donations. See Annex B for additional information on the range of specific donation incentives available to individuals and corporations.

Federal tax assistance to the charitable sector amounts to approximately \$3 billion annually. In addition, the sector benefits from GST/HST rebates. Provincial and territorial governments also provide tax assistance.

Tax expenditures reduce the tax revenues the government requires to fund direct expenditure programs. It is critical that they be effectively targeted to address clearly defined objectives.

³⁶ Certain types of NPO income, however, are subject to taxation.

2. Taxation and Regulatory Framework for Registered Charities

In Canada, the regulation of charities is a matter of provincial jurisdiction. However, the federal government provides significant tax assistance to charities that are registered by the Canada Revenue Agency. To safeguard the donations of Canadians, a number of restrictions are placed on registered charities through the *Income Tax Act*. This helps ensure that the tax exemption is respected and provides assurance to Canadians that their donations are devoted to charitable purposes.

There are three categories of registered charities under the *Income Tax Act*, as distinguished by their structure, their source of funding and their mode of operation.

- *Charitable organizations* primarily carry out their own activities. A majority of the members of the board of directors must be at arm's length from all other directors.
- *Public foundations* also must have an arm's length board of directors, but primarily fund the activities of other registered charities.
- *Private foundations* primarily fund the activities of other registered charities. They have a non-arm's length board of directors and/or they are controlled by a group that has contributed more than 50% of the capital of the foundation.

Under the *Income Tax Act*, public and private foundations are required to operate exclusively for charitable purposes, while charitable organizations are required to devote all of their resources to charitable activities.³⁷ These requirements effectively mean that registered charities cannot have a mix of charitable and non-charitable purposes, nor can they carry on activities that may be "socially beneficial" but are not charitable in the sense defined by the courts. For example, not all of the activities that are promoted under the broad heading of social enterprise (e.g., promoting entrepreneurship) would be considered charitable at law. These requirements help to ensure that tax-assisted funds are only used in the delivery of charitable programs to charitable beneficiaries. An entity that pursues purposes that are not charitable cannot be registered as a charity and registered charities that engage in non-charitable activities may lose their registered status under the *Income Tax Act*.

In addition to carrying on their own charitable activities, registered charities may make gifts of their resources, but only to other qualified donees.³⁸ This ensures that charitable resources

³⁷ A registered charity may devote resources to activities that, while not charitable in and of themselves, are necessary to accomplish their objectives (e.g., expenditures on fundraising and administration). However, any resources so devoted must be reasonable and the activities must not become an end in and of themselves.

³⁸ Registered charities are the largest category of qualified donees. In addition, qualified donees include:

either remain within the charitable sector, or are directed at certain other organizations operating for a broader public purpose. Registered charities are not permitted to make assets and resources available for the benefit of private individuals or organizations that are not qualified donees (e.g., NPOs or for-profit enterprises), except for fair market value.³⁹ A registered charity that gifts its resources, or provides an undue benefit, to a non-qualified donee may be subject to a monetary penalty, temporary suspension of its receipting privileges, or revocation of its registration.

That said, there are ways by which registered charities can work with non-charitable entities engaged in social finance, while ensuring the proper level of control and direction over donated funds – for example, registered charities can arrange agency agreements or use contracts for services.⁴⁰ These rules ensure that registered charities maintain effective control over charitable resources.

Registered Charities and Business Activities

Most registered charities may engage in related business activities. Under the *Income Tax Act*, charitable organizations and public foundations (sometimes collectively known as “public charities”) are permitted to engage in business activities to raise revenues, provided that these are “related businesses”. Related businesses include businesses which are related to the public charity’s purposes and subordinate to those purposes, as well as businesses that are unrelated to a public charity’s purposes but substantially run by volunteers. The CRA provides detailed administrative guidance on what constitutes a “related business”.⁴¹

Public charities are not permitted to carry on any business activity they wish, whether inside or outside the charity, and have the profits exempt from tax if used for charitable purposes. Given the generous tax assistance provided to registered charities, other taxpayers, including small businesses, could be placed at a competitive disadvantage if registered charities were able to enter the commercial mainstream without restriction. In addition, restrictions help to ensure that registered charities remain focused on furthering their charitable purposes. Further, there would be concerns that tax-assisted donations might be put at risk to finance inefficient or unsuccessful business ventures, instead of being used for the benefit of charitable beneficiaries.

registered Canadian amateur athletic associations (RCAAs); prescribed foreign universities; foreign charitable organizations to which Her Majesty has made a gift; the United Nations or an agency thereof; federal, provincial, and territorial governments; municipal governments and municipal or public bodies performing a function of government; and certain low-cost housing corporations in Canada.

³⁹ These restrictions are relevant when considering proposals that recommend that regulatory rules be relaxed to allow registered charities to work through non-qualified donees. Such proposals increase the opportunity for abuse or for charitable funds to be diverted to non-charitable activities.

⁴⁰ See the CRA’s *Using an Intermediary to Carry out a Charity’s Activities within Canada*, CG-004, 2011.

⁴¹ See the related business rules in “What is a Related Business?”, CRA publication CPS-019, 2003.

s.21(1)(a)

s.21(1)(b)

While registered charities are prohibited from carrying on unrelated business activities (unless run by volunteers), charitable organizations and public foundations can invest in a separate taxable corporation⁴² or trust with few restrictions. (Private foundations may also make such investments but there are special considerations which are discussed below.)

In all cases, the organization's directors would need to satisfy themselves that the investment represents a prudent use of the registered charity's assets. They would also need to ensure that no benefit of a private nature is conferred on the corporation or trust.



Corporations

A corporation established by a registered charity could transfer its profits to a registered charity, including any registered charity that controls the corporation, and claim a deduction of up to 75% of its net income for tax purposes.



⁴² See <http://www.cra-arc.gc.ca/chrts-gvng/chrts/plcy/cps/cps-019-eng.html#N10389>. Public foundations are not permitted to acquire control of a corporation; however, control may be obtained as a result of a donation.

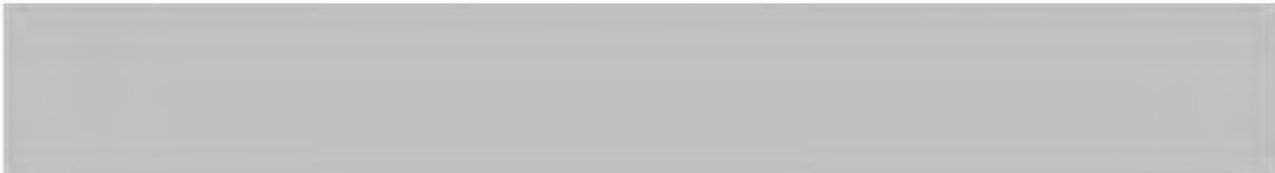



s.21(1)(a)

s.21(1)(b)

Trusts

A trust is taxable under the *Income Tax Act* as an individual. However, the trustees of a trust may allocate the trust's income to its beneficiaries, such that it is taxable only in the hands of these beneficiaries. Since registered charities are exempt from taxation, their share of trust income is not subject to tax.



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s.21(1)(a)

s.21(1)(b)

To address this and other self-dealing concerns, private foundations are subject to the excess corporate holdings regime found in the *Income Tax Act*. These rules permit a private foundation to hold up to 20% of the outstanding shares of any class of shares of a corporation, if non-arm's length parties do not have any holdings in that share class. Where non-arm's length parties have such holdings, the foundation and the non-arm's length parties cannot, together, hold more than 20% of that share class. The foundation must divest itself of excess holdings. However, the holdings of non-arm's length parties are ignored if foundation holdings do not exceed 2%.

Other Options

3. Taxation and Regulatory Framework for NPOs

An NPO that is a club, society or association organized and operated exclusively for social welfare, civic improvement, pleasure or for any other purpose except profit, qualifies for an

s.21(1)(a)

s.21(1)(b)

income tax exemption if it meets certain conditions. NPOs include such varied groups as professional associations, recreational clubs, civic improvement organizations, cultural groups, housing corporations, advocacy groups and trade associations.

Concerns have been raised that some organizations claiming the NPO tax exemption may be earning profits that are not incidental to carrying out the organization's non-profit purposes, making income available for the personal benefit of members or maintaining disproportionately large reserves. In addition, because reporting requirements for NPOs are limited, members of the public may not be adequately able to assess the activities of these organizations, and it may be challenging for CRA to evaluate the entitlement of an organization to the tax exemption.

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SECTION 2:

Limited Partnerships and Registered Charities

Issue

Registered charities are seeking more flexibility to invest in limited partnerships (LPs).

Background

A partnership is a relationship among persons carrying on business in common with a view to profit. An LP involves one or more general partners and one or more limited partners. This arrangement provides limited liability for the limited partners. Under the law governing partnerships, the general partner who carries on the business is generally treated as the agent of the limited partner(s) providing the financing.

Given the definition of partnerships, a registered charity that becomes a limited partner in a partnership is considered to be carrying on a business, even though the registered charity may not play an active role in the business and is essentially making a passive investment. As discussed earlier, public charities can lose their charitable registration if they carry on an unrelated business, and private foundations can lose their charitable registration if they engage in any business activity.

On the other hand, a for-profit corporation controlled by a charitable organization, for example, could act as a general or limited partner in an LP.

Philanthropic Foundations Canada (PFC⁴⁸) and a number of entities in the field of social finance have asked that registered charities be permitted to invest in LPs. This request has been argued in two different ways.

- For example, PFC argues that registered charities require a full range of investment opportunities in order to achieve a balanced investment portfolio that will provide a good rate of return. Each year registered charities are required to meet a minimum calculated amount, known as the disbursement quota, which they must spend on their own charitable programs or on gifts to qualified donees. The disbursement quota is determined with reference to total assets not currently employed in charitable activities. In the current period of low returns, it is argued, foundations need to take advantage of better investment opportunities in order to meet their disbursement quota obligations.

⁴⁸ Philanthropic Foundations Canada is a member association of Canadian grant-makers, including private and public foundations, other charities and corporations that promotes philanthropy in Canada.

s.21(1)(a)

s.21(1)(b)

- Others in the charitable sector argue that registered charities need to be able to invest in LPs in order to be effective in their social enterprise endeavours, which may include investments in social impact bonds.⁴⁹ In particular, it is argued, registered charities making program-related investments (PRIs) need to be able to invest in LPs because many PRIs are only workable or available in that form.

⁴⁹ See, for example, material prepared by KPMG for the Association of Canadian Community Colleges [now known as Colleges and Institutes Canada], April 2014.

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Chapter 4: Analysis of Tax Administration Barriers

Chapter prepared by Canada Revenue Agency

Issues

Concerns have been expressed regarding certain aspects of the Canada Revenue Agency's (CRA) *Guidance CG-014 Community Economic Development Activities and Charitable Registration*. The following provides a response to requests for clarification on perceived barriers to and misunderstanding surrounding program-related investment and mission-related investment.

Background

In 1999, CRA published RC4143, *Registered Charities: Community Economic Development Programs* to help charities and the public better understand CRA's interpretation of the legal requirements related to community economic development (CED) activities. In recent years, the emergence of social enterprise necessitated a review of the document to clarify the content and reflect CRA's updated approach to CED activities.

In 2012, after consultations with key players in the charitable sector, an updated guidance was reissued. CG-014, *Community Economic Development Activities and Charitable Registration*, clarified that organizations that carry out CED activities may be eligible for charitable registration under the *Income Tax Act* if all their activities further charitable purposes.

Key changes included:

1. Clarification of the fact that the current legal framework applicable to charities in Canada does not recognize CED as a **charitable purpose**.
2. Confirmation that individual development accounts (IDAs) and micro-enterprises (now under loans and loan guarantees) are no longer restricted to relief of poverty purposes.
3. Expansion of the program-related investment (PRIs) section to provide more detailed explanation of how and when PRIs are acceptable.
4. Confirmation that PRIs are no longer limited to qualified donees.

Following a one-year post-implementation period, CRA undertook a review to determine if any additional changes needed to be made to the document to improve clarity and comprehension. The review process incorporated information received from both internal and external sources. A number of recommendations to further improve the document are currently being reviewed by CRA.

Tax Administration Issue One: Determining Fair Market Value for Program-Related Investment Activities

The lack of detailed and specific guidance on how to determine the fair market value (FMV) for program-related investment (PRI) activities was highlighted as a barrier.

The following questions were asked:

- a. What benchmarks should one use to determine fair market value for the different asset classes?
- b. Does CRA have specific ones for shares, terms deposits, loans, etc. or can the investor charity set these based on prudent and financial analysis of comparable rates, index, etc. and maintain such analysis in policy and documented files for each PRI? For example, for an investment in a loan fund over 10 years, could we use 10-year Canada Bond as a benchmark?

Assessment

Tax Administration Issue Two: Determining Proportionality

Question: With reference to Example A in paragraph 42, is there a specific definition or method for how "proportionate" should be calculated?

Example 1 In the case mentioned above, if we purchase 5% of shares, should 5% of units be destined for the charitable purpose?

Example 2 In the case of an intermediary fund whose clients include charities and other enterprises; and where the investor charity is interested in making a PRI to enable larger sums of capital to the charities, but as in any fund deal cannot DIRECT the fund managers in the deal decisions *per se* (as fund managers must follow their investor responsibilities); would it be sufficient to specify that the amounts loaned to charities will always be equal or exceed the amount disbursed by the investor charity?

Assessment



Tax Administration Issue Three: Constraints in Supporting Social Enterprises

Questions regarding specific programs revealed an interest in better understanding how social entrepreneurship could be supported while furthering a charitable purposes. Examples given of programs that the CRA has deemed problematic include:

- grants to non-profits to fund business planning;
- award money to a for-profit social enterprise.

It was felt that the promotion of commerce or industry could be furthered by such activities.

Assessment



s.21(1)(a)

s.21(1)(b)



Tax Administration Issue Four: Opportunity Cost

Difficulties with the provision related to opportunity costs and disbursement quota were expressed. The position of the sector is that CRA's unwillingness to recognize the funds allocated to PRIs as a charitable expenditure is inconsistent with its decision to recognize that activities that are funded by PRIs can further charitable purposes.

Assessment



Tax Administration Issue Five: Private Benefit

Members expressed difficulty understanding the private benefit restrictions, particularly when employment is provided by a single employer, and asked for clarification.

Assessment

The CED guidance explains at paragraph 20 that:

s.21(1)(a)

s.21(1)(b)

When the emphasis is on helping employers recruit employees, this does not further a charitable purpose due to the delivery of a more than incidental private benefit to the employers.

This condition is reflected as well in paragraph 21, however, that same paragraph notes that exceptions are possible.

Generally, employment-related training must not be limited to a specific employer, because this could result in an unacceptable private benefit to the employer. Exceptions may be possible in areas of social and economic deprivation (see [paragraphs 84-91](#)). For more information, go to [Policy Statement CPS-024, Guidelines for Registering a Charity: Meeting the Public Benefit Test](#).

The guidelines for assessing private benefit in general are outlined in *Section E. Community economic development activities in areas of social and economic deprivation*. Factors taken into consideration when assessing private benefit restrictions related to employers are outlined in paragraph 90.

In deprived areas, preventing further unemployment by providing training to the employees of a specific company may be charitable, when it would otherwise deliver a more than incidental private benefit, if:

- *without this training, the company would be forced to close or dismiss workers; and*
- *the training can be generally applied in the marketplace (such as literacy or computer skills), as opposed to training that is useful only to the specific employer.*



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Chapter 5: Analysis of Business Development Support-related Barriers

Chapter prepared by Industry Canada

Issue Area: Availability or Accessibility of Business Development Supports from Government

Social finance leaders have recommended that governments take action to ensure that social enterprises have explicit access, and feel welcome to participate in business development programs for small and medium-sized enterprises.

Industry Canada supports small and medium-sized enterprises (SMEs) through business development supports including the Canada Small Business Financing Program. Portfolio partners, such as the Business Development Bank of Canada, the National Research Council, Social Sciences and Humanities Research Council, FedNOR and regional offices and development agencies also administer business development support.

Supports from Industry Canada

The Department has taken action to improve social enterprises' access to these and other resources on the Canada Business Network website. There is now a specific landing page for social enterprises and non-profits to better connect them with guidance documents on starting and managing their business and with access to financing programs.

The Canada Small Business Financing (CSBFP) is a loan loss-sharing program, between the government and private sector lenders, to stimulate growth and create jobs among small businesses. It operates by facilitating access to affordable asset-based financing to small businesses for their establishment, expansion, modernization and improvement. The CSBFP is a cornerstone of Industry Canada's support for small businesses. It plays an important role in providing small businesses with access to financing to grow and start up.

For-profit social enterprises are eligible for funding from Industry Canada's CSBF Program, though not-for-profits are not at this time. However, there is authority in the *Canada Small Business Financing Act* to establish a pilot project for the voluntary sector. The establishment of a pilot project was last explored with social economy stakeholders in 2005 but was not pursued given the needs and structural issues identified by stakeholders. Specifically, stakeholders indicated that they were not well structured to apply for a traditional loan as some types of not-for-profits did not have the capacity to repay a loan on regular intervals and

those that did have this capacity had an organizational structure that did not facilitate mitigation of personal liability and risk (i.e., volunteer boards/management); had limited security to pledge; and had a lack of knowledge about financial matters and how to approach lenders. Stakeholders also raised that their need was often focussed on financing working capital, which is not eligible under the CSBFP. For these reasons, fundraising was considered by not-for-profit stakeholders to be a better-suited source of financing.

Given that the information on hand about financing not-for-profits through the CSBFP is about 10 years old, it would be helpful to update knowledge of current financing needs and abilities of not-for-profit enterprises. The 2015 statutory review of the CSBFP could commit to conducting an in-depth analysis of the debt financing needs of not-for-profit enterprises, and their ability to access financing from the private market (including the structural reasons why they may have difficulties). Policy responses could then be considered, as appropriate, in response to the findings.

With respect to other small and medium-sized enterprise programs administered by Industry Canada, since 2004, the Department has been voluntarily reviewing these programs to determine whether changes are necessary to facilitate access by social enterprises. Assessments have identified that 45 of 51 SME programs and services administered by Industry Canada were accessible by both for-profit and not-for-profit social enterprises. More specifically, four programs targeted the not-for-profit sector. In 40 programs, social enterprises (including not-for-profits) could be eligible if they met certain requirements, although the programs did not target specifically target not-for-profits or social enterprises. Programs that were not accessible by social enterprises had narrow mandates (e.g., they targeted the high-tech sector where there was less involvement by social enterprises).

Support from the Business Development Bank of Canada (BDC)

BDC is a Crown corporation with a mandate to support entrepreneurship with a focus on small and medium-sized enterprises. BDC is financially self-sustaining and required to generate a return on equity at least equal to the government's long-term cost of funds. To meet this requirement, BDC finances entities that are willing to pay for its services and that can service their debt, which are almost exclusively for-profit enterprises.

BDC is itself a certified B Corp (beneficial corporation), the first Canadian financial institution and the 100th Canadian company to join the international B Corp community of 1,000 companies in 30+ countries. As a certified B Corp, the BDC must meet comprehensive standards related to purpose (in its case, support for Canadian entrepreneurship), transparency

and accountability that benchmark its economic, social and environmental performance against that of other businesses.

BDC sought B Corp certification as part of its exploration of the marketplace of social purpose firms. BDC has observed that the central challenge for entrepreneurs that create social purpose firms and enterprising not-for-profits is the need for business acumen and management skills.

As part of its efforts to support social purpose finance, BDC collaborates with and supports where feasible and appropriate, a number of organizations across Canada that serve and support the broader social enterprise community (e.g., social purpose firms, as well as not-for-profit enterprises). Specifically, it supports programs designed to teach entrepreneurialism and management skills.

Stakeholders have expressed an interest in how BDC is financing social enterprises, including not-for-profit cooperatives that finance social purpose firms. BDC has responded by improving the tracking of existing firms in its portfolio that have a social purpose and by heightening its efforts to find and serve them in two markets: Québec/Ontario and British Columbia.

BDC continues to fill gaps by providing financial and management services not available through private sector financial institutions. Often, not-for-profits, including social enterprises, are determined to be outside the risk tolerance of commercial banks.

The Report of the Standing Senate Committee on Banking, Trade and Commerce on The Ten-Year Statutory Review of the Business Development Bank of Canada recommended that BDC offer indirect financing through third parties, for example, not-for-profit organizations, trusts and cooperatives. Statutory amendments are required to provide the BDC with the authority to consider further options for supporting social enterprises.

BDC already supports social-purpose companies as clients. Following the introduction of the legislative changes to the *Business Development Bank of Canada Act*, BDC will continue to examine ways it can provide greater support to third-party organizations that help the not-for-profit community meet their central challenges (i.e., entrepreneurial skills and business acumen).

Support from the Social Sciences and Humanities Research Council (SSHRC)

In Canada's Economic Action Plan 2014, the Government proposed \$10 million over two years to support social innovation research projects at colleges and polytechnics. The funding will be

administered by SSHRC through the Community and College Social Innovation Fund, a pilot initiative commencing in 2014-15. The initiative will connect the talent, facilities and capabilities of Canada's colleges and polytechnics with the research needs of local community organizations and builds on the strong linkages of colleges and polytechnics with communities across Canada in support of social innovation.

Support from the National Research Council (NRC)

The mission of the NRC is to work with clients and partners to provide innovation support, strategic research, scientific and technical services to develop and deploy solutions to meet Canada's current and future industrial and societal needs.

Budget 2013 provided the NRC with \$121M over two years (ending 2014-15) to support NRC's realignment to industry-focused research and programs and \$60M over five years (ending 2017-18) as part of the Canada Accelerator Incubator Program (CAIP) to expand services to entrepreneurs and provide them with the resources needed, such as extensive mentoring, to gain a strategic advantage in a competitive international marketplace. Budget 2014 proposes to provide the program with an additional \$40 million over four years, increasing its CAIP's total funding to \$100 million.

Accelerators are typically for-profit organizations owned and operated by venture capital investors, who intend to generate returns from equity-based investments in their client firms. Accelerators provide a range of services to early-stage firms, including financial support, business advice, office and development space and complementary services offered by partner organizations.

Incubators are typically not-for-profit organizations that offer similar services to accelerators but tend to provide longer tenure for participating firms and a broader suite of services in terms of physical space and mentorship. Incubators are often sponsored by universities, colleges and economic development corporations.

The CAIP provides funding over a five-year period, in the form of non-repayable contributions to a limited number of outstanding and high-potential accelerators and incubators that meet strict eligibility and selection criteria. Recipients are required to demonstrate matching contributions on at least a 1:1 basis during the period of the contribution funding. Eligible organizations are incorporated, not-for-profit or for-profit business accelerators or incubators operating in Canada, that are market-driven. Businesses must have sustainable operating models, as demonstrated through such factors as return on investment; and/or profit

from graduate companies, and/or access to diverse sources of funding and investment and/or a track record of supporting multiple cohorts of firms.

The CAIP contributions support incremental activities and services to early-stage firms and entrepreneurs and promote a higher output of SMEs that are investment-ready and able to develop into sustainable, high-growth businesses.

In June 2014, the Government announced the organizations that have been chosen to advance in the selection process for the Canada Accelerator and Incubator Program (CAIP). The recipient list has been announced on the Prime Minister's Office website at <http://www.pm.gc.ca/eng/news/2014/06/20/pm-helps-canadian-start-companies-grow-and-prosper>.

CATALYTIC OR CAPACITY-BUILDING PROGRAMS, POLICIES, and FRAMEWORKS

Stakeholders have identified other regulatory or program-related issues as having catalytic potential for social enterprises and social finance. These include the creation of special corporate form(s) for social enterprises and other supportive policies.

CORPORATE FORM

Social enterprises in Canada may take many forms including those structured under the *Canada Business Corporations Act* (CBCA), the *Canada Cooperatives Act*, or the *Canada Not-for-Profit Corporations Act* or under provincial corporate governance laws. There is currently no special corporate governance framework law or provisions specific to social enterprises at the federal level, though such laws do exist in some provinces and other jurisdictions.

For example, British Columbia recently enacted specific legislation to allow for the registration of community contribution companies and Nova Scotia passed the *Community Interest Companies Act*, which permits companies to seek designation as a Community Interest Company. The incorporation and governance rules under these laws differ from other corporate law as entities must have a stated social purpose, special reporting requirements, and limitations on payment of dividends upon dissolution (dividend caps) and safeguards for the transfer of assets upon acquisitions or dissolution (asset locks).

Internationally, the United Kingdom (UK) has had a regulatory regime for community interest corporations (CICs) in place since in 2005. In 2014, there were over 9,300 CICs in the UK. The UK adopted additional measures such as outreach, education on the model, and funding to support CICs.

Several jurisdictions in the United States (US) have also created specialized hybrid frameworks that combine social interest goals with profit-making. One such framework is a low-profit limited liability company (L3C). An L3C is intended to significantly further the accomplishment of one or more charitable or educational purposes. Profit-making, while permitted, must not be the significant purpose of an L3C company. L3Cs can distribute profit to equity owners, like for-profit corporations. L3C legislation was intended to align with the Internal Revenue Services (IRS) guidelines so that L3Cs can attract foundations' program-related investments (PRIs). Since L3C legislation was first adopted in the US in 2008, only approximately 1,063 L3Cs have formed. Some writers suggest that there has been low uptake of the L3C model because it does not include asset locks, dividend caps and oversight by a regulator. In addition, commentaries have noted that foundations are still reluctant to invest in L3Cs given remaining uncertainty to what constitutes acceptable PRIs.

Another form of hybrid corporations in the US is benefit corporations (corporations that are for-profit corporations but that also have social goals). Some common legislated requirements for benefit corporations include enhanced protection for directors to take into account other interests (i.e., social purpose) in corporate decision-making, a minimum of 2/3 votes to pass resolutions and special reporting requirements. Twenty-one states have passed legislation for the creation of benefit corporations. Benefit corporations are taxed at the corporate rate.

Benefit corporations do not need to be certified, as their structure exists under legislation. However, any corporation can obtain "certified B-corporation" status from the US not-for-profit organization B-Lab. This is a voluntary, non-legislated and unregulated process. Certification shows that these corporations have met a high standard for social and environmental performance. There are currently over 950 certified B-corporations from over 30 countries, including over 100 from Canada.

Industry Canada recently held public consultations on the CBCA which included whether its provisions work for social enterprises or whether they could be improved to better support them. There were 21 submissions on this topic (of a total of 79 submissions). Just over half of these supported special incorporation and governance rules for social enterprises. Stakeholder views were divergent on the appropriate framework for such changes (i.e., having special rules in the CBCA or creating a new federal legislative regime). Supporters thought that special rules could further clarify director liability (i.e., that social enterprise director duties balance profit-driven with social goals) and disclosure issues (i.e., to require explicit disclosure of the enterprises' social objectives). Some advocates for such changes believe they will help social enterprises attract investment and serve as a basis for changes to taxation benefits. In particular, stakeholders indicated that legislation including dividend caps, limits on the

distribution of assets on dissolution and the transfer of assets may help to attract investors looking to invest in social purpose enterprises.

The remaining stakeholders questioned the need for additional requirements to support social enterprises or opposed special or additional regulation altogether arguing that, in the Canadian context, case law is sufficiently clear on the limits of director liability and that special regulation could be burdensome.

Industry Canada will continue its assessment of corporate statutes to ensure that they adequately support social enterprises.

COOPERATIVES POLICY

Cooperatives are an important part of the social innovation and social finance landscape, acting as social enterprises, intermediaries and financial partners. Cooperatives can operate as for-profit businesses (generating billions of dollars in revenues), non-profit organizations, and even obtain charitable status. Federal responsibility for cooperatives policy resides with Industry Canada.

The cooperative sector has recently been involved in a number of social innovation pilots in partnership with ESDC:

- The Social Development Partnerships Program is supporting the British Columbia Cooperative Association to develop and test innovative cooperative models using leveraged resources and encouraging communities to coalesce around the complex social issues of aging population;
- New Horizons for Seniors Program is supporting the *Coopérative radiophonique de Toronto* to conduct a pan-Canadian elder abuse prevention and awareness project to reach francophone populations living in minority communities across Canada; and
- ESDC is exploring cooperatives that function as intermediaries for third-party delivery funding model; a knowledge event on this topic on February 20, 2014 provided an opportunity to learn from IC - Cooperatives Policy, the Canadian Co-operative Association and regional co-op associations about their experience as intermediaries.

Development supports for cooperatives vary by jurisdiction in Canada. Specific policy and program support for cooperatives can be found in Québec, Manitoba, Newfoundland and Labrador and Nova Scotia. Every province and territory has specific statutes for non-financial co-operatives and the majority of cooperatives are incorporated and regulated at the provincial/territorial level.

Provincial/territorial officials responsible for cooperatives have expressed interest in learning more about the recent developments for social enterprises across Canada and how they implicate the cooperative model. Industry Canada will continue to explore the issue on an ongoing basis with its cooperative federal/provincial/territorial working group.

Parliament's Special Committee on Cooperatives tabled recommendations in Fall 2012. Industry Canada has taken steps to meet the Special Committee on Co-operatives' recommendations with the launch of a four-point action plan, which includes: 1) an assessment for cooperative eligibility to Industry Canada, portfolio and Regional Development Agency programs and services that are now listed on the Canada Business Network landing page for cooperatives; 2) an outreach and engagement strategy that held meetings with over 114 co-operative sector stakeholders across Canada; 3) the establishment of a Federal Network on Cooperatives that brings together all the federal departments and agencies responsible for cooperatives for horizontal collaboration and information sharing; and 4) the development and facilitation of a Federal/Provincial/Territorial Working Group of Officials Responsible for Co-operatives to ensure collaboration and information sharing with officials on legislative, policy, program and data issues that impact the co-operative business sector across Canada.

Cooperatives are early adopters of social innovation and social finance. Their corporate form and legislative and regulatory environment require them by law to meet the needs of their members, rather than external shareholders, and they have a democratic governance structure and do not distribute profit based on share-ownership. Despite their well-established presence in Canada, Industry Canada has observed through its outreach and engagement with stakeholders that the limited awareness and knowledge of the cooperative business is a challenge faced by the sector. This issue was also identified in the final recommendations of the Special Committee on Cooperatives.

In order to ensure cooperatives are considered as a viable social enterprise model, the knowledge and understanding of the model needs to continue to be promoted. To this end, Industry Canada is facilitating collaboration and information-sharing on cooperatives with federal, provincial and territorial counterparts, including ESDC.

Cooperatives must continue to be considered as part of the social enterprise landscape in the development and delivery of new policies and programs. Industry Canada will continue to ensure its programs and services are accessible to cooperatives and collaborate with federal/provincial/territorial counterparts to promote the knowledge and understanding of the cooperative model.

Chapter 6: Non-technical Survey of Policy Options Suggested by Stakeholders

Chapter prepared by Employment and Social Development Canada

Some social finance stakeholders cite policies in other jurisdictions as potential remedies to some of the regulatory barriers they describe. These policies are outlined below to illustrate potential solutions suggested by the MAC and other social finance stakeholders. They are not intended to be considered as rigorously scrutinized policy options in the Canadian context and, as such, they have not been analyzed or verified by regulatory experts for potential unintended consequences.

- **Unrelated Business Income Tax (UBIT)** – The American UBIT allows tax-exempt organizations to carry on business that is not related to their tax exemption (a university running a restaurant, for example) by taxing the income generated from said unrelated business. This gives tax-exempt non-profits greater flexibility in generating revenues without endangering their tax-exempt status, while simultaneously creating new tax revenues and ensuring a level playing field with other tax-paying for-profit businesses according to stakeholders.⁵⁰ The Australian government had proposed a UBIT in 2011 but ultimately decided that it was not required, instead leaving in place the current destination test (see below); some in the NFP sector welcomed the change of approach as they argued the UBIT was not needed to level the playing field with the private sector and would have been overly burdensome for smaller organizations in comparison with the more laissez-faire approach of a destination test.⁵¹
- **Destination of profits test** – Used in New Zealand and Australia, the destination of profits test allows charities to generate tax-exempt revenue so long as the profits are used to further their charitable purposes. Stakeholders, including the BC Centre for Social Enterprise,⁵² argue that the final use of the profits should be of paramount interest to regulators, and not necessarily how the profits are generated. Canadians in general seem to agree with the principles underpinning the destination test, with 79% agreeing that “charities should be able to earn money through any type of business activity they want, as long as the proceeds go to their cause” and 64% agreeing that

⁵⁰ For example: Canada’s National Advisory Board, created for the international Social Impact Investment Taskforce (see below)

⁵¹ For example: *NFP Sector welcomes scrapping of unrelated business tax*, Governance Institute of Australia
<http://www.governanceinstitute.com.au/news-media/news/2014/06/nfp-sector-welcomes-scrapping-of-unrelated-business-income-tax/>

⁵² For example: *Empowering Non-profits to Unleash maximum impact*, BC Centre for Social Enterprise,
www.centreforsocialenterprise.com/f/Destination_test_in_Canada_BCCSE_Sept_2012.pdf

charities should not be taxed on those earnings so long as they support the cause.⁵³

Debates in the US around the time of the UBIT's creation centred on the fact that, while possibly more simple to apply than a UBIT, a destination test creates a potential horizontal equity problem by giving tax-exempt organizations an unfair advantage over for-profit, tax-paying organizations.⁵⁴ Australia's Future Tax Systems Final Report suggests that this unfair competitive advantage may not materialize:

- "In relation to pricing, NFP organisations, like for-profit organisations, will seek to maximise their profits in support of their philanthropic activities. Accordingly, it appears that the income tax exemption does not provide an incentive for NFP organisations to undercut the prices of their for-profit competitors; rather, NFP organisations follow the same pricing policies as their competitors to maximise their profits," and thus, "NFP income tax concessions do not generally violate the principle of competitive neutrality where NFP organisations operate in commercial markets."⁵⁵

As this finding was based on a theorem and not on real-world studies of actual markets, it is difficult to make a strong conclusion. Further, the report noted that not all NFPs should necessarily receive the same tax concessions. It found that, "Where NFP clubs operate large trading activities in the fields of gaming, catering, entertainment and hospitality, the rationale for exempting receipts from these activities from income tax on the basis of a direct connection with members is weakened." Additionally it found that other tax concessions in Australia did give NFPs a competitive advantage. It is unclear at this time whether Canada has similar tax concessions that could benefit non-profit or charitable organizations unfairly, but it is clear that the matter would require extensive research before considering any reforms.

- **Independent charities regulators** – Several jurisdictions, including Australia (Australian Charity and Not-for-Profit Commission), the UK (Charity Commission), and New Zealand (Charities Services) have separate charities regulators with varying degrees of independence from their respective tax regulators. Some stakeholders argue that such a body, if it involved provinces (who have some jurisdiction in the area of charities and non-profits), could better respond to the sector's specific and changing needs, including the emerging needs created by social finance. It has also been suggested that housing

⁵³ *Talking about Charities*, Muttart Foundation, p. 76

<http://www.muttart.org/sites/default/files/survey/3.Talking%20About%20Charities%202013.pdf>

⁵⁴ *Charities' Tax Privileges in New Zealand: A Critical Analysis*, Journal of the Australasian Tax Teachers Association 2012 Vol. 7 No. 1 p. 23, p. 82

⁵⁵ "Australia's future tax system" Final Report, Detailed Analysis

http://taxreview.treasury.gov.au/content/FinalReport.aspx?doc=html/publications/Papers/Final_Report_Part_2/chapter_b3-2.htm

the charities regulator within the tax agency charged with protecting the tax base creates a conflict of interest. The C.D. Howe Institute, for example, argues that a new regulatory system allowing for more flexibility with respect to social enterprise and social finance would require “a re-evaluation of the overlap between federal and provincial priorities and jurisdiction” and that “independent provincial attempts to allow for greater social enterprise will always be stymied by federal dominance over the income tax – primarily in the charity sphere.”⁵⁶

- **Redefinition of charitable purpose** – Some stakeholders⁵⁷ have argued that the laws governing Canada’s charitable sector may require updating and that more nuanced laws could create more space for organizations on the demand side of social finance to proliferate. Recognizing that many of common law cases used to define charitable purpose did not reflect current social-sector realities, the UK sought to modernize its treatment of charities in both 2006 and 2011 (with the *Charities Act 2006 and 2011*), largely by formally codifying existing rules.

Prior to the *Charities Act 2006*, there was no statutory definition of charitable purposes in the UK. Instead, the definition was set out in case law, built up over time and later refined into what became known as the four heads of charity (the relief of poverty; the advancement of education; the advancement of religion; and other purposes beneficial to the community). To be a charity, an organization had to exist for wholly charitable purposes and those purposes had to be for the public benefit. It was generally considered that charities with purposes for the relief of poverty, the advancement of education or the advancement of religion were presumed to exist for the public benefit, while charities with purposes under the fourth head had to demonstrate their public benefit in order to qualify for charitable status.

The 2006 UK *Charities Act* aimed to clarify what constitutes a charity with a clearer and more explicit list of charitable purposes, retaining the flexibility for what is considered a charitable purpose to continue to evolve over time, and re-emphasizing the public nature of charity. The Act contained a list of 13 “headings of charitable purposes”, including the catch-all “other purposes beneficial to the community...” While the Act made the list of acceptable charitable purposes more explicit, only one purpose not previously recognized by the Courts was added (the promotion of amateur sport) and one was expanded upon (the prevention of poverty). The key (and controversial) change

⁵⁶ At the Crossroads, *New Ideas for Charity Finance in Canada*, C.D. Howe p. 8

http://www.cdhowe.org/pdf/Commentary_343.pdf

⁵⁷ For example: Richard Bridge, Barrister & Solicitor from Nova Scotia

http://socialfinance.ca/2009/02/17/options_for_change_for_charity_law_in_canada/

brought about by the 2006 legislation was that all organizations are now required to demonstrate public benefit, regardless of the purpose they are furthering.

- **Tax Credits** – Several jurisdictions have begun using tax credits to incentivize impact investing. The UK's 2014 Social Investment Tax Relief allows for a 30% tax deduction on investments in social enterprises. Similarly, Nova Scotia allows for 35% tax credits on investments in Community Economic Development Investment Funds, which make investments similar to impact investments.

Pre-Budget submissions have been made by organizations citing issues raised in this report. Several organizations⁵⁸ for example, including Imagine Canada, have called for a continued expansion to business development supports, specifically in order to enhance organizations' ability to generate earned income to support their missions. The Social Enterprise Council of Canada explicitly calls for the regulatory restraints on charitable and non-profit businesses to be relaxed.⁵⁹ The MaRS Centre for Impact Investing's pre-Budget submission⁶⁰ focuses mainly on the recommendations of the Canadian National Advisory Board to the G7-based Social Finance Impact Investment Taskforce (see below). The National Charities and Not-for-Profit Law Section of the Canadian Bar Association made several relevant recommendations in its submission, including removing the related business restriction on private foundations and the prohibition on their investing in limited partnerships.⁶¹

Again, it should be noted that these issues have not been thoroughly researched for the purposes of this report, nor have consultations taken place to determine whether a significant portion of the non-profit and charitable sector, donors or taxpayers would support these changes. In particular, not all of the potential unintended consequences of legislative or regulatory changes have been mentioned or discussed.

⁵⁸ Imagine Canada

(http://www.parl.gc.ca/Content/HOC/Committee/412/FINA/WebDoc/WD6615327/412_FINA_PBC2014_Briefs%5CImagineCanada-e.pdf) and The Association for Healthcare Philanthropy (http://www.parl.gc.ca/Content/HOC/Committee/412/FINA/WebDoc/WD6615327/412_FINA_PBC2014_Briefs%5CAssociationForHealthcarePhilanthropy-e.pdf) for example.

⁵⁹ The Social Enterprise Council of Canada

http://www.parl.gc.ca/Content/HOC/Committee/412/FINA/WebDoc/WD6615327/412_FINA_PBC2014_Briefs%5CSocialEnterpriseCouncilOfCanada-e.pdf

⁶⁰ MaRS Centre for Impact Investing

http://www.parl.gc.ca/Content/HOC/Committee/412/FINA/WebDoc/WD6615327/412_FINA_PBC2014_Briefs%5CMaRSCentreForImpactInvesting-e.pdf

⁶¹ The Canadian Bar Association

http://www.parl.gc.ca/Content/HOC/Committee/412/FINA/WebDoc/WD6615327/412_FINA_PBC2014_Briefs%5CCanadianBarAssociation-e.pdf

In addition to these examples of potential remedies from other jurisdictions, an international Social Impact Investment Taskforce, created under the UK presidency of the G8 in 2013, has been studying impact investment and social finance both at a global level and through national advisory bodies (NABs) in each member country. The Canadian NAB has submitted a report to the overarching international body, which itself has issued a report building on collected input from all of the NABs. All of these reports are now public and contain detailed recommendations for governments.⁶²

Canada's NAB has made two main recommendations regarding regulatory barriers to impact investing:

1. Enable charities and non-profit organizations to carry out social enterprise activities by introducing:
 - a **Canadian version of the UBIT**; and
 - clarifying rules preventing charities from **conferring a private benefit**.
2. Unlock capital and assets of foundations for investing by:
 - clarifying **prudent investor rules**;
 - **allowing foundations to make below-market-rate investments** to advance charitable objectives; and
 - allowing **investment in limited partnerships**.

The NAB has also made recommendations that do not specifically touch on regulatory barriers:

- **Investment Matching Program:** To co-invest with private investors to reduce investment risk and attract new capital to the sector.
- **Outcomes Payment Fund:** To catalyze the development of outcome-based contracts.
- **Support for investment and contract readiness:** To help build the capacity of the sector and develop a pipeline of investment-ready social enterprises and projects.
- **Overarching impact investment strategy:** A coordinated, multi-government strategy to support Canada's impact investment market.
- **Engage investors:** Consult with investors to understand their perspectives on the opportunities for mainstream investors to play a role in social impact investing.

The final report of the overarching G7-based Taskforce also puts forward a mix of recommendations for governments that touch on both barriers to social impact investing and other types of catalytic and capacity-building policies. The recommendations most relevant to a discussion on regulatory barriers are recommendations concerning the creation of a **separate legal form** for for-profit social-purpose organizations that locks in their social mission and the

⁶² <http://www.socialimpactinvestment.org/>

relaxation of restrictions on charities and non-profits' **revenue-generation activities**. In addition, the Taskforce calls on governments to **reduce the restrictions on foundations** to allow them to make more social impact investments, and to **allow pension funds to take impact into account** when making investments.

Conclusion

This report represents a first step in identifying potential barriers to social finance. Analyzing the concerns raised by stakeholders regarding perceived barriers is not a straight-forward process. Crafting policy advice on any one barrier will demand a nuanced approach that balances competing government priorities. Departments and agencies will use the work done for this report to continue monitoring and analyzing these issues, and will present policy advice to their respective Ministers in the course of reviewing legislative, policy and program tools and when considering specific proposals as part of Cabinet and other decision-making processes.

**Pages 60 to / à 62
are withheld pursuant to sections
sont retenues en vertu des articles**

21(1)(a), 21(1)(b)

**of the Access to Information Act
de la Loi sur l'accès à l'information**

Annex B: Donation Incentives Available to Individuals and Corporations

Canada's incentives for charitable donations have been described as the most generous in the world. At the federal level, individuals making cash donations to registered charities receive a charitable donations credit at the rate of 15% on the first \$200 in annual donations, and a credit at 29% on donations above \$200. When provincial and territorial tax relief is added, total tax assistance averages about 46% on cash donations over \$200. Most individuals receive a tax credit at a rate that exceeds the tax they pay. Donations to registered charities by corporations receive tax assistance in the form of a deduction from income.

Taxpayers may claim donations up to 75% of their net income in a year (in some cases the limit is 100%). Unused donations can be carried forward for up to five years (ten years in the case of ecological gifts). These provisions encourage taxpayers to make large gifts.

Additional tax incentives encourage Canadians to donate particular types of capital property to registered charities. The following types of property are exempt from capital gains tax if they are donated to a registered charity: publicly listed securities; ecologically sensitive land; and certified cultural property. When the capital gains tax exemption is considered, the rate of assistance on donations of listed securities is typically 60%, and can be as high as 69%.

Donations of other types of capital property (e.g., land, buildings) are generally subject to the normal one-half inclusion rate that applies on the realization of capital gains. For almost all individuals, the value of tax assistance more than eliminates any capital gains associated with the donation. The charitable deduction and reduced capital gains inclusion rate will generally ensure that corporations do not pay tax on amounts donated to registered charity of up to 75% of net income.

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Who we are

As part of the June 2013 G8 meeting, an international effort was undertaken to explore the potential for impact investing to accelerate economic growth and to address some of society's most important issues. To continue this exploration and catalyze the development of the impact investment market, the Social Impact Investment Taskforce was launched, chaired by Sir Ronald Cohen.

Under the auspices of that effort, the Canadian National Advisory Board was formed to focus on the domestic policy agenda. The board is composed of 24 thought leaders, including private investors, fund managers, entrepreneurs, academics, and leaders from foundations, non-profit organizations, financial institutions, and impact-oriented intermediary organizations. The board includes members from the 2010 Canadian Task Force on Social Finance, providing continuity with past work.

The group's purpose is to highlight key priorities for Canadian policy-makers, in order to support the growth of impact investing and to provide counsel to the global policy discussion.

This report is the result of a collaborative process. Each member of the board contributes unique perspectives and priorities to this effort. Members of the board have participated in their capacity as individuals, rather than as representatives of their organizations. The report embodies the collective perspectives of the group, rather than the specific viewpoints of each individual.

MEMBERS OF CANADA'S NATIONAL ADVISORY BOARD TO THE SOCIAL IMPACT INVESTMENT TASKFORCE:

1. Ilse Treurnicht, CEO, MaRS Discovery District (*Chair*)
2. Tim Jackson, Director, MaRS Centre for Impact Investing (*Canadian sector representative on the Taskforce*)
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Introduction and Executive Summary

The practice of impact investment (or social finance) is gaining domestic and international attention. Focused on directing private capital into projects and ventures whose aims are to deliver measurable social outcomes, impact investment has the potential to foster innovation in the social sector. It can be used to develop and test new ideas that may effectively tackle social challenges, and to scale up those that work.

Impact investment can spur non-profit, private, and public sector collaboration, to assist individuals and communities to realize greater social and economic outcomes.

BUILDING FROM A RICH HISTORY

Impact investment builds from a robust, pan-Canadian history of investing private capital with the aim of generating financial returns along with positive social, environmental, cultural, or economic impacts. This practice reaches back to the early 1900s, with the emergence of credit unions, and continues through to the present day, with the development of, for example, co-operatives, community economic development initiatives, solidarity finance and the social economy in Quebec, Aboriginal Financial Institutions, micro-finance, public-private partnerships, socially responsible investment (SRI), and corporate social responsibility. Impact investment also builds on efforts to focus philanthropy and public social expenditure on the achievement of specific outcomes.

While there is no hard stop between these concepts and impact investment, the latter emphasizes the importance of impact measurement, and presents new opportunities for multi-sector partnerships in a market that, while still nascent, is driven by an existing network of leaders spanning the country.

Investments can target a range of positive impacts. Throughout this report, the term "social impact" is understood to include economic impacts in depressed regions, and for disadvantaged populations, as well as environmental impacts, in alignment with the Social Impact Investment Taskforce.

"The Canadian impact investment market is demonstrating positive momentum..."

WHAT IS IMPACT INVESTMENT?

Using the definition adopted by the report *State of the Nation: Impact Investing in Canada*, impact investment embodies three key characteristics:

- 1. Investor intention:** Investors seek to allocate capital (debt, equity, or hybrid forms) to investments from which they expect to receive a financial return (ranging from return of principal to market rate returns) and a defined societal impact.
- 2. Investee intention:** Business models for investees (whether they are for-profit or non-profit enterprises, funds or other financial vehicles) are intentionally constructed to seek financial and social value.
- 3. Impact measurement:** Investors and investees are able to demonstrate how these stated intentions translate into measurable social impact.

Impact investment differs from the most prevalent forms of SRI in that it moves from negative screening (avoiding investments that do not meet certain environmental, social or governance criteria) to investment with the intention to achieve positive social outcomes. Canada's National Advisory Board views impact investment as complementary to public social expenditure and philanthropy.

The Canadian impact investment market is demonstrating positive momentum, surfacing numerous examples of established multi-sector partnerships in which private capital is being used to drive positive social impacts, and with various new initiatives underway.¹

The Fiducie du Chantier de l'économie sociale, created by the Chantier de l'économie sociale in 2007, is the first patient capital fund in Quebec. The Fiducie is a result of successful collaboration between governments and labour organizations, and responds to the unmet need for long-term capital in the social economy. The fund was initially capitalized by Economic Development Canada with a grant of \$22.8 million. Investors (trustees) in the Fiducie include the Fonds de solidarité (\$12 million), Fondation (\$8 million) and the Québec government, Investissement Québec (\$10 million). To date (December 31, 2013), the Fiducie has authorized over \$37 million in investments for 128 social enterprises, and is estimated to have created and maintained about 2,000 jobs.

The Government of Québec has made direct investments in social economy organizations through Investissement Québec (IQ), an economic development agency and financing corporation. Between 2002 and 2012, the social economy division of IQ invested \$27 million, which in turn leveraged \$375 million of additional investment with an overall impact of \$3.5 billion in the Québec economy. This division has the lowest default rate of the IQ.²

The Capital for Aboriginal Prosperity and Entrepreneurship (CAPE) Fund is a \$50 million private equity investment fund that aims to encourage Aboriginal entrepreneurship and business ownership by providing capital, businesses expertise, and mentorship to projects with the potential to deliver both a financial return and a social return.

Indigena Solutions exemplifies how First Nations-driven businesses can attract investors to create impact. Based in Vancouver, Indigena Solutions is a partnership between the Tsawwassen First Nation, Accenture, and the CAPE Fund. Indigena opened its first delivery centre in July 2012, delivering information technology and business support services at competitive prices. Indigena's services and workforce model align with its belief in community transformation through creating jobs that allow people to live and work in or close to First Nations communities, while leveraging technology to enable First Nations socio-economic development.

Founded in 1946, Vancity has grown to become Canada's largest credit union, serving over 500,000 members at about 60 locations across British Columbia, with more than \$17 billion in assets under management. Vancity delivers competitive returns to its members while targeting social, economic and environmental impact through loans and investments. Vancity's impact lending and investing is focused in the areas

of: Aboriginal communities; energy and environment; impact real estate; labour unions and members; local, natural and organic food; microfinance; and social enterprise. Vancity is a member of the Global Alliance for Banking on Values, and is a widely recognized pioneer in the areas of social finance, and supporting social enterprise.

The Immigrant Access Fund (IAF) was launched in Alberta in 2005. It provides micro-loans of up to \$10,000 to immigrants who face barriers to accessing mainstream credit, for example, because they are unemployed, have no credit history, or lack collateral. These loans can be used to finance licensing and training, and ultimately aim to help immigrants enter the workforce. The IAF has invested over \$5 million in loans, with an average loan amount of \$6,500. The annual interest rate is set at the Bank of Canada prime rate plus 1.5 percent. Principle repayments and interest are recycled back into the fund. Loan capital for IAF Alberta is provided by donors and through lines of credit secured by guarantees from members of the community. The IAF is being expanded across the country, with support from the Government of Canada's Foreign Credentials Referral Office. IAF Saskatchewan was launched in 2012, with loan capital provided by donors and the Government of Canada.

Under Ontario's Social Enterprise Strategy, a number of initiatives are being advanced, including a \$4 million Social Enterprise Demonstration Fund that will be used to pilot new social finance projects and to unlock additional capital for social enterprises, and a call for Social Impact Bond (SIB) ideas.

The Canadian Alternative Investment Cooperative (CAIC) was created in the early 1980s and now manages \$6.7 million in capital. CAIC invests in non-profit organizations, charities, co-operatives and social enterprises, providing mortgages for community-based projects; loans for social and affordable housing initiatives; and loans and equity investments for social enterprises.

CAIC invested in YWCA Halifax in 2013. The YWCA's vision was to build a daycare and office space. After investments were made by the YWCA and the Government of Nova Scotia, CAIC provided a second mortgage. CAIC facilitated the deal by taking the riskier position as a second lender, without charging the interest premiums normally associated with such a position. CAIC reports that the investment is meeting their financial expectations, and full enrolment at the daycare suggests a strong social return.

Figure 1: Canadian Task Force on Social Finance 2010 Recommendations

Capital Mobilization				Enabling Tax & Regulatory Environment		Investment Pipeline
Foundations should invest at least 10% of capital in impact investments by 2020	Government should partner with investors to establish a national impact investment fund	Develop new financial products, including SIBs, Community Bonds & Green Bonds	Mobilize the assets of pension funds in support of impact investing	Modernize frameworks governing non-profits & charities; explore hybrid corporate forms	Explore tax incentive options	Make SME business development programs more accessible to social enterprises
<ul style="list-style-type: none"> • Education & peer-to-peer learning • Regulatory & fiduciary clarification • Reporting on MRI activity 	<ul style="list-style-type: none"> • National fund of funds with a public first loss capital investment of \$20M/year over 5 years • Build & strengthen regional funds 	<ul style="list-style-type: none"> • Clarify rules on the public sale of Community Bonds by non-profits • Pilot a Green Bond • Pilot a SIB 	<ul style="list-style-type: none"> • Clarify fiduciary duty • Mandatory disclosure of responsible investing • Mitigate investment risk through guarantees & credit enhancement 	<ul style="list-style-type: none"> • Establish a profits "destination test" for related businesses run by charities & non-profits • Examine the need for a hybrid corporation 	<ul style="list-style-type: none"> • Establish a tax working group & consider tax incentives for: <ul style="list-style-type: none"> - Impact investors - Social enterprises - Social hires 	<ul style="list-style-type: none"> • Expand eligibility for SME services • Target services to social enterprises • Build a network of regional hubs supporting social enterprises

PART OF A BROADER IMPACT INVESTMENT AGENDA

In 2010, the Canadian Task Force on Social Finance made seven recommendations, addressed to governments, foundations, pension funds, entrepreneurs, non-profit organizations (NPOs), and others, focused on mobilizing new sources of capital, creating an enabling tax and regulatory environment, and building a pipeline of investment-ready social enterprises (summarized in Figure 1).³ These recommendations remain relevant. The growth of the impact investment market will require all of these actors to come together, often with the help of intermediaries, to design new products, policies, and impact measurement methods, and to galvanize both supply and demand side development.

Canada's National Advisory Board to the Social Impact Investment Taskforce, launched by the G8, has built from these recommendations, focusing on priorities that have the potential to be catalytic in the short term, as part of a longer-term, more comprehensive impact investment strategy.

ORGANIZATION OF THE REPORT

The National Advisory Board has identified two priority areas:

1) Addressing legislative and policy barriers to social entrepreneurship and impact investment in the non-profit

and charitable sector, with a focus on the *Income Tax Act*; and

2) Encouraging impact investment through "catalytic capital" measures.

Parts 1 and 2 of this report describe key barriers, opportunities, and recommendations in each of these areas. Part 1, developed with guidance from an expert working group, is addressed primarily to federal ministers and officials from the Department of Finance, the Canada Revenue Agency and the Department of Employment and Social Development. Some recommendations are addressed to provincial governments. Part 2, developed by KPMG on the basis of interviews with existing and potential impact investors, is also targeted to a federal government audience but is relevant to provincial governments and others.

While focused on governments as critical leaders with the power to unlock capital, support social enterprise development, and catalyze market growth, this report recognizes that expanding the Canadian impact investment market will require action on the part of financial institutions, entrepreneurs, non-profit and philanthropic organizations, intermediaries, and individual Canadians. Governments can create policy frameworks that will enable these other actors to achieve results.

SUMMARY OF RECOMMENDATIONS

PART 1: RETHINKING THE NON-PROFIT / FOR-PROFIT DIVIDE: INCOME TAX ACT BARRIERS TO SOCIAL ENTREPRENEURSHIP AND IMPACT INVESTMENT IN THE NON-PROFIT AND CHARITABLE SECTOR.

The rules governing NPOs and charities have not kept pace with the trends of social entrepreneurship and impact investment, which are increasingly regarded as valuable tools for more effectively and efficiently addressing social challenges.

Two distinct sets of recommendations are provided, to better enable social entrepreneurship and impact investment in Canada's non-profit and charitable sector. These recommendations focus primarily on the *Income Tax Act* (ITA) and related guidance. The second set of recommendations also touches on provincial trust law.

RECOMMENDATIONS:

1. ENABLE CHARITY AND NPO SOCIAL ENTERPRISE ACTIVITY.

NPOs and charities are key providers of social services in Canada. They also have a significant economic impact, with a GDP contribution of \$35.6 billion, or \$100.7 billion including hospitals, universities and colleges (2007 figures), a workforce of over two million, and more than two billion volunteer hours.⁴

To maximize their social and economic impacts, many charities and NPOs are taking an entrepreneurial approach – engaging in revenue generating and capital raising activity to improve financial sustainability, develop and test innovative ideas, and grow successful services to scale. While social entrepreneurship has been evident in the sector for many years, the *Income Tax Act* and related guidance generally do not recognize the value of this activity, and may in some cases inhibit it.

The federal government's Budget 2014 announcement of a consultation on NPOs could provide an opportunity to examine the rules governing revenue-generating activities, in light of the benefits of fostering social entrepreneurship. While not its original intent, this consultation could also potentially provide an opportunity to examine the related business and public benefit rules pertaining to charities.⁵

a) Allow charities and a sub-set of NPOs with clear public benefit objectives to pursue certain related business activities on an income tax exempt basis, and to pursue other business activities subject to income tax.

This would provide charities and NPOs with increased flexibility to generate revenue for the purpose of advancing their public benefit objectives, while addressing concerns about unfair competitive advantage and mission drift.

b) Allow charities to provide a private benefit where it is necessary to achieve a broader public benefit, by clarifying guidance on the public benefit test.

For example, charities should be allowed to support employer recruitment efforts when this would achieve better employment outcomes for disadvantaged populations and result in reduced unemployment.

2. UNLOCK FOUNDATION CAPITAL FOR IMPACT INVESTING.

The potential for foundations to act as early leaders in Canada's impact investment market is significant. Canadian foundations

collectively manage about \$45.5 billion (based on 2012 data).⁶ While they are required to direct 3.5 percent of their assets into grants each year (to meet their annual disbursement quota), the rest is generally invested with the sole aim of maximizing financial returns. Impact investing offers foundations the opportunity to align at least a portion of their investment portfolios with their charitable objectives.

Existing legislative and policy frameworks allow foundations to make a wide range of impact investments; however, a strong signal from provincial governments is needed, to clarify prudent investor rules and encourage impact investment activity. In addition, certain impact investment opportunities that are currently off-limits for foundations should be permitted through targeted legislative changes.

a) Clarify that impact investments can be part of a balanced portfolio under current prudent investor rules (under provincial jurisdiction).

Impact investment opportunities offer a range of risk and return profiles, and can currently be considered alongside more traditional investments as part of a balanced portfolio. In some cases, low correlation to standard financial markets may create an added incentive for considering these investments. It should be noted that prudent investor rules do not exclude consideration of social impact.

b) Alter trust law to state that, in the case of a charity, a prudent investor should consider social impact (under provincial jurisdiction).

c) Allow charities to make below market rate investments, where appropriate to advance their charitable objectives, ensuring that no part of these investments, or any associated opportunity costs, would be considered as gifts to non-qualified donees.⁷

While it is important to recognize that many impact investments are prudent by traditional financial standards, impact investments for which no return or a below market rate return is expected are sometimes warranted. For example, early stage social enterprises can struggle to attract risk capital and may not be able to offer risk-adjusted market rate returns. In addition, tranching investing, in which certain investors take higher-risk positions that are not necessarily commensurate with return expectations, may be necessary to attract more risk-averse capital to worthwhile projects. This type of investment can be used to complement granting. In many cases, it will also provide a financial return.

In the United States, the Bill and Melinda Gates Foundation has invested in early stage drug, vaccine, and health technology development, in some cases leveraging external capital from private investors that would not otherwise have been available by taking a first loss position or providing guarantees. These investments have been used to accelerate the development of innovative solutions to health challenges that disproportionately affect populations in developing countries, aligned with the foundation's charitable objectives. Grand Challenges Canada, funded by the Government of Canada, engages in similar investment activities. Canadian foundations should be encouraged to play a comparable role in catalyzing investments with positive social impact.

d) Allow charities to invest in limited partnerships (LPs).

Private foundations are prohibited from carrying on a business and other charities are discouraged from doing so. By reason of the legal definition of a partnership, a charity that invests in an LP is considered to be carrying on a business even if it plays no active role in the business, and even though investments are generally understood to provide passively earned income.

The barrier to investments in LPs is problematic from the standpoint of building Canada's impact investment market, as impact investment funds are often structured as LPs. This structure has also been used as a vehicle for investing in SIBs.

PART 2: CATALYZING IMPACT INVESTING: THE OPPORTUNITY FOR GOVERNMENTS

Canada's impact investment market is gaining momentum. It will continue to do so irrespective of government involvement; however, to catalyze this growth, government leadership is needed.

From the Government of Canada's recently launched Venture Capital Action Plan, to the Government of Nova Scotia's Community Economic Development Investment Funds, to the joint investment by the governments of Canada and Quebec in the Fiducie du Chantier de l'économie sociale, initiatives designed to attract additional capital to a variety of markets in support of public policy priorities are not new. These initiatives can take the form of capital matching, credit enhancements, guarantees, and tax incentives.

Outcomes-based financing is another tool available to governments. Service providers can gain access to investment capital based on a government commitment to pay if certain outcomes are achieved, and governments can test or expand services without taking on financial risk.

Government adoption of these tools is recommended, in the context of a broader strategy for building the impact investment market, to ensure a clear vision and comprehensive plan for supporting the development of the supply, demand, and intermediation components of this market.

For example, support for business development, through accelerators or similar programs, is needed to develop a pipeline of investment-ready social enterprises and projects. Similarly, support for contract readiness represents an important complement to an outcomes payment fund, to build the capacity of service providers to engage in outcomes-based financing arrangements.

Given that provincial governments hold many policy levers for market development, and in some cases are already actively engaged, intergovernmental collaboration is advisable.

Input from a wide range of stakeholders would also be beneficial, including investors, social enterprises, NPOs, charities, and intermediaries. Design of the initiatives in Recommendations 3 and 4, in particular, will require input from current and potential impact investors.

KEY RECOMMENDATIONS:

3. ESTABLISH AN IMPACT INVESTING MATCHING PROGRAM, PAIRED WITH APPROPRIATE INCENTIVES.

This could take the form of a fund, capitalized by the government, which would co-invest with private investors, either directly in

eligible social enterprises or projects, or in impact investment funds that require additional capital to close a funding round. Similar activities could be undertaken using a pool of grant money and request for proposals approach.

Another option is a fund of funds, which would provide the scale necessary to attract large institutional investors (such as pension funds) to the market, and which could be established through co-investments in partnership with these investors.

Regardless, incentives are recommended to attract new capital, for example, in the form of tax credits or first loss capital.

4. ESTABLISH AN OUTCOMES PAYMENT FUND.⁸

A dedicated fund for outcomes payments would catalyze the development of outcomes-based approaches to service delivery within and outside of governments. The government could specify maximum prices that it is willing to pay per outcome, as has been done in the United Kingdom, enabling the market to respond with innovative solutions.

SUPPORTING RECOMMENDATIONS:

- Provide support for investment and contract readiness; to develop the pipeline of investment opportunities.
- Embed these initiatives in a broader strategy for building Canada's impact investment market, coordinating with all levels of government.
- Engage investors in the design of these initiatives.

CONCLUSION

Public policy challenges – ranging from youth unemployment to homelessness and chronic disease – demand innovation, or they will increasingly represent a drag on the wellbeing of Canadian communities, the economy, and government budgets. Importantly, impact investment – like venture capital for business startups – can provide much needed financing to test and implement innovative approaches to addressing a vast range of social challenges, and can provide an outcomes-focused lens that will help to demonstrate which approaches deliver the best results.

There is nothing illusory about the impact investment market. It is evident in the investment decisions of individual Canadians, in the creation of impact investment funds by financial sector leaders including mainstream banks, and in the demand for capital among social enterprises across Canada.

The Government of Canada, while demonstrating early interest, now needs to determine whether it wishes to position itself at the forefront or at the sidelines of this market. As leaders in this market, governments can accelerate its growth, driving the development and implementation of initiatives designed to improve social and economic outcomes for individuals and communities.

Enabling impact investment and social entrepreneurship in the non-profit and charitable sector, and catalyzing impact investment through capital matching, investor incentives, and outcomes payments, are two immediate priorities for government action.

Canada's National Advisory Board is prepared to provide further advice and support to the Government of Canada, and to provincial or municipal governments, to help advance these recommendations, or related initiatives.

PART ONE

September 2014

Rethinking the non-profit
/ for-profit divide:
income tax Act barriers
to social entrepreneurs, social
and impact investment in
the social purpose and
business sectors

Mobilizing Private Capital for Public Good: Priorities for Canada

Rethinking the non-profit / for-profit divide:

Income Tax Act barriers to social entrepreneurship and impact investment in the non-profit and charitable sector

Part 1 of this report was informed by Canada's National Advisory Board to the Social Impact Investment Taskforce, launched by the G8, and benefited from the direct guidance of an expert working group.

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RETHINKING THE NON-PROFIT / FOR-PROFIT DIVIDE: INCOME TAX ACT BARRIERS TO SOCIAL ENTREPRENEURSHIP AND IMPACT INVESTMENT IN THE NON-PROFIT AND CHARITABLE SECTOR

1. INTRODUCTION

Interest in social entrepreneurship has grown over the last several years, both internationally and in Canada, and new expectations have emerged on the part of interested consumers and investors for products, services and financial returns that are twinned with social impact. It is increasingly recognized that multi-sector collaboration, social entrepreneurship, and impact investment (or social finance) are valuable tools for more effectively and efficiently addressing social challenges.

The *Income Tax Act* (ITA) and related rules governing non-profit organizations (NPOs) and charities have not, however, kept pace with these evolving trends.

This part of Canada's National Advisory Board report proposes two distinct sets of recommendations for amending the ITA and related guidance, as appropriate, to better enable social entrepreneurship and impact investment activities, respectively, in Canada's non-profit and charitable sector. To ensure that these proposals are comprehensive and effective, the second set of recommendations also touches on provincial trust law.

RECOMMENDATIONS:

1. Enable charity and NPO social enterprise activity.

- a) Allow charities and a sub-set of NPOs with clear public benefit objectives to pursue certain related business activities on an income tax exempt basis, and to pursue other business activities subject to income tax.
- b) Allow charities to provide a private benefit where it is necessary to achieve a broader public benefit.

2. Unlock foundation capital for impact investing.

- a) Clarify that impact investments can be part of a balanced portfolio under current prudent investor rules (under provincial jurisdiction).
- b) Alter trust law to state that, in the case of a charity, a prudent investor should consider social impact (under provincial jurisdiction).
- c) Allow charities to make below market rate investments, where appropriate to advance their charitable objectives.⁹
- d) Allow charities to invest in limited partnerships.

2. BACKGROUND

Charities and NPOs fall under shared jurisdiction in Canada. While provinces have primary constitutional jurisdiction over charitable property, the federal government exerts authority through its taxation powers.

Some of the federal rules governing charities and NPOs are embedded in the ITA and associated regulations, while others flow from guidance developed by the Canada Revenue Agency (CRA).

The ITA uses the common law definition of charity as the basis for determining requirements for registration and special tax treatment. The CRA is responsible for the administration of the ITA, while policy development related to the ITA generally falls within the mandate of the Minister of Finance.

Provincial legislation governing charities and NPOs, while addressed briefly in the recommendations, is not a primary focus of this report.

2.1 Charities and NPOs

While both operate on a non-profit basis, charities and NPOs are subject to different rules.

Under sub-section 149.1(1) of the ITA, there are three types of registered charities: 1) charitable organizations; 2) public foundations; and 3) private foundations. Charities must serve at least one of four charitable purposes: relief of poverty; advancement of education; advancement of religion; and other purposes beneficial to the community.¹⁰ Charities must be established for the benefit of the public or a sufficient segment of the public, and are required to expend all of their resources on their own charitable activities or on gifts to other charities or qualified donees.¹¹ Broadly, charities are exempt from the payment of income tax. They also benefit from the ability to provide receipts to donors, who may claim a tax credit or deduction, and are able to accept charitable donations from other charities or foundations. To become a registered charity, it is necessary to apply to the CRA for registration.

NPOs also benefit from an income tax exemption. Unlike charities, they cannot issue charitable donation tax receipts, and are not eligible to receive grants from registered charities. NPOs can operate for any purpose other than profit. A wide range of NPOs exist. Some have a clear public benefit mandate, while others do not.¹² NPOs are not required to register with the CRA.

Charities and NPOs make a significant economic impact. According to a 2007 survey, gross domestic product (GDP) for the core non-profit sector (which includes most charities, but excludes hospitals, universities, and colleges) was \$35.6 billion, accounting for 2.5 percent of the Canadian economy. With hospitals, universities, and colleges included, the sector contributed \$100.7 billion to Canada's GDP.¹³ The sector employs over two million people, and is supported by more than two billion volunteer hours.¹⁴ There are over 80,000 charities in Canada.¹⁵ It is more difficult to accurately count the number of NPOs, given that they are not required to register with the CRA; however, it is estimated that the total number of NPOs in Canada also exceeds 80,000.¹⁶ While exempt from income tax, charities and NPOs do generate tax revenue, for example, through sales tax and employee payroll tax.

2.2 Impact investment and social entrepreneurship

As noted in the introduction, impact investment is understood to involve the investment of capital with the intention to generate and measure positive social impact alongside a financial return - which could range from the return of a portion of the principal to market rate returns. Investees are also understood to have the intention to generate social and financial value, and sometimes operate as social enterprises.¹⁷

According to the Canadian Task Force on Social Finance, a social enterprise is an "organization or business that uses the market-oriented production and sale of goods and/or services to pursue

a public benefit mission." A social enterprise can take the form of a charity, NPO, co-operative, for-profit corporation, or hybrid corporation.¹⁸ Additional information on the structural options available to social enterprises in Canada is provided in Annex A. Recommendation 1 focuses on charities and NPOs.

Realizing the potential of Canada's impact investment market will require action in relation to capital supply and capital demand. This part of the report addresses both, within the context of the non-profit and charitable sector.

3. ITA RESTRICTIONS ON SOCIAL ENTREPRENEURSHIP: REVENUE GENERATING ACTIVITY AND THE PUBLIC BENEFIT TEST

3.1 Charities: Operating a related business

Charities – with the exception of private foundations – are allowed to operate a "related business." This is defined by the CRA as run substantially (90 percent) by volunteers or as linked and subordinate to a charity's purpose.

- **Linked:** Using profits from the business to advance the charitable purpose does not make the business "linked": the business must either be a "usual and necessary concomitant of charitable programs" such as a hospital parking lot; "an offshoot of a charitable program," such as the sale of flour from a heritage village mill; "a use of excess capacity," such as renting out university rooms for conferences during the summer; or "the sale of items that promote the charity or its objects," such as T-shirts depicting the charity's logo.
- **Subordinate:** The CRA has identified four factors that must be considered in determining whether a business is subordinate: 1) "Relative to the charity's operations as a whole, the business activity receives a minor portion of the charity's attention and resources"; 2) "The business is integrated into the charity's operations, rather than acting as a self-contained unit"; 3) "The organization's charitable goals continue to dominate its decision-making"; and 4) "The organization continues to operate for an exclusively charitable purpose by, among other things, permitting no element of private benefit to enter in its operations."¹⁹

Charitable organizations can create and maintain control over a separate taxable corporation, which could deduct up to 75 percent of net profits in determining income for tax purposes, through donations to the parent charity or another qualified donee.

In this case, any investments in the separate corporation would have to satisfy normal prudent investment rules and no private benefit could be conferred on the corporation by the charity.²⁰

3.2 Charities: Public benefit test

A charity must meet two basic requirements. Its purposes must be exclusively charitable, falling into one of the four categories identified in Section 2.1, and it must be established for the benefit of the public or a sufficient segment of the public. To pass the latter test, several sub-requirements must be met, including that a charity must provide a tangible benefit to either the public-at-large or a sufficient segment of the public, determined by the charitable purpose being served, and may not otherwise provide benefits to private individuals, except where they are "a minor and incidental by-product of the charitable purpose."²¹

A private benefit to an employer could be considered as more than incidental. For example, in the case of a charitable job-training program that supports business recruitment efforts, or when the program is targeted to a specific employer, the indirect benefit to the broader public of relieving unemployment could be viewed as too remote relative to the direct benefit conferred on the employer.²²

3.3 NPOs: Restrictions on earning a profit

Under paragraph 149(1)(l) of the ITA, an NPO must be exclusively organized and operated for an objective other than profit. Recent CRA interpretations of this requirement are stricter than this wording and previous guidance might suggest, equating the intention to earn a profit with being organized or operated with the objective of profit, and seemingly equating surplus with profit.

CRA guidance and interpretive rulings have been varied; however, in one statement, the CRA indicated that an NPO may earn a profit if it is incidental to and results from activities that support its not-for-profit objectives. It further specified that "where an organization intends, at any time, to earn a profit, it will not be exempt from tax under paragraph 149(1)(l) even if it expects to use or actually uses that profit to support its not-for-profit objectives."²³

NPOs may be allowed, with certain restrictions, to maintain control over a separate taxable corporation; however, CRA guidance to date has been unclear on this point.

3.4 ITA restrictions on social entrepreneurship: The challenge

While charities and NPOs have engaged in business activities for many years, the ITA and related guidance generally do not recognize the value of these activities.

Restrictions on business activity may in some cases limit the growth and impact of successful organizations. The severity of the potential consequences of a misstep, including financial penalties, suspension of tax-receipting privileges, and loss of charitable status or NPO tax-exemptions, may also act as a disincentive to adopt entrepreneurial models. In addition, anecdotal evidence from key informant interviews, and the results of the CRA's recently concluded NPO Risk Identification Project, suggest that a number of registered charities and NPOs have adopted models that expose them to legal risk. They either do not understand the rules or have opted to push the boundaries of these rules in order to innovate.

A case study on Habitat for Humanity, outlined in Annex B, highlights challenges related to current interpretations of the related business rules for charities.

The situation is more severe for NPOs. The Risk Identification Project found that a significant number of the NPOs examined do not meet the requirements under paragraph 149(1)(l) of the ITA. Of the factors reviewed, one of the most serious compliance problems relates to profit-generating activity. It was found that "a significant number" of the NPOs examined are not operated exclusively for a purpose other than profit, and that many engage in a range of activities with profit motives, or carry large reserves generated by non-incidental profits.

Notably, this audit also found that many NPOs view these activities as necessary to further their non-profit missions. It "observed that many in the non-profit sector believe that NPOs must produce a profit for their programs to thrive and for their capital assets to be maintained. In particular, there is a common view that, as long as profits are used to further the organization's purpose, the source of the funding shouldn't matter."²⁴

While charities can establish taxable subsidiaries, smaller organizations often lack the capacity and resources to do so. This generally requires, for example, a separate board of directors; separate accounting, banking, reporting and administration functions; and a fair market value exchange for the corporation's use of any charitable resources, such as staff and office space. For NPOs, the rules governing ownership of a separate taxable corporation are unclear.

Finally, current guidance on the requirement for charities to provide a public benefit, and to avoid conferring private benefits, may exclude services that are tailored to helping particular individuals, or based on partnerships with private businesses – even when these services demonstrate significantly improved outcomes aligned with a charitable purpose. A case study on Social Capital Partners, in Annex B, exemplifies this challenge. From a social enterprise perspective, freedom to innovate, with the aim of designing services that will deliver improved social outcomes, is vital.

3.5 ITA restrictions on social entrepreneurship: The opportunity

As key providers of social services, NPOs and charities form a vital part of Canada's social enterprise landscape. To maximize their effectiveness, they require flexibility to develop and test innovative ideas, grow successful services to scale, and ensure financial sustainability.

Imagine Canada has stressed the importance of earned revenue activities, which make up a significant portion of core non-profit revenue (45.6 percent in 2007).²⁵ Government grants have been uneven and subject to fiscal pressure in the wake of the 2008 financial crisis. Philanthropic giving by individual donors and foundations also slowed, and is only now returning to previous levels. In addition, donor priorities and restrictions often constrain charities' ability to meet core funding needs. Earned revenue can provide a buffer against declines in public and philanthropic funding, and a source of unrestricted funds. It can also help to attract investment capital, and is arguably the only source of non-profit and charitable income with reliable growth potential.²⁶

In addition, while direct government funding for social services will continue to be vital across the social sector, governments are signaling increased interest in outcomes-based financing. Except in the case of the Social Impact Bond model – in which investors provide upfront financing to service providers, generally based on a government commitment to pay investors if certain outcomes are achieved – this will create new demand for service providers that are able to manage their cash flow until outcomes payments are received, at least in part through revenue generating activities.

The federal government's Budget 2014 announcement of a consultation on NPOs could provide an opportunity to examine the rules governing revenue-generating activities among NPOs, in light of the benefits of fostering social entrepreneurship.²⁷ While not its original intent, this consultation could also potentially provide an opportunity to examine the related business and public benefit rules pertaining to charities.

4. RESTRICTIONS ON IMPACT INVESTMENT

4.1 Impact investments

Investments made by charities (generally foundations) are

governed by provincial trust law, incorporating statutes, internal documents, and the ITA.

Under the ITA, charities are prohibited from making a grant to an entity that is not a qualified donee. Foregone revenue resulting from an investment that was expected to yield a below market rate return is considered to be a charitable grant. Therefore, the recipient of such an investment must either be a qualified donee or must use the investment for a program over which the investor charity maintains direction and control. If an investment does not fall into these categories, it must be made with the expectation of a risk-adjusted market rate return, and meet standard investment requirements.

Investments that focus primarily on advancing a charity's stated charitable purposes have been termed Program Related Investments (PRIs) in CRA guidance.²⁸ PRIs may be made with the expectation of receiving no return or a return that is below market rate, and can take the form of loans, loan guarantees, share purchases, or property leases. Generally, a charity could fund PRI activity through grants; however, PRIs offer the possibility of having capital returned, potentially with interest, allowing for reinvestment in charitable activities. In addition to any amount of a PRI that cannot be recovered, the opportunity cost of a PRI could be considered as a charitable expenditure and counted towards a charity's annual disbursement quota, if this quota has not already been met.²⁹

Under provincial law, charities are subject to prudent investor rules. Provinces and territories, with the exception of Quebec, have established prudent investor standards in trust legislation. Quebec's *Civil Code* includes rules that parallel these standards.³⁰ Generally, the prudent investor standard is tied to the management of a balanced portfolio, which contains a diversity of investments, across asset classes and with different levels of risk and expected rates of return. This standard implies that risk must be judged across the portfolio as a whole, rather than by individual investments.³¹

4.2 Investments in limited partnerships

Private foundations are prohibited from investing in limited partnerships (LPs) and other charities are discouraged from doing so.

Paragraph 149.1(4)(a) of the ITA bars private foundations from carrying on a business. While other charities are allowed to carry on a related business, this is defined as either 90 percent volunteer-run or linked and subordinate to the charity's purpose. CRA guidance specifies that, while investments are generally described as providing passively earned income, and are therefore allowable, a charity that invests in an LP is considered, by reason of the legal definition of a partnership, to be carrying on a business "even though the charity plays no active role in the business."³²

4.3 Restrictions on impact investment: The challenge

According to current ITA rules relating to permissible charitable expenditures, certain impact investments are not possible – specifically, investments into NPOs, co-operatives, social purpose for-profit businesses, hybrid entities, or impact investment funds (which may invest in a range of entities in addition to charities), for which returns are expected to range from zero to below market rate, unless the investor charity maintains direction and control, which is often impractical.

In addition, the barrier to investments in LPs is problematic, from the standpoint of building Canada's impact investment market, as impact investment funds are often structured as LPs. Impact investment funds are of particular interest to foundations, as they offer a relatively cost-efficient opportunity to make large investments that are aligned with their charitable objectives. In contrast, sourcing and evaluating direct investments generally involves a high cost per transaction, and requires resources and expertise beyond the capacity of most foundations. In a few cases, foundations or funds have set up independent trusts as vehicles for foundation investments in LPs. However, this workaround can be costly, onerous, and potentially risky, and has in some instances deterred boards and investment committees from considering impact investments structured as LPs. LPs have also been used as a vehicle for investing in Social Impact Bonds.

While other forms of market rate impact investments (generally termed Mission Related Investments) are currently permissible as part of a balanced portfolio, limited awareness, capacity and deal flow, in addition to risk aversion, may be limiting this kind of activity. Foundation boards tend to invest with a view to maximizing returns and minimizing portfolio risk, focusing on a mix of equities, fixed income, and cash, with some alternative investment assets held for diversification purposes. However, there is a perception that impact investments generally offer lower returns and higher risk. As a result, foundation endowments are often being invested according to conventional asset allocation strategies, rather than in communities.

4.4 Restrictions on impact investment: The opportunity

The potential for foundations to act as early leaders in Canada's impact investment market is significant. Canadian foundations collectively manage about \$45.5 billion (2012).³³ While they are required to direct 3.5 percent of their assets into grants each year (to meet their disbursement quota), the rest is generally invested with the aim of maximizing financial returns.³⁴ Foundations are ideal impact investors because their social missions naturally align with the objectives of impact investing.

Recent studies indicate a discrepancy between targeted and actual impact investments by foundations. In a survey of 66 Canadian foundations, almost three quarters (a sample that may represent those already more inclined towards impact investing) reported five-year impact investment targets of five percent of their endowments or higher; however, less than a quarter had actual impact investment allocations in this range. A related survey found that about 29 percent of foundations surveyed had made Mission Related Investments (MRIs) and 20 percent had made PRIs.³⁵ It indicated plans to increase MRIs by 29.5 percent and PRIs by 23 percent on average. Current foundation impact investments include about \$207.5 million in MRIs and \$80.3 million in PRIs.³⁶

Many impact investment opportunities are already available to foundations within current policy frameworks. Increasing the uptake of these opportunities could be achieved through clear signals from provincial governments that impact investments can – and should – be considered as part of a prudently invested portfolio.³⁷

Permitting foundations to invest in LPs would unlock additional impact investment opportunities. This change would also contribute to the diversification of risk and optimization of returns across foundations' investment portfolios.³⁸

In addition, foundations could fill an important gap in the impact investment market by making investments with return expectations that range from zero to below market rate, with the primary aim of advancing their charitable purposes. Changing federal tax rules to allow for this type of investment in any entity (including non-qualified donees) could significantly increase the amount of foundation capital invested in supporting Canadian communities, and catalyze additional non-foundation impact investment. In particular, patient risk capital would be available for early stage social enterprise development, which may not always offer returns commensurate with risk. Foundations could confidently act as first-loss investors, without the high returns that this normally entails, where necessary to attract more risk-averse or finance-first investors to an initiative that would advance their charitable objectives. The longevity of foundation endowments would still be protected, provided that below market rate investments make up only a portion of a foundation's investment portfolio. This would enable a greater proportion of a foundation's assets to work directly in service of its charitable objectives.

Impact investments are attracting increasing interest from Canadian foundations and could become an important part of their investment and public benefit strategies, and a key element of their value proposition from the perspective of donors, governments, and the public at large.

5. RECOMMENDATIONS

Canada's National Advisory Board is confident that appropriate amendments to the rules governing charities and NPOs, in the ITA and related guidance, would accelerate the growth of social enterprise and impact investment activity in Canada. This, in turn, would enhance the ability of NPOs and charities to innovate and contribute to building resilient Canadian communities.

Two sets of recommendations are proposed. Some require legislative change. It is possible that others could be realized, at least in part, through changes to administrative guidance. Two proposals, under Recommendation 2, would require action by provincial governments.

5.1 Recommendation 1:

Enable charitable and NPO social enterprise activity

"Over the last decade, the charitable and nonprofit sector has been one of the most rapidly growing parts of the Canadian economy. Yet, there remains a pressing need to ensure the sustainability of the sector's revenue base, which consists of earned income, government support, and philanthropy. Together, charities, nonprofits, governments, and the private sector need to explore innovation within each of these revenue streams in order to build on the sector's achievement and sustain the benefits it provides to Canadian communities."

– Bruce MacDonald, President and CEO, Imagine Canada

a) Allow charities and a sub-set of NPOs with clear public benefit objectives to pursue certain related business activities on an income tax exempt basis, and to pursue other business activities subject to income tax.

In 2010, the Canadian Task Force on Social Finance recommended the adoption of a destination of profits test, according to which an NPO or charity could engage in any revenue generating activity on an income tax exempt basis provided that the proceeds are used to

advance its public benefit objectives.³⁹ While this would have the advantage of simplicity, it might raise concerns about horizontal equity or mission drift. This report offers a pragmatic alternative that captures the spirit of this rule – the focus on public benefit.

Currently, charities – with the exception of private foundations – are permitted to operate related businesses, which are narrowly defined. It is recommended that the definition of a related business be expanded and applied equally to all charities and to a suitable sub-set of NPOs, with any business activity that falls outside of this definition being permissible within the structure of the charity or NPO, but subject to income tax. Fundamentally, this would allow charities and NPOs the flexibility to engage in any revenue generating activity (subject to other relevant laws) without suffering penalties. It should be noted that this recommendation in no way intends to deprive registered charities of tax exemptions that exist under the current related business provisions.

The changes proposed in this recommendation should be restricted to registered charities, including private foundations, and a sub-set of NPOs under paragraph 149(1)(l) that serve a clear public benefit. The widely accepted International Classification of Non-profit Organizations, which classifies NPOs according to 12 primary areas of activity, could be used as the basis for defining the sub-set of NPOs that would qualify as serving a clear public benefit.⁴⁰ An alternative would be to emulate the definition that has been used by the Ontario Nonprofit Network in certain agreements with the Government of Ontario, which includes an asset lock in addition to public benefit requirements.⁴¹

This recommendation has some commonality with the Unrelated Business Income Tax (UBIT) policy, which the Internal Revenue Service administers in the United States. An overview of select international models for regulating charitable business activity can be found in Annex C.

More specifically, it is recommended that the requirement for a related business to be linked to the organization's purpose be adjusted to capture a broader range of revenue generating activity, which would be permissible within the structure of the organization, and tax-exempt. Excluded from the tax exemption would be businesses that are: only complementary to the organization's programs and/or objectives insofar as they provide a source of revenue that is used to advance these programs and/or objectives; not based on the sale of donated items; and run using employees and/or physical assets that are separate from the charity or NPO. Such activity could still be pursued within the registered charity or NPO, but would be subject to the corporate rates of tax applicable to Canadian Controlled Private Corporations (CCPCs).

Under this definition, examples of activities that would be subject to applicable income tax include:

- a) An organization established for the purpose of providing food at no cost to a low-income population running a commercial restaurant in a separate building, with separate employees, and using the profits of this restaurant to finance its food bank;
- b) An organization established for the purpose of providing low-income housing owning and operating a hotel, and using the profits to finance the purchase of a separate property for low-income housing; and
- c) An organization purchasing a franchise and operating the business to direct profits to its public benefit activities, with no

social hiring or other direct public benefit objectives expressed within the franchise.

For illustrative purposes only, the following are examples of business activities that should be allowed on an income tax exempt basis, when pursued by registered charities or a subset of NPOs with public benefit objectives, or that may currently be allowed in certain cases but for which the CRA guidance is unclear. These are only a few of many possible examples:

- a) Charging a fee to certain clients based on ability to pay, for example: an organization that sells healthy foods at market rates to those who can pay, and provides healthy foods at no or low cost to a low-income population; or an organization that runs a job training program targeting individuals who face labour market barriers and charges a fee to certain employers, based on their ability to pay;
- b) Selling donated items, including in the context of a sustained business operation that uses separate staff, for example, an organization that runs a hardware store selling donated construction materials that are used, end-of-line or damaged, and uses the proceeds to advance its public benefit mission; and
- c) Using physical, human, or other assets associated with the organization's programs and/or objectives to generate revenue, for example: a youth entrepreneurship training facility that rents unused space to paying clients; or an organization that runs a mixed-income building, a significant portion of which is used for low-income housing and the rest of which is rented at market rates.

In addition, a *de minimis* test could specify that if revenue from any activity is less than a prescribed amount, the revenue would be exempt from income tax.

Without suggesting a specific maximum portion of charitable or NPO resources that could be allocated to business activities, it is recommended that this should be higher than under the current charity rules, which state that a related business, unless it is run substantially by volunteers, must be subordinate to the charity's purposes, receiving no more than "a minor portion of the charity's attention and resources." Different thresholds could apply for tax-exempt and taxable businesses within the organization. This change would recognize the importance of investing in the success of a business, to ensure a reliable source of revenue, while remaining focused primarily on public benefit objectives. The existing requirement for a related business to be "integrated into the charity's operations, rather than acting as a self-contained unit" is also overly restrictive.

In keeping with the current rules, any business activity that directly advances a charitable or public benefit purpose (for example, by employing individuals who face labour market barriers) should be permissible on a tax-exempt basis, for charities and NPOs. In particular, charitable activities that generate revenue should continue to be counted as charitable activities. These activities would not be subject to any restriction on the percentage of an organization's assets that could be utilized by them.

In addition, charities should continue to be permitted, where appropriate to protect assets from business risk, to run a business as a separate taxable subsidiary. Consideration could be given to adapting the rules to allow charities to fund subsidiaries more easily. Similar permission should apply to NPOs. To this end, it is

recommended that enabling guidance pertaining to NPOs running for-profit subsidiaries be released.

Finally, it is recommended that charities and NPOs operating businesses be required to report on business activities. Reports could be made public on the CRA website. This would enhance current reporting requirements for charities, and extend reporting requirements to NPOs, supporting transparency and accountability. Caution should be exercised, however, to ensure that reporting requirements do not place an undue burden on charities or NPOs.

It should be noted that the introduction of a purpose-built corporate form for social enterprises – for example, allowing share capital to be raised, and requiring a community benefit purpose, caps on dividends, and an asset lock, as in British Columbia – would not address many of the challenges outlined in this part of the report. While a distinct legal structure would provide a useful addition to the range of structural options available to social enterprises, it does not supersede the need to enable social enterprise activity among charities and NPOs. Social entrepreneurs should have the flexibility to choose the structure that best suits their needs. Social enterprises that are not seeking to attract share capital, and that need an income tax exemption or qualified donee status (in

the case of charities) to remain viable, will continue to require a charitable or NPO structure.

“The world is changing and Canadian charities, nonprofit and cooperative organizations providing public benefit in their communities need to adapt too. Updating the Income Tax Act and related regulations that constrain social enterprise activity in nonprofit organizations will allow them to further build community wealth and vibrant, thriving communities. Canada has one of the strongest public benefit sectors in the world. Let’s keep it that way.”

– Cathy Taylor, Executive Director, Ontario Nonprofit Network

b) Allow charities to provide a private benefit where it is necessary to achieve a broader public benefit.

Finally, guidance on the public benefit test for charities should be reexamined to ensure that a private benefit is permissible where it is necessary to achieve a broader public benefit. For example, charities should be allowed to support employer recruitment efforts when this would achieve better employment outcomes for disadvantaged populations.

Figure 2 Summary chart: Proposed business activity categories for charities and a subset of NPOs with public benefit objectives

TYPE OF BUSINESS ACTIVITY	INTERNAL TO THE ORGANIZATION / SEPARATE	TAXABLE / TAX-EXEMPT	PERCENT OF ASSETS THAT CAN BE USED TO RUN THE BUSINESS
1. Directly advances a charitable or public benefit purpose	Internal	Tax-exempt	No limit
2. Complementary to the organization's programs and/or objectives (beyond providing a source of revenue); based on the sale of donated items; or run using the charity/NPO's employees or physical assets	Internal	Tax-exempt	Limited, but higher than under current related business rules for charities; similar rules would apply to NPOs
3. Does not meet the criteria for #1 or #2, but revenue falls under a specified <i>de minimis</i> threshold	Internal	Tax-exempt	Limited, but higher than under current related business rules for charities; similar rules would apply to NPOs
4. Only complementary to the organization's programs and/or objectives insofar as it provides a source of revenue that is used to advance these programs and/or objectives; not based on the sale of donated items; and run using separate employees and physical assets from the charity or NPO	Internal	Taxable	More limited than for businesses in categories #2 and #3
5. For-profit subsidiary	Separate	Taxable	Limited, but current rules could be adapted to allow subsidiaries of charities to be funded more easily; similar rules should apply to NPOs and CRA guidance should explicitly permit NPO ownership of separate taxable businesses

5.2 Analysis of potential risks and costs

Horizontal equity

There is a risk that some for-profit business stakeholders may perceive more facilitative rules with respect to revenue generating activity by charities and NPOs as providing these entities with an unfair competitive advantage through tax exemptions and other tax assistance. The proposed requirement to pay income tax on certain revenue generating activities would help to address this concern.

It is important to note that expecting enterprising charities and NPOs to adopt taxable corporate forms would in many cases not be viable, particularly for smaller organizations. A social enterprise that directs all profits to a public benefit purpose, and invests less than its for-profit counterparts in, for example, new technology, employee training, or growing the business, would find it challenging to develop a self-sustaining business model. A case study on Eva's Phoenix Print Shop, in Annex B, illustrates these challenges.

Enterprising charities and NPOs often employ individuals who face labour market barriers, serve populations that would not otherwise be able to access or afford important services, rely on volunteer labour that is potentially untrained, focus on delivering their public benefit mandate rather than on maximizing profit, and have higher costs associated with this mandate. The tax exemptions provided to charities and NPOs help to level the playing field and allow more resources to flow to the public benefit purposes of these organizations.

Moral hazards

Another risk relates to mission drift – specifically, the risk that a charity or NPO could devote most of its time and resources to developing and running a business rather than to advancing its public benefit purpose. This would be addressed through limitations on the proportion of a charity's or NPO's assets that could be dedicated to the business.

Existing rules, for example related to self-dealing, would continue to protect against abuse of the ITA, as would the proposed public reporting requirements for business activity.

Business risk

The importance of enabling charities and NPOs to improve their sustainability and better deliver on their public benefit objectives via revenue generating activity – which is a core premise of this report – merits emphasis. While many businesses fail, this risk is outweighed by the benefits. An emerging class of donors, recognizing this, may be keen to have their donations support the development of business activities. The existing risk that charitable donations could be used to fund unsuccessful programs should also be noted.

In addition, social enterprise activity can be viewed as a new phase of fundraising. Donations are currently used to finance fundraising activities, such as gala events, which are expected to yield a net gain. Using donations to finance business development is therefore not a complete departure from conventional practices.

While the possibility of donations being used to finance a business that proves unsuccessful could raise concerns for some charitable donors (including past donors), this concern would be mitigated

by the proposed limitations on the proportion of an organization's assets that could be used to fund certain types of business activities. In addition, donors would continue to have the option of providing directed donations, stipulating that their gift be used solely for charitable programs.

Costs

These recommendations would be unlikely to result in significant tax revenue losses. Many NPOs already operate under the assumption that they are allowed to intentionally generate profits. These profits are often directed into social programs in the same year, resulting in low net annual profit. In addition, it is unlikely that charities currently operating taxable subsidiaries would dismantle these corporations in order to bring the business in-house; even if they did, the tax differential would not be significant as these subsidiaries already benefit from income tax deductions based on donations to the parent charity.

It is the National Advisory Board's view that these proposals would generate a net positive benefit for Canada, given that enterprising charities and NPOs would face fewer restrictions in achieving financial sustainability and expanding effective social services.

5.3 Recommendation 2:

Unlock foundation capital for impact investing

To unlock foundation capital for impact investing, action at the federal and provincial levels is needed.

"Looking ahead a few years, social finance should be a key part of how foundations in Canada have impact. We are ready to use more and more of our assets for public good, but in order to maximize this potential, we will need a more enabling legislative and policy environment."

– Ian Bird, President, Community Foundations of Canada

a) Clarify that impact investments can be part of a balanced portfolio under current prudent investor rules.

Part of the answer to unlocking more foundation capital for impact investment lies in clarifying permissible investments under provincial trust law. Both low- and high-risk impact investments are currently permitted as part of a balanced portfolio. It could also be reinforced that prudent investor rules do not exclude consideration of other factors, such as social impact.

While a foundation would not wish to invest all of its assets in high-risk ventures – for example, unsecured investments in early stage social enterprises – a portion of a balanced investment portfolio could be allocated to higher risk impact investments. A range of low-risk impact investments is also available, allowing for the possibility of a foundation devoting 100 percent of its endowment to impact investments, while maintaining a balanced portfolio.

This recommendation falls under provincial jurisdiction.

b) Alter trust law to state that, in the case of a charity, a prudent investor should consider social impact.

Going a step further, it could be explicitly stated that, in the case of a charity, a prudent investor should consider social impact. This would encourage more charities (generally foundations) to consider impact investments.

This recommendation also falls under provincial jurisdiction.

c) Allow charities to make below market rate investments, where appropriate to advance their charitable objectives.

Traditionally, foundation activities have been understood to fall into the two distinct categories of charitable granting and financial investment. Impact investment crosses this divide, and for impact investments that may not be entirely justifiable as financial investments under existing trust law, a new category is needed. This could be achieved through changes to the ITA or related guidance, potentially supported by changes to provincial trust law.

It is recommended that charities be permitted to make investments with the aim of advancing their charitable purposes and for which below market rate returns are expected, regardless of whether the recipient is a charity, NPO, co-operative, for-profit, or hybrid entity. No part of these investments, or any associated opportunity costs, should be considered as gifts to non-qualified donees.

It is important to recognize that many impact investments are prudent by traditional financial standards; however, there are situations in which below market rate impact investments may be warranted. For example, tranching investing, with certain investors taking higher-risk positions that are not necessarily paired with commensurate returns, may be necessary to attract more risk-averse capital to worthwhile projects.

However, in the current context of a 3.5 percent disbursement quota, it is not recommended that a charity be permitted to count losses or opportunity costs resulting from this type of impact investment towards its annual disbursement quota, except insofar as the current rules permit this for investments in qualified donees. While such a measure could help to encourage foundation boards and investment committees to make this type of impact investment, the National Advisory Board's position is that impact investments should complement rather than replace existing charitable granting activity.

One option for implementing this recommendation would be to allow charities to provide financial assistance to any form of organization whose operations result in a direct, tangible public benefit, and not only to qualified donees, provided that charities exercise expenditure responsibility, ensuring that their assets are used to advance their charitable purposes.

This recommendation would likely be supported by the recommendation to allow charities to provide a private benefit (in this case, provided to the recipient of the investment) where it is necessary to achieve a broader public benefit (Recommendation 1b).

In the United States, foundations are allowed, and even encouraged, to make a range of below market rate investments in furtherance of their charitable objectives. Information on select international models for regulating foundation impact investments can be found in Annex C.

d) Allow charities to invest in limited partnerships.

Finally, the ITA should be amended to allow charities to invest in limited partnerships, by adding a reference to section 149.1 in section 253.1. This would clarify that charities would not, if they were holding an interest as a limited partner, be considered to be carrying on any business of the partnership, solely due to their acquisition and holding of that interest.⁴²

"Foundations as charitable investors are eager to broaden the scope of their investments for social impact. The opportunity to provide more capital for social purposes through asset aggregating structures such as Limited Partnerships would certainly expand the market for impact investing and also permit endowed charities to fulfill their fiduciary commitments to prudent and diversified investment strategies. We strongly encourage the federal government to reconsider the current limitation on charities that prevents them from investing as passive investors and not business owners in a widely offered and accepted investment asset class of Limited Partnerships."
- Hilary Pearson, *Philanthropic Foundations Canada*

5.4 Analysis of potential risks and costs

Moral hazards

Existing rules restricting investment practices and governing the use of charitable resources would continue to safeguard against abuse of the ITA (for example, a foundation investing at below market rates in a business in which it has a private interest).

Investment risk

As prudent investors, trustees would continue to determine the proportion of a foundation's overall investment portfolio that could be dedicated to higher risk investments (whether impact investments, venture capital investments, or other investments), to ensure a balanced portfolio, support the advancement of the foundation's charitable purposes, and guard against the depletion of the foundation's endowment, as appropriate. It should be remembered that risk is not unique to impact investments.

5.5 Supporting recommendations

While not a focus of this report, consideration should also be given to fostering intergovernmental coordination on measures to accelerate social enterprise development and impact investment in the non-profit and charitable sector, potentially through an intergovernmental forum.⁴³

It is vital for early NPO and charity leaders to communicate best practices, in order to contribute to a culture shift towards confidently deploying social entrepreneurship and impact investment tools where appropriate.

NPOs and charities have indicated other barriers to raising investment capital that stem, for example, from securities laws at the provincial level. These issues could be the subjects of future studies.

6. CONCLUSION

The recommendations advanced in Section 5 could have a catalytic impact on the Canadian impact investment market. They would create a more enabling environment for the development of investment-ready social enterprises in the charitable and non-profit sector, and unlock additional foundation capital for impact investment.

Most importantly, these changes would contribute to the development of a more sustainable, efficient, and effective non-profit and charitable sector, with an enhanced ability to improve social outcomes for Canadian communities.

Annex A: Organizational structures for social enterprises in Canada

Social enterprises exist across a spectrum, including charities, non-profit organizations, co-operatives, and for-profit corporations. A hybrid corporate form for social enterprises has also been established in British Columbia – the Community Contribution Company (C3). Nova Scotia has passed Community Interest Company (CIC) legislation; however, the regulations are still in development. Ontario has launched a consultation process on a potential hybrid corporate form. This diversity is important, as it allows social entrepreneurs to choose from a wide menu of legal structures, to identify the one that best suits their needs and objectives.

Figure 3 describes the structural options currently available to social enterprises in Canada.

Figure 3

For-Profit Business	<ul style="list-style-type: none"> • Not specifically designed for a social purpose • Can receive certification as a B Corporation • Incorporated under the <i>Canadian Business Corporations Act</i> or provincial equivalent; can also be structured as a sole proprietorship, a partnership, or a business trust • Flexibility in activities, capital raising, managing assets, and revenue generation • No income tax exemption; cannot receive funds from charities, except through market rate investments • Responsibility to shareholders, when shares have been issued to raise capital
Registered Charity	<ul style="list-style-type: none"> • Non-share capital corporations with legally enforced social purpose (within the definition of charitable purpose) • Restrictions on business activities; can operate a related business (substantially run by volunteers or linked and subordinate to the charity's purpose); assets are locked • Generally derive their revenue from a combination of earned income, government grants, and donations; as qualified donees, can receive grants from other charities; can be eligible for debt financing; generally cannot issue shares • Exempt from paying income tax; can issue donation receipts for donor tax benefits
Non-profit Organization	<ul style="list-style-type: none"> • Non-share capital corporations with legally enforced non-profit purpose (broader range of allowable activities / purposes than for charities) • Generally derive their revenue from a combination of earned income and government grants; not eligible for charitable grants; can be eligible for debt financing; generally cannot issue shares • Subject to increasing scrutiny regarding earned income activity; according to certain CRA guidance, not allowed to have the intention of generating a profit • Generally exempt from paying income tax; cannot issue donation receipts
Co-operative	<ul style="list-style-type: none"> • Owned and democratically controlled by its members; generally designed to benefit members • One member, one vote • Must reinvest surplus to benefit members or broader community • Ability to raise outside capital through shares and loans • Limits on interest and dividends • No preferential tax treatment
Community Contribution Company (C3)	<ul style="list-style-type: none"> • Introduced in British Columbia (BC); option became available in July 2013 • Modeled on the United Kingdom (UK) CIC; informed by the BC Social Innovation Council • Established through amendments to the <i>Business Corporations Act</i> and C3 regulations • Legally enforced social purpose; majority of profits must be used for community purposes or transferred to a qualified entity • Cap on dividends payable to investors of 40 percent of annual profits; asset lock upon dissolution (at least 60 percent of assets must be directed to qualified entities) • Requirement for annual reporting on community contributions; no official verification of reports; no regulator • A taxable corporation • We understand that there are currently 14 C3s registered in BC (as of April 2014).
Community Interest Company (CIC)	<ul style="list-style-type: none"> • Introduced in Nova Scotia; modeled on the UK CIC; similar to the C3 • <i>Community Interest Companies Act</i> passed in December 2012; regulations are still in development (option not yet available) • Registrar of Community Interest Companies to oversee formation and conduct of CICs

Annex B: Case studies

CASE STUDY - RELATED BUSINESS: HABITAT FOR HUMANITY'S RESTORE

Habitat for Humanity Canada, a charity, acts as an umbrella organization for about 60 affiliates across the country. Its mandate is to provide affordable housing for low-income families. In its early years, Habitat struggled to expand, due partly to donations being directed to particular housing projects, leaving limited discretionary funds to build organizational capacity.

Habitat launched ReStore in 1991 to overcome this hurdle. While there is some variation among affiliates, in general, ReStores sell recycled, end-of-line, or damaged building materials, which are donated. Net revenues are used to fund Habitat's charitable activities. Some ReStores also provide skills training and employment for disadvantaged groups. They are operated by a combination of volunteers (generally 75 percent) and paid employees (usually one dedicated full-time manager, and a paid truck driver for pickup of donated materials).

In the last several years, we understand that the CRA has been assessing whether the ReStore model constitutes a fundraising activity or a business activity. Most recently, the CRA suggested that ReStores were not meeting the requirements of a fundraising activity or of a related business.

To qualify as a related business, the CRA indicated that ReStores would need to be: 1) 90 percent volunteer-run (based on a head-count of paid employees and volunteers working at least 40 hours a year) and generate no more than 50 percent of Habitat affiliates' revenue and operate using no more than 50 percent of their resources; or 2) sell only excess material from its build sites and not accept donations with the main purpose of sale at ReStores (rather than for the purpose of building affordable housing).

Under this interpretation, few, if any, ReStores would - or could - meet the latter requirement, while many would struggle to recruit a sufficient number of volunteers to meet the 90 percent rule. Even if they could be met, these requirements would challenge the sustainability, scalability, and efficiency of the model.

Other possible remedies were considered: 1) create a separate, taxable corporation (which would pay tax on remaining taxable income after donating up to 75 percent of its net income to the Habitat affiliate); 2) create a separate non-profit organization with its own board of directors; or 3) seek to operate ReStore as a charitable program.

The viability of these options would require further analysis. The ReStore model relies on donated building materials, for which a charitable donation receipt is issued. Operating ReStore as a separate for-profit corporation or non-profit organization would require Habitat affiliates to receive and provide receipts for donated goods and to sell these through the separate for-profit or non-profit entity, on the basis of a consignment or similar arrangement, with profits flowing back to the affiliate.

The for-profit option could elicit loss of credibility among donors and volunteers, and potential uncertainty about the maintenance of ReStore's social purpose, and relationship to the affiliate, over time. In addition, operating as a for-profit corporation would mean losing the benefits of charitable status - income tax exemption, ability to

issue charitable donation receipts, and qualified donee status - which could make it challenging to sustain a business that is focused on supporting a charitable mission, and therefore has fewer funds available for business development.

For the non-profit option, it is not clear that ReStore would meet the associated prohibition (expressed in certain CRA guidance) on intending to generate a profit.

To become a separate registered charity, a ReStore would likely need to adjust its model, in line with a particular charitable purpose (e.g., protection of the environment, through a focus on recycling construction materials; or relief of poverty, through a focus on employing or training disadvantaged individuals).

Habitat has invested thousands of dollars in legal fees and significant staff and board time to ensure a robust understanding of CRA guidance. Ultimately, the CRA indicated that Habitat could continue to operate as it has been, subject to further instruction.

While Habitat's ReStore continues to operate, and is widely regarded as a best practice, the CRA has suggested that it is not in compliance with the ITA. This may limit Habitat's growth plans, and could inhibit other charities from adopting similarly effective models.

CASE STUDY - PUBLIC BENEFIT RULES: SOCIAL CAPITAL PARTNERS

Social Capital Partners (SCP) is a non-profit organization that applies market-based solutions to improve outcomes for people who face barriers to employment, focusing on youth, new Canadians, persons with disabilities, Aboriginal peoples, and single parents. It was founded in 2001 by Bill Young, a Canadian business leader and philanthropist.

Through community employment loans to small businesses and partnerships with employers, SCP has facilitated thousands of employment opportunities for people who face labour market barriers.

An initial application for charitable status was rejected, leaving SCP without access to charitable grants or the ability to provide receipts for donations. SCP has, however, received funding from charitable organizations, which have used SCP's innovative approaches to advance their own charitable objectives, related to the alleviation of poverty. Maintaining a focus on the charitable objectives of these organizations can, however, challenge SCP's ability to operate in a way that maximizes efficiency and effectiveness.

Based on its experience working with employers, SCP is currently testing a program based on the principle that training for individuals who face employment barriers should shift from a supply (job seekers) focus, towards a demand (employer) focus, to ensure alignment with labour market needs. Making it easier for employers to hire individuals who face barriers to employment ultimately generates more robust outcomes for the individuals involved (i.e., more stable and meaningful employment) and for society as a whole (i.e., reduced unemployment).

We understand that the CRA has indicated that the public benefit rule may exclude SCP's job training program from being considered charitable, and therefore from receiving funding from a registered charity. This is because it could be viewed as providing a private benefit to employers that is not incidental to achieving the charitable objective of poverty alleviation - even if the program demonstrates significantly improved outcomes aligned with this objective.

CASE STUDY - EXPENSE OF RUNNING A SOCIAL ENTERPRISE: EVA'S PHOENIX PRINT SHOP

Eva's Phoenix Print Shop is a socially and environmentally responsible commercial printing company that employs and trains homeless and at-risk youth. It operates within a charitable organization, and combines practical job training with a broader array of services, including transitional housing, counseling, job placement assistance, a scholarship fund, and mentorship and follow-up support, with a focus on enabling youth to become self-sufficient over the long-term. Over 70 percent of graduates from Eva's Phoenix Print Shop have entered full-time work or returned to school.

It has established cooperative arrangements with private sector stakeholders. For example, Xerox has allowed Eva's Phoenix to retain old equipment as part of an agreement to lease new equipment. In addition, a number of for-profit print shops have agreed to consider hiring youth trained at Eva's Phoenix. Eva's Phoenix seeks to target its services to companies with corporate social responsibility policies.

Training and supporting youth constitutes an added expense line, reducing the funds available for business development. Charitable status is important to Eva's Phoenix Print Shop. An income tax exemption, access to charitable grants and donations, and the trusted brand identity associated with charitable status help to offset the challenges of running a business in which profits are reinvested in youth programs.

Annex C: International and domestic models

UNITED STATES (US): UNRELATED BUSINESS INCOME TAX (UBIT)

In general, organizations that benefit from an income tax exemption in the US are not taxed on business activities that are "substantially related to the charitable, educational, or other purpose that is the basis for the organization's exemption."⁴⁴ Business activities that do not meet this test, and that are regularly conducted, are subject to income tax at corporate rates.⁴⁵

A business is regularly conducted if it is pursued frequently and continuously, and in a similar manner to comparable businesses run by for-profit organizations.

To be substantially related to the organization's exempt purpose, a business must "contribute importantly to accomplishing that purpose (other than through the production of funds)."⁴⁶ To meet this test, the scale of the business activity must not be greater than necessary to carry out the exempt purpose. A link to the exempt purpose on its own is insufficient. For example, selling products that result from the pursuit of the exempt purpose would only qualify as a related business if the products were sold more or less in the form in which they were created, or with further processing only to the extent needed to dispose of them. Dual use of assets or facilities would also not qualify as a related business, unless they were used in a way that contributed importantly to advancing the exempt purpose.⁴⁷

A number of exceptions exist, including for: certain income related to investments, royalties, rentals, research activities, gains or losses from the disposition of property; any business substantially carried out by volunteers; businesses carried on primarily for the benefit of the organizations' members, students, patients, officers, or employees (such as a school cafeteria); any business based substantially on the sale of donated merchandise; and certain bingo games; among other activities.⁴⁸

Examples of related and unrelated businesses and exempt activities can be found in the Internal Revenue Service (IRS) publication *Tax on Unrelated Business Income of Exempt Organizations*.⁴⁹

This model arguably addresses concerns about unfair competition, but may be associated with certain challenges, related, for example, to the accounting complexity of allocating expenditures to taxable and tax-exempt operations.⁵⁰

US: PROGRAM RELATED INVESTMENT (PRI)

In the US, PRIs are defined as investments: that are made primarily to accomplish one or more of the foundation's charitable purposes; for which the production of income or appreciation of property is not a significant purpose (an indicator of which is whether profit-minded investors would be likely to make the investment on the same terms); and which do not have a purpose of political lobbying. The potential for a high rate of return does not necessarily disqualify an investment from being a PRI.

PRIs are exempt from treatment as jeopardizing investments - investments that could threaten a foundation's ability to pursue its charitable activities, for which foundations may be fined.⁵¹

PRIs are excluded from the assets that must be counted in determining how much a foundation is required to disburse in a given tax year. Like grants, they can also be counted towards a foundation's five percent disbursement requirement in the year the PRI is made. PRI principal repayments must be recycled as new PRIs or grants in the year in which they are received, over and above the five percent requirement. Any interest, capital appreciation, or dividends are considered as income.⁵²

PRI recipients can include non-profit or for-profit organizations, or individuals, provided that they are instruments for advancing a charitable purpose - investees do not need to be charities themselves. The foundation must exercise expenditure responsibility, which could mean obtaining written agreement from the PRI recipient that the investment capital will be used only to accomplish a specified charitable purpose. PRIs can take the form of loans, equity investments, or credit enhancements.⁵³ The IRS recently issued proposed regulations outlining a series of new PRI examples, to further clarify cases in which PRIs are permissible. Final action will be taken on these proposed regulations by the end of 2014.⁵⁴

Use of PRIs has been increasing in the US; however, the practice remains restricted to less than one percent of US foundations, and is more common among large foundations.⁵⁵ Foundations that use PRIs as a key part of their charitable strategies include, for example, the Rockefeller Foundation, Ford Foundation, Bill and Melinda Gates Foundation, F. B. Heron Foundation, and Omidyar Network.⁵⁶

While most foundations count PRIs towards their annual five percent grant disbursement requirement, some make PRIs outside of this requirement.⁵⁷

UNITED KINGDOM (UK): PRIMARY PURPOSE AND NON-CHARITABLE TRADING

In the UK, primary purpose trading (which occurs in the course of carrying out the charity's purpose) and trading carried out mainly by beneficiaries of the charity are both exempt from tax.

In the case of non-charitable trading, which is used to raise funds to advance the charitable purpose, profits are subject to tax unless the trading activity generates income that is less than £5,000 or accounts for no more than 25 percent of overall income up to a limit of £50,000 (small trading exemption).⁵⁸ This form of trading is permissible only if no significant risk to charitable assets is involved.⁵⁹

Charities are also permitted to use separate, taxable trading subsidiaries, which can donate their profits to the parent charity through Gift Aid contributions, reducing or eliminating the profits that are subject to tax. This structure can be used to protect the charity's assets from business-related risk.⁶⁰

Under the Gift Aid program, charities can reclaim the equivalent of the basic rate of income tax (20 percent) on a donation from an individual, such that a £10 donation becomes worth £12.50. Donors can only claim a tax credit for a donation if they pay a higher tax rate – in which case, they can claim the difference between the basic and higher tax rates on a donation.⁶¹

UNITED KINGDOM (UK): PROGRAM-RELATED AND MIXED MOTIVE INVESTMENTS

In the UK, a program-related investment (PRI) is an investment that directly furthers the charity's stated aims. A PRI has the potential to achieve a financial return, but this is not its primary objective. Trustees making PRIs are not subject to the legal rules governing financial investments, because PRIs are not investments in a strict legal sense. Any private benefit resulting from a PRI must be "necessary, reasonable and in the interests of the charity."⁶²

Any losses resulting from PRIs are counted as charitable expenditures. Charities in the UK are not required to meet an annual quota for charitable expenditures;⁶³ however, they are required to spend the income they receive within a reasonable period of time. Trustees should therefore be able to justify any retained income as reserves.⁶⁴

A mixed motive investment (MMI) is intended to advance the charity's aims and achieve a financial return. Generally, an MMI could not be entirely justified either as a PRI or as a financial investment, but includes elements of both.⁶⁵

Guidance and case studies clarifying the ability of foundations to make various kinds of investments to further their charitable aims, including through subordinated investments in co-mingled funds, has been released in the last few years.⁶⁶

In addition, the UK Law Commission has launched a consultation on social investment by charities, which proposes a new statutory power to make social investments that would clarify and supplement existing provisions.⁶⁷

AUSTRALIA AND NEW ZEALAND: DESTINATION OF PROFITS TEST

In Australia and New Zealand, charities are allowed to generate revenue through businesses activities, on an income tax exempt basis, provided that profits are used to advance the charitable purpose of the organization and are not for private financial benefit.

In a 2008 case, Commissioner of Taxation of the Commonwealth of Australia v Word Investments Ltd, the High Court of Australia determined that, where the aim of making a profit is only in aid of an organization's charitable purposes, it should be considered as incidental or ancillary to these purposes and should not be regarded as an end in itself. It stated that "[t]o point to the goal of profit and isolate it as the relevant purpose is to create a false dichotomy between characterisation of an institution as commercial and characterisation of it as charitable."⁶⁸

This system has been supported by Australia's 2010 Future Tax System report, Productivity Commission studies, and 1995 Industry Commission Charities report. These reports concluded that income tax exemptions for non-profit organizations do not result in an unfair competitive advantage, given that they do not affect output or pricing decisions, or the aim to maximize profit. In general, the difference between for-profit and non-profit organizations lies in whether profit is directed to private gain or community benefit. While income tax may cause for-profit organizations to seek to use profits in ways that minimize their tax exposure, this impact was considered to be minimal. These studies did conclude, however, that exemptions from input taxes, such as the fringe benefits tax (FBT), created market distortions given, for example, the contingent ability to pay market wages at a lower cost.⁶⁹ The Future Tax System report recommended that NPOs "should be permitted to apply their income tax concessions to their commercial activities."⁷⁰ This review was conducted by a panel chaired by Dr. Kenneth Ross Henry, who was the Secretary of the Department of the Treasury at the time.

We understand that consideration was given to adopting an unrelated business income tax in Australia, but the line between related and unrelated business, and the range of exceptions, was ultimately determined to be too difficult to define.⁷¹

Sections 5(3) and 5(4) of the New Zealand *Charities Act* specify that a non-charitable purpose is permissible provided that it is "ancillary, secondary, subordinate, or incidental to a charitable purpose... and not an independent purpose."⁷² According to Charities Services' guidance, this means that "a business may be registered as a charity if all its profits are directed to its charitable purposes" provided that other registration requirements are met.⁷³

In both countries, decisions on business activities, including the amount of a charity's assets that can be used to run a business, rest with the charity's board, which is expected to act prudently.⁷⁴

ONTARIO: NOT-FOR-PROFIT CORPORATIONS ACT

The Ontario *Not-for-Profit Corporations Act*, which has not yet passed into law, supports the concept of a destination of profits test.

In announcing Bill 65, the *Not-for-Profit Corporations Act*, in 2010, the Ontario government indicated that one of the highlights of the bill would be "[a]llowing not-for-profit corporations to engage in commercial activities where the revenues are reinvested in the corporation's not-for-profit purposes."⁷⁵

The text of the Act indicates that if an organization has purposes of a commercial nature, then the articles of incorporation must "state that the commercial purpose is intended only to advance or support one or more of the non-profit purposes of the corporation." Regardless, this Act would not override the *Income Tax Act*.⁷⁶

PART TWO

September 2014

Catalyzing Impact Investing: Empowering Investors for Environmental

Mobilizing Private Capital for Public Good: Priorities for Canada

Prepared by
KPMG LLP



Catalyzing impact investing: the opportunity for governments

Part 2 of this report was informed by Canada's National Advisory Board to the Social Impact Investment Taskforce, launched by the G8, and benefited from the insights of key informants.

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CATALYZING IMPACT INVESTING: THE OPPORTUNITY FOR GOVERNMENTS

1. INTRODUCTION

The intersection of social purpose and financial return is well established in Canada through the vast network of member-owned financial co-operatives including Vancity, Assiniboine Credit Union, and Desjardins. These credit unions and *caisses populaires* are values-driven, holding social and economic objectives, which are reflected in the innovative financial products and investment opportunities offered based on community and member needs.

Recently the term "impact investing" has emerged, as an increasing number of investors, financiers and ventures are taking note and entering into transactions that are based on similar principles. Impact investing differs from conventional investing as impact investors expect a financial return from their investment as well as a defined positive social impact, demonstrated through measureable social outcomes.

Further advancing the field are innovative market-based approaches that are emerging from the social entrepreneurship movement, effectively addressing key social issues and transforming lives. Social enterprises require funding beyond what can be fulfilled through traditional philanthropy or government funding. As the number of social enterprises and effective solutions are increasing, so too is the need to attract additional resources in the form of private capital, to fund the innovations being delivered. The impact investing market in Canada is still nascent, and government action is required to accelerate its growth.

The goal in this part of Canada's National Advisory Board report is to explore how the federal government, in particular, can help catalyze an increased flow of private capital directed towards impact investing, and strengthen the impact investing ecosystem in Canada.

This part of the report examines global examples of government measures that have been implemented to stimulate investment of private capital in impact investing and other priority areas, to identify success stories and lessons learned. Canadian examples of catalytic capital outside the scope of impact investing have been examined, particularly in the venture capital asset class. The types of government measures considered include credit enhancements, capital matching, guarantees, tax incentives, and outcomes-based finance.

The recommendations reflect the deep experience of Canada's National Advisory Board to the Social Impact Investment Taskforce established by the G8, as, for example, impact investors, impact investment fund managers, financial and not-for-profit sector leaders, and academics. Interviews have also been conducted with a select group of leaders in venture capital, wealth management, banking, and other areas of traditional finance to assess investor perceptions of government interventions designed to lower barriers to entering the impact investing market.

KEY RECOMMENDATIONS:

3. Establish an impact investing matching program, paired with appropriate incentives.
4. Establish an outcomes payment fund.

SUPPORTING RECOMMENDATIONS:

- Provide support for investment and contract readiness, to develop the pipeline of investment opportunities.
- Embed these initiatives in a broader strategy for building Canada's impact investment market, coordinating with all levels of government.
- Engage investors in the design of these initiatives.

2. SCOPE AND LIMITATIONS

The scope of this part of the report is focused on assessing the merits of government interventions designed to lower barriers to impact investing; and investors' perceptions of these interventions and how they may influence investment decisions. The intent is to stimulate and inform discussion regarding potential initiatives to catalyze increased placement of private capital in impact investments. Decisions regarding new public policy or the design of initiatives would require further assessment.

Canada's National Advisory Board has discussed the need to view impact investment as an opportunity to attract additional private capital to help solve social policy challenges, rather than as a replacement for government or philanthropic funding.

Initiatives to develop and strengthen the broader impact investing ecosystem are required. Government-led market building measures including to increase the capacity of social ventures or to address broader regulatory barriers to investment pipeline development are important, however fall outside of the scope of this part of the report.

3. SNAPSHOT OF IMPACT INVESTING IN CANADA

Impact investing covers a broad range of opportunities including investment in non-profit, public or private for-profit entities, or new forms of hybrid corporations such as Community Contribution Companies in British Columbia. Investment may be in the organization itself, or directed to a program designed to deliver a specific social outcome, such as supporting women and children at risk. Investment may be in early stage or mature organizations in the form of debt, equity, or innovative types of financing arrangements such as Social Impact Bonds (SIBs).

Examples of impact investing and related activities in Canada:

- **Social Capital Partners' Community Employment Loan program** provides access to low interest loans for small business owners, entrepreneurs, and franchisees based on their commitment to fill entry-level positions by hiring individuals who face employment barriers, including youth, new Canadians, and people with disabilities, through community employment service providers. The interest rate on the loan decreases for every employee hired from a partnering service provider.

- **The Community Forward Fund Assistance Corporation (CFFAC)** is a Canadian non-profit organization (NPO) that makes loans to, or arranges financing for, NPOs and charities. The Fund addresses a gap in access to patient working capital and provides bridge loans for the sector for small- and medium-sized organizations. Loan interest rates are dependent on the type of loan or guarantee, plus other fees. In addition to offering loans, CFFAC provides financial review and coaching services, and assessment tools to help build financial skills and capacity in the non-profit and charitable sector.

- **Capital régional et coopératif Desjardins** is a publicly-traded company created on the initiative of the Mouvement des caisses Desjardins. Managed by Desjardins Venture Capital, the development capital fund manager for the Mouvement des caisses Desjardins, Capital régional et coopératif Desjardins is rapidly becoming a major player on the Quebec development capital scene. One of its priorities is to meet the capital needs of co-operatives and to invest in the resource regions of Quebec. Geared to retail investors, shares may be purchased by any resident of Quebec and are eligible for a Quebec tax credit of 50 percent of the purchase amount.

- **Renewal Funds** provides an opportunity for investors to participate in the development of businesses at the forefront of social and environmental innovation. It invests in early stage growth companies with between \$1 and \$20 million in annual revenue. It is one of the largest investors in the organic and natural food and green products sectors in North America. Portfolio companies include Seventh Generation, a pioneer in developing household and sustainable cleaning products; and Kitchener, Ontario-based Miovision, which develops products and services that minimize traffic congestion, reduce environmental impacts of idling and inefficient transportation flow, and improve overall road safety.

- The **RBC Generator Fund** is a \$10 million pool of capital for investing in for-profit businesses that not only generate a financial return, but

also demonstrate community and social impact. In addition to being able to deliver market, or near-market returns, businesses must deliver benefits in the areas of energy, water, youth employment, or employment for disadvantaged groups, and be able to report on their impact to be considered for investment. Its portfolio includes a \$250,000 equity investment in Nudge Rewards, a software provider that focuses on enabling and rewarding positive environmental, wellness, and community behaviours through its mobile platform.

- Community Bonds issued by the **Centre for Social Innovation (CSI)** were used to fund its expansion through the purchase and renovation of a 36,000 square foot building. As a further bonus, these bonds were eligible for inclusion in the bondholders' Registered Retirement Savings Plan accounts, enabling investors to take advantage of preferential tax treatment. A loan guarantee from the City of Toronto allowed CSI to secure a mortgage from Alterna Credit union, at an affordable interest rate. The sale of Community Bonds raised \$2 million to cover the remaining funding gap.

- **Resilient Capital** is the result of a partnership between Vancity and the Vancouver Foundation to provide capital to eligible for-profit and non-profit social enterprises. Investors make Resilient Capital term deposits with Vancity held for a period of five to seven years that are 100 percent insured and earn a fixed rate of interest with return of principal on maturity. The founding partners created a first-loss reserve in support of the investments made; any additional risks are borne by Vancity.

As impact investing opportunities vary, so do the types of investors they may attract. Institutional investors, including banks, insurance companies, and pension funds; venture capital, private equity, and retail investors; and family offices, all have the potential to participate. A number of foundations, credit unions, and high net worth individuals are already leading the way.

4. THE OPPORTUNITY TO STIMULATE THE INVESTMENT OF PRIVATE CAPITAL

Impact investing is an innovative financing opportunity that enables market-based approaches to social challenges. The examples of impact investments noted in Section 3 illustrate the increasing demand for capital and the breadth of impact investing opportunities. Organizations have indicated that access to capital is a significant barrier to their ability to sustainably achieve social objectives.⁷⁷

The amount of private capital directed towards impact investing is growing – the fourth annual global impact investor survey conducted by The Global Impact Investing Network (GIIN) and J.P. Morgan in 2013 gathered data from 125 impact investors, including pension funds, insurance companies, and high net worth individuals. These investors represent US\$10.6 billion committed to impact investment with the intent to increase investment by 19 percent in 2014.⁷⁸ Existing activity in Canada has been estimated at \$2.2 billion, based on the value of impact assets under management at foundations, community finance organizations, and credit unions. However, this estimate excludes assets invested by pension funds, high net worth individuals, and other institutional investors.⁷⁹ The 2010 report issued by the Canadian Task Force on Social Finance suggested that impact investment in Canada could potentially reach \$30 billion, or one percent of assets under management.⁸⁰

Figure 4: Potential for market growth in the near-term⁸¹

It is challenging to arrive at a reliable estimate of the current and potential size of the Canadian impact investment market, given a lack of transaction and portfolio data, and lack of definitional clarity. However, a comparison with the more advanced markets of the United States (US) and United Kingdom (UK) suggests significant growth potential. It is likely that this potential will only be realized with the initial support of government incentives.

This figure shows the potential 2017 Canadian impact investment market size, extrapolating from 2012 impact investment market size estimates for the US and UK as a share of gross domestic product (GDP) and capital markets, assuming US and UK market development is roughly five years ahead of Canadian market development.

Estimated Canadian Annual Impact Investment (2017 range)



Estimated Canadian Impact Investment AUM (2017 range)



The current size of Canada's impact investment market is estimated to be about \$2.2 billion (MaRS State of the Nation Report 2013 – supply-side estimate)

Methodology: Potential for market growth in the near-term

Implied Potential Annual Canadian Impact Investment Market Size

Reference Country	USA (\$CND B)	UK (\$CDN B)
GDP	\$16,245	\$2,472
Capital Markets	\$50,160	\$9,091
Annual Impact Investment	\$5.6	\$0.32
Canadian GDP	\$1,821	\$1,821
Canadian Capital Markets	\$3,462	\$3,462
Implied Potential Canadian Annual Impact Investment via GDP	\$0.67	\$0.25
Implied Potential Canadian Annual Impact Investment via Capital Markets	\$0.41	\$0.13
Average	\$0.37	
Implied Potential Canadian Impact Investment AUM Market Size		
Reference Country	USA (\$CND B)	UK (\$CDN B)
GDP	\$16,245	\$2,472
Capital Markets	\$50,160	\$9,091
Impact Investment AUM	\$28.2	\$6.07
Canadian GDP	\$1,821	\$1,821
Canadian Capital Markets	\$3,462	\$3,462
Implied Potential Canadian Impact Investment AUM via GDP	\$3.36	\$4.76
Implied Potential Canadian Impact Investment AUM via Capital Markets	\$2.07	\$2.46
Average	\$3.16	

Key steps in developing potential market size estimates:

- JP Morgan, Global Impact Investing Network, and Big Society Capital estimates used for US and UK impact investing AUM and annual market size
- Calculated impact investing share of US and UK capital markets and GDP
- Inferred possible impact investment share of Canadian capital markets and GDP
- Backed out potential Canadian impact investing AUM/annual investments from inferred GDP and capital markets share
- 2012 figures used due to data availability and for consistency

Caveats: These figures represent estimates of the potential size of the Canadian impact investment market based on comparisons with the US and UK markets, which are considered to be more mature. They are rough order of magnitude estimates, and a broad range is provided given that:

- Methodologies for classifying impact investments vary by source; thus, initial inputs are not based on consistent calculations.
- The size of capital markets and GDP are imperfect points of comparison for anchoring impact investment market estimates.

Research for this part of the report included interviews with experienced impact investors, venture capitalists, and conventional retail and institutional investors. As an emerging investment opportunity area, awareness and understanding of impact investing varied, with many identifying impact investing with financing charities and NPOs, over investment in for-profit entities with a social purpose.

Several key themes emerged from our discussions with potential and active impact investors. All investors considered the ability to generate financial returns as important, however there were varying expectations on financial return. Conventional investors were seeking market or risk-adjusted returns, and generally held the perception that impact investments were higher risk and that returns would not be aligned, thus compromising fiduciary duty.

Investors were also concerned about the financial viability of the investee. The ability to generate the desired social impact is a key driver for impact investment, but it does not compensate for weak governance or financial management, or unsustainable business models. The receiving organization needs to be well managed and pass other normal due diligence tests. The limited track record of impact investment opportunities has deterred some investors.

Government-led catalytic measures provide the opportunity to bridge the divide between the capital needed by social entrepreneurs, and potential impact investors. Governments can take steps to make it easier for investors to enter the market, enabling scale and lowering the perceived risk of impact investment opportunities, to help build a track record of successful investments and prove the viability of the market.

5. GOVERNMENT INTEREST IN IMPACT INVESTING IN CANADA

Governments in Canada and around the world are demonstrating active interest in impact investing and its role in directing capital towards

investments with the added intent of delivering a social benefit, as evidenced by government initiatives focused on supporting social innovation, building the impact investing ecosystem, and catalyzing investment in social enterprises, in addition to the global popularity of SIBs. Increasingly, social challenges are being viewed as economic issues, and the focus is shifting towards results-oriented approaches.

One of the most visible examples of a government-enabled impact investment, SIBs have been issued in a number of countries including the UK, US, the Netherlands, Australia, and most recently, Canada.

The federal government and several provincial governments have undertaken initiatives that lay the framework for impact investing in Canada, for example:

- Over several decades, the Government of Quebec has been leveraging private investment for specific social, cultural, and environmental objectives through a variety of policies and programs including tax credits, first loss capital, and direct investment. For example, it helped catalyze investment in social economy enterprises through matching dollars from the corporate sector, leading to the creation of RISQ, a \$10 million fund created in 1997 that has since made over 700 investments in NPOs, charities and co-operatives. The Government also made an investment of \$10 million in 2007 in the Chantier de l'économie sociale Trust, a \$52.8 million patient capital fund that has authorized over \$37 million in investments for 128 social enterprises (as of December 31, 2013).
- The Government of Saskatchewan partnered with private investors and a non-profit service provider to launch Canada's first SIB in May 2014, designed to achieve the social outcome of keeping children out of foster care. The SIB is funding a program that provides affordable housing and support to single mothers with children under the age of eight who are at risk of requiring Child and Family Services, enabling them to complete their education, secure employment, or participate in pre-employment activities. The ultimate goal is to help these families to transition back into the community. The SIB raised \$1 million in investment capital for a 5-year term, complementing funding from other levels of government and private donors. An independent assessor will measure outcomes at the end of years two, four, and five.
- Employment and Social Development Canada launched a literacy and essential skills pilot, surfacing new and effective ways of generating employer and private investments to help unemployed and underemployed Canadians to develop literacy and skills to better connect to available jobs. The pilot is inspired by global SIB precedents. Employers and investors will be reimbursed as they meet the objectives that were established together.
- The Government of Ontario provided startup funds to help launch and scale the SVX, an impact-first platform connecting impact ventures, funds, and investors in order to catalyze new debt and equity instrument capital for local ventures that have demonstrable social and/or environmental impact, including NPOs, charities, co-operatives and for-profit corporations. More recently, the Government of Ontario launched a call for SIB ideas, seeking innovative prevention-oriented solutions that address one or more high-priority social policy challenges facing Ontario families including housing, youth at risk, and improving employment opportunities for persons facing barriers.

- The Governments of British Columbia and Nova Scotia have both passed legislation to enable creation of a hybrid type of company – one that is for-profit with a socially beneficial purpose. This type of company, known as Community Contribution Companies and Community Interest Companies respectively, provides broader options for revenue generation and to attract investment, however is subject to certain requirements including restrictions on the distribution of dividends to retain profits within the company or to direct profits towards social benefit.
- The Government of Alberta is launching a \$1 billion social innovation endowment fund, which will support the development of new approaches to solving social challenges, including through new funding models and partnerships. Finance Minister Doug Horner has indicated that the endowment “will be a catalyst for innovation for complex social issues.”⁸²

6. THE ROLE OF THE GOVERNMENT AS A CATALYST

Two basic scenarios underpin impact investing arrangements:

- 1) Investors place capital in a social enterprise or initiative that has a revenue-based business model, thus the potential to generate the necessary cash flow to pay expected returns; or
- 2) A third party pays investors based on the ability of contracted social enterprise(s) or service provider(s) to deliver specified social outcomes. Broader public and economic benefits are derived from cost savings due to reduced dependency on social services (for example, as a result of reduced recidivism), increased economic participation (for example, unemployed individuals transitioning to full employment status as a result of a skills development program), or improved social service delivery for target populations. This scenario is associated with but not limited to SIBs, for which a government is commonly the third party payer.

The policy interventions necessary to catalyze further investment activity under each scenario are unique.

The exchange mechanisms needed to attract investment in revenue-based enterprises are emerging through initiatives such as the SVX and investment funds offered by Renewal Partners. Continued focused effort is needed to accelerate the pace of development, and to lower barriers to capital deployment, including concerns regarding the risk-return profile of investments.

Interventions are also required for the second scenario, for example, to identify priority social issues and value outcomes; enter into contracts to pay for outcomes; and engage intermediaries to build service provider capacity.

7. GOVERNMENT INITIATIVES TO CATALYZE IMPACT INVESTING

When asked about the role of government, the investors we spoke with expressed varying views on government-led interventions to catalyze the investment of private capital, largely based on their past experiences with government incentive programs.

Overall, a common theme that emerged is the importance of holding a long-term view of success and the desired impact of an intervention. Investors wanted to know upfront the intent of

the measure, including whether it would be in place for a fixed period of time, and the criteria for the types of organizations and initiatives that would qualify for incentive programs, in order to concentrate efforts and help to ensure that funding is supporting intended outcomes.

Investors also indicated interest in catalytic measures. For governments to catalyze the market for impact investing, striking the right balance between being responsive to market needs, and being proactive in helping to develop the market is important. Investors would support measures that help offset risk or mitigate losses, such as tax-based incentives, however are cautious about the risk of subsidizing poor investment decisions that would not achieve the broader intent of the measure.

Governments around the world have deployed a number of tools to direct new private capital to the impact investment market, or other priority markets. Broadly, these measures fall into four categories: credit enhancements, tax incentives, direct capital investment, and direct payment for outcomes. Examples of instances in which these tools have been utilized by governments are described in Section 7.1.

7.1 Credit enhancements

Governments can implement credit enhancement initiatives to share capital risk with investors and increase the supply of capital available to impact investment opportunities. The objective is to mitigate the actual or perceived higher risk of impact investments through instruments including junior equity positions structured to take the first loss, grants or guarantees provided for the express purpose of covering a set amount of first-loss, or subordinated debt.⁸³

Western Economic Diversification Canada (WD)

WD is a federal government program designed to diversify the economy in Western Canada while improving the quality of life of its citizens. In particular, its Loan and Investment Program has encouraged independent Western Canadian financial institutions to lend to higher-risk small businesses that would otherwise have experienced difficulty in accessing capital. WD contributed funds to share in losses incurred when lending to these higher-risk clients. The program was viewed as a success, with over 3,400 loans approved and \$259 million disbursed. Over a five-year period, the program generated \$9 in new loans and \$19 in investments from other sources for every dollar provided by WD.⁸⁴

Social Enterprise Development and Investment Funds (SEDIF)

In Australia, the SEDIF provides finance solutions to help social enterprises develop, grow, and sustain their work and impact. The SEDIF was seeded through grant funding of AUD\$20 million, however fund managers were required to at least match the grant funding with private investment, creating a total investment pool of over AUD\$40 million. For example, Christian Super, a small private pension fund, is an anchor investor in the Community Finance Fund – Social Enterprise, which provides secured loans to sophisticated social enterprises. The Australian government, through the SEDIF, matched Christian Super's AUD\$6 million investment with an AUD \$6 million grant. Of this, AUD\$4.5 million is designated to take the first loss, which facilitated Christian Super's investment. The initial capital protection is designed to diminish over time as more limited partners invest in the fund.

7.2 Tax incentives

Tax incentives can offer a reprieve on income taxes to encourage investment in certain sectors, asset classes, corporate structures, or investment vehicles. In addition to encouraging investment, the reduction in taxes payable may also act as a buffer against risk or below market rate returns.

Community Economic Development Investment Fund (CEDIF)

The CEDIF program was designed to stimulate economic growth, provide new employment opportunities, and rejuvenate existing economic sectors in the province of Nova Scotia. CEDIFs are pools of capital formed through the sale of shares to persons in a defined community, which are invested in the creation or expansion of local businesses. The program is built with three distinct policy levers:

- a simplified offering document for seeking equity investment, to help alleviate the cumbersome and expensive transaction process associated with the typical, lengthier investor prospectus;
- a 35 percent income tax credit for investors once their investments have been registered with the Nova Scotia Securities Commission; and
- the ability for investors to register their investments through a self-directed Registered Retirement Savings Plan, which qualifies investors for further federal income tax deductions.

Since its inception in 1999, the total funds raised have grown 572 percent, with the number of investors increasing 250 percent and the total funds invested increasing 92 percent. Only three business ventures out of more than 120 that received investments have failed. This has been attributed to the community-centric governance model which the CEDIF program employs.

Social Investment Tax Relief

To encourage individuals to invest in social enterprises and to help social enterprises access new sources of finance, the UK government recently introduced income tax and capital gains tax relief on investments in qualified organizations. For investments held for a minimum of three years, individuals may deduct 30 percent of the cost of the income tax liability in the year in which the investment is made. Individuals who have earned capital gains may defer tax if the gain is invested in a qualifying social investment opportunity.

7.3 Direct capital investment

Public funds may be deployed to catalyze private investment, fill an underserved gap, or advance investment in priority areas that help to grow the domestic ecosystem. Commonly the government will invest alongside private investors, however the terms of investment may differ.

Ontario Emerging Technologies Fund (OETF)

The OETF is a \$250 million fund that co-invests on the same terms, at the same time, with qualified venture capital funds and other qualified investors, directly into innovative, high growth Ontario-based companies. The program was designed to stimulate venture capital and angel investment in clean technology, life sciences, and digital media and information and communication technologies at a time when venture capital returns were low and available investment capital was limited. Eligible investors have driven the investment opportunities, submitting proposals for consideration by a third party investment manager, limiting government intervention in the market.

Bridges Ventures

In 2002, the UK Government provided a £20 million matching investment to Bridges Ventures, part of which was subordinated in that it took the first loss risk and had a capped return, acting as an investment catalyst. Bridges then turned to progressive private equity firms and entrepreneurs – Apax Partners, 3i, Doughty Hanson, and Tom Singh – as initial backers. Bridges closed its first Sustainable Growth Fund at £40 million in May 2002. Based on the results of Fund I, Bridges was able to raise its second fund in 2007 purely from private sector investors, including pension funds and banks. Fund II was oversubscribed at £75 million, substantially more than the original £50 million target. Subsequently, Bridges raised £125 million with Fund III in 2012. Today, Bridges manages £460 million and is building its eighth fund. These funds span three different impact investment areas: Sustainable Growth, Property, and Social Sector.

7.4 Direct payment for outcomes

Also known as payment-by-results or outcomes-based financing, these mechanisms are aimed at redistributing government funding to reward higher levels of impact, verified through measurement of attributable outcomes. The government can take a number of different approaches, including outcomes-based direct contracting with service providers; creation of an outcomes fund to finance outcomes-based contracts or top-up payments for outcomes achieved; or commitments to pay investors based on results achieved. SIBs are one mechanism being explored by governments, which may incorporate a number of these attributes to focus on scaling interventions that address a particular social challenge, engaging private capital in the solution.

New South Wales Social Benefit Bonds

The New South Wales government, in Australia, has entered into two Social Benefit Bond (SBB, also known as SIB) trials. The first is the Newpin SBB, an AUD\$7 million bond spanning seven years, funding UnitingCare Burnside's program, which provides support for families to facilitate their child's return from foster care. The Benevolent Society SBB is an AUD\$10 million bond with a five-year term, which funds the Resilient Families service, providing intensive support for up to 400 families and children for 12 months, including up to nine months of post-crisis care. The two SBBs differ in their contracting structure, financial structure, and measurement of outcomes, demonstrating the need for flexibility given the unique circumstances of the problem being tackled. Investors included corporations, financial institutions, foundations, individuals, and trusts. A survey undertaken by Social Ventures Australia demonstrated that investments in SBBs are 'new' investments, not simply a diversion of existing philanthropic funds.

Social Outcomes Fund

Launched in November 2012 by the UK Cabinet Office, the £20 million fund tops up funding into new outcomes-based approaches. The objective of the fund is to address the complexity of aggregating benefits and savings that accrue across the complex public sector landscape, and to help to grow the payment-by-results market in the UK.

Taking an outcomes-based approach to structuring returns appeals to the investors interviewed for this part of the report. However, concerns include unfamiliarity with new products such as SIBs, the complexity of the underlying contracting arrangements involving parties with varying interests, and difficulties making the opportunity more readily available to more investors.

8. RECOMMENDATIONS

Government support is needed to help take impact investing to the next level in Canada. Deployment of multiple initiatives would support continued growth and attract new investors. Broadly, federal government leadership, in partnership with provincial and municipal governments, private investors, social entrepreneurs, and intermediaries, will be required to create an enabling tax and regulatory environment, build a pipeline of investment-ready social enterprises, and mobilize new sources of capital. This part of the report is focused on the latter.

The federal government can play a unique role to help coalesce investment opportunities, and send a signal to the broader market, supporting the attraction of new private capital. It should be noted that different categories of investors will respond to different forms of incentives, and that a variety of approaches would therefore be required to attract capital from across the investor landscape.

The government could undertake a number of initiatives to direct private capital towards organizations and projects that are addressing pressing social challenges. Based on a review of existing efforts to catalyze private sector involvement and feedback obtained through expert interviews, the following recommendations reflect initial steps that could be taken by the federal government to engage the investment community.

8.1 Recommendation 3: Establish an impact investing matching program, paired with appropriate incentives.

There are many options for structuring an impact investing matching program. For example, it could be geared towards direct investment opportunities, with the government co-investing directly in organizations alongside private sector investors. This would enable investors to pursue qualified deals that require more capital than currently available, or enable fund managers to close a funding round. Alternatively, the program could support development of a fund of funds which would serve to aggregate investment opportunities in existing Canadian impact investment funds. Investors currently not participating in impact investing could co-invest with the government. Whether the government would invest *pari passu* or take a subordinate capital position would need to be determined.

In any case, the program should have clearly established criteria to guide eligibility for funding, including measures to help ensure that funding is allocated in support of regional initiatives. Investors interviewed indicated that it is important to have investment opportunities led by investors, and funding decisions made independent of governments. A third party fund manager could be engaged to manage, advise on, and monitor fund activity. Also important to attract new investors is the inclusion of incentives, such as tax credits or first loss capital, as have been employed to catalyze venture capital, to help mitigate risk and transaction costs.

The 2010 Canadian Task Force on Social Finance recommendation of a \$20 million investment of first loss capital in existing funds, followed by \$20 million per year over four years to create a fund of funds, conditional on matches, remains relevant. While impact investing funds can take varying sizes, a larger scale fund would be necessary to attract large institutional investors, such as pension funds. The appropriate size for a government investment to catalyze impact investing will depend on the objectives and design of the initiative. A sizable investment would, however, be required, to have a catalytic impact with national reach, and to bring new investors into the impact investment market.

8.2 Recommendation 4: Establish an outcomes payment fund

As the impact investing field is building, a broader shift to outcomes-based approaches is influencing government budgeting and procurement. These approaches focus on identifying the interventions that are having the greatest positive impact in addition to supporting the development of innovative ideas that have the potential to achieve superior social outcomes. Investors have a unique role to play, and have expressed interest in participating, however the opportunity for their participation is currently limited.

An outcomes payment fund could be used to catalyze the use of outcomes-based approaches to service delivery. A flexible approach to establishing contracts, whether they take the form of SIBs or other arrangements, is key to enable testing of innovative opportunities and to further investment in proven solutions. Payments could be based on a specified maximum price per outcome as has been done in the UK, enabling the market to respond with innovative solutions. This model would provide organizations with access to capital markets through government commitments to pay for outcomes.

An outcomes payment fund could have significant impact at various sizes; however, the bigger the fund, the stronger the market signal, and the greater the potential impact. UK equivalents have ranged from £20-40 million.

8.3 Supporting recommendations

A number of investors interviewed expect the government to indicate priority social issues to help galvanize efforts to develop both the supply of and demand for capital. Efforts to enhance the visibility, capacity, and investment readiness of organizations seeking funding have also been identified as important to help overcome challenges related to sourcing appropriate investment opportunities.

- The recommended interventions should be paired with support for investment and contract readiness, to develop the pipeline of investment opportunities.

These recommendations focus on specific initiatives to catalyze the investment of new private capital. Other steps that the federal government could take to more broadly support the growth of the impact investing ecosystem include:

- Developing a comprehensive impact investing vision and strategy that identifies initiatives to develop both the supply of and demand for capital as well as the role of intermediaries, coordinating with provincial and municipal governments.
- Engaging in direct discussions with the investor community to understand their perspectives on the opportunity for mainstream institutional investors.

9. CONCLUSION

The recommendations outlined in Section 8 merit further exploration, to develop a focused business case. As with any intervention, caution should be taken to avoid unintended consequences, including diverting existing impact investment capital rather than inviting new capital into the market, at the risk of freezing or stalling existing market activity.

Each of these recommendations could have a catalytic impact on Canada's impact investment market, mobilizing additional private capital for public benefit.

References

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6. Philanthropic Foundations Canada. (n.d.). Canadian foundation facts. Retrieved August 2, 2014 from Philanthropic Foundations Canada: <http://pfc.ca/canadian-foundation-facts/>
7. "Below market rate" is understood, here, to mean an investment that is expected to deliver anywhere from no return, to a return that is not high enough to compensate for the risk of the investment; in other words, an investment that a traditional, profit-motivated investor would be unlikely to make on the same terms.
8. Outcomes-based financing can take a variety of forms, including payment-for-results contracts between governments and service providers and Social Impact Bonds (SIBs) - in which investors provide up-front financing for a particular service, generally delivered by one or more charitable or non-profit organizations, based on the commitment of an outcomes funder (often a government commissioner) to pay investors an agreed-upon amount of money if certain outcomes are achieved. SIBs, in particular, are a relatively new model for funding social services, and there are mixed views on their use in the Canadian context. Lessons from other countries should inform the application of this model in Canada, as should the perspectives and interests of service providers, investors, and governments, or other outcomes funders, on a case-by-case basis.
9. See footnote 7 for this report's working definition of "below market rate" investments.
10. This last category is narrower than it appears, as it is applied based on case law precedent.
11. Qualified donees are organizations that can issue donation receipts for gifts and can receive gifts from registered charities. Qualified donees include:
 - "a registered charity (including a registered national arts service organization);
 - a registered Canadian amateur athletic association;
 - a listed housing corporation resident in Canada constituted exclusively to provide low-cost housing for the aged;
 - a listed Canadian municipality;
 - a listed municipal or public body performing a function of government in Canada;
 - a listed university outside Canada that is prescribed to be a university, the student body of which ordinarily includes students from Canada;
 - a listed charitable organization outside Canada to which Her Majesty in right of Canada has made a gift;
 - Her Majesty in right of Canada or a province; and
 - the United Nations and its agencies."An organization's own charitable activities can either be carried out by the charity itself or through an intermediary. When a charity uses a non-qualified donee as an intermediary, it must maintain direction and control even if day-to-day operations are delegated, such that the activities amount to activities carried on by the charity itself. Canada Revenue Agency. (2011, August 15). Qualified donees (Guidance No. CG-010) Retrieved August 2, 2014 from Canada Revenue Agency: <http://www.cra-arc.gc.ca/chrts-gvng/chrts/plcy/cgd/qlfddns-eng.html>; Canada Revenue Agency. (2011, June 20). Using an intermediary to carry out a charity's activities within Canada (Guidance No. CG-004). Retrieved August 2, 2014 from Canada Revenue Agency: <http://www.cra-arc.gc.ca/chrts-gvng/chrts/plcy/cgd/ntrmdry-eng.html>
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16. Canada Revenue Agency. (2014). Non-profit organization risk identification project report. Retrieved August 2, 2014 from Canada Revenue Agency: <http://www.cra-arc.gc.ca/tx/nnprft/nprft-prjct-rprt-eng.html>
17. An effective business plan for generating revenue is usually necessary to attract investment capital. An important exception exists in the case of Social Impact Bonds (SIBs), which allow NPOs and charities to access capital markets based on a government commitment to pay for certain outcomes. While they are a significant part of the global impact investment landscape, SIBs are not a primary focus of this part of the report.

18. Examples of hybrid corporate forms include the Community Interest Company (CIC) in the United Kingdom, the Benefit Corporation, Low-Profit Limited Liability Company, and Flexible Purpose Corporation in the United States, and Community Contribution Company (C3) in British Columbia. CIC legislation has also been passed in Nova Scotia.
19. Canada Revenue Agency. (2003, March 31). What is a related business? (Policy Statement No. CPS-019). Retrieved August 2, 2014 from Canada Revenue Agency: <http://www.cra-arc.gc.ca/chrts-gvng/chrts/plcy/cps/cps-019-eng.htm#N102AD>
20. Ibid. Foundations cannot acquire more than 50 percent of the voting shares of a taxable subsidiary, unless they are donated.
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 - Loans: the outstanding loan multiplied by the difference between the interest rate the investor charity could have earned if it invested the amount in T-bills or GICs, and the interest rate the charity received.
 - Share purchase: the difference between the return the investor charity could have realized had it invested in T-bills or GICs and the actual return or loss from purchasing shares.
- Lease: the difference between the fair market value of the lease and the actual amount the investor charity received from the lease."
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 - General economic conditions;
 - The possible effect of inflation or deflation;
 - The expected tax consequences of the investment decision or strategy;
 - The role that each investment or course of action plays within the overall trust portfolio;
 - The expected total return from income and the appreciation of capital;
 - Needs for liquidity, regularity of income and preservation or appreciation of capital; and
 - An asset's special relationship or value, if any, to the purpose of the trust or its beneficiaries."
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EXPLORING THE POTENTIAL OF SOCIAL FINANCE IN CANADA

Report of the Standing Committee on Human Resources, Skills and Social Development and the Status of Persons with Disabilities

**Phil McColeman
Chair**

JUNE 2015

41st PARLIAMENT, SECOND SESSION

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THE STANDING COMMITTEE ON HUMAN RESOURCES, SKILLS AND SOCIAL DEVELOPMENT AND THE STATUS OF PERSONS WITH DISABILITIES

has the honour to present its

TWELFTH REPORT

Pursuant to its mandate under Standing Order 108(2), the Committee has studied Exploring the Potential of Social Finance in Canada and has agreed to report the following:

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EXPLORING THE POTENTIAL OF SOCIAL FINANCE IN CANADA

INTRODUCTION

On 5 February 2015, the House of Commons Standing Committee on Human Resources, Skills and Social Development and the Status of Persons with Disabilities (the Committee) adopted a motion to “study Social Finance’s potential for unlocking new sources of capital to improve social and economic outcomes for Canadians...”¹ The Committee held a total of 14 meetings on this topic between 17 February and 26 May 2015, heard from 51 witnesses including three federal government departments, and now submits its final report entitled *Exploring the Potential of Social Finance in Canada*.

The Committee observed that governments around the world are making increasing use of social finance instruments, and momentum is building in Canada and internationally toward greater stakeholder engagement and capital investment in this market. As highlighted in the 2015 federal budget, social finance can contribute to the development of genuinely new and innovative approaches to addressing complex social issues. Recognizing the growing interest and engagement in this area, the Committee undertook this study in hopes of contributing to our understanding of the potential benefits and limits of social finance in Canada.

Social finance is a broad field that incorporates a variety of tools and business models. This report begins with a general discussion of social finance and the range of initiatives within this market that were raised by witnesses, in order to help clarify some of the basic concepts and issues surrounding the current status and possible future development of social finance in Canada.

The Committee heard a wide variety of evidence with respect to practical measures needed to support the development of legal and policy frameworks for social finance. In particular, witnesses raised issues and made recommendations regarding the current regulatory environment, the development of tools to measure the effectiveness of social finance initiatives, capacity building and training of stakeholders in this new market, and other financial and non-financial measures the federal government could implement to support the social finance market in Canada. The final sections of this report summarize these discussions and make recommendations for further action on these issues.

1 House of Commons, Standing Committee on Human Resources, Skills and Social Development and the Status of Persons with Disabilities [HUMA], Minutes of Proceedings, 2nd Session, 41st Parliament, 5 February 2015.

CHAPTER ONE: THE SOCIAL FINANCE MARKET IN CANADA

A. What is Social Finance?

In brief, social finance is said to be “the use of private capital in financial markets for social good.”² The Committee heard that the terms “social finance” and “impact investment” are often used interchangeably to refer to a type of investing that seeks to generate both financial and social returns. Stated another way, “social finance” describes an approach to mobilizing repayable capital in ways that seek to create positive social impacts.

Representatives from Employment and Social Development Canada (ESDC) outlined the concept of social finance in the following terms:

Simply put, social finance is using money in ways that generate both social and financial returns. It's an approach that mobilizes multiple sources of capital to deliver a positive, measurable social outcome and an economic dividend.

Social finance provides opportunities to leverage additional investments and increase available dollars to develop, deliver, and scale up proven approaches that seek to address social and economic challenges in our communities. It includes new approaches to investing. It's often known as “impact investment.”³

Social finance is not a new idea, but has been expanding in popularity around the world in recent years as a means to support the social economy and social sector organizations, and develop new approaches to address complex social problems. The Committee heard that the United Kingdom (U.K.) has led this recent revival internationally, having developed its social finance sector over the past 15 years and used its recent presidency of the G-8 to establish a taskforce on social impact investment.⁴ In addition, under the auspices of that effort, national advisory boards were established in G-8 member countries, including Canada, to contribute research into the domestic policy agenda. The final report of Canada's National Advisory Board to the Social Impact Investment Taskforce was released in September 2014.⁵

As Kieron Boyle of the U.K. Government noted, the concept of social finance is necessarily broad because of the range of stakeholders and perspectives that are engaged:

2 HUMA, *Evidence*, 2nd Session, 41st Parliament, 10 March 2015, 1530 (Sandra Odendahl, Director, Corporate Sustainability and Social Finance, Royal Bank of Canada).

3 HUMA, *Evidence*, 2nd Session, 41st Parliament, 17 February 2015, 1530 (Siobhan Harty, Director General, Social Policy Directorate, Strategic Policy and Research Branch, ESDC).

4 See: G-8 Social Impact Investment Task Force, *Impact Investment: The Invisible Heart of Markets*, 15 September 2014.

5 For the report of Canada's National Advisory Board to the Social Impact Investment Taskforce, see: *Mobilizing Private Capital for Public Good: Priorities for Canada*, September 2014.

Definitions are everything here. Essentially, within the U.K. there seems to be two broad definitions that sit around the world of social finance. The first one seems to be social finance being about repayable capital that helps social organizations increase their impact. That's very much from the investee's perspective. There's a broader one that we used in the G-8 task force that was talking about social investment being investment that intentionally seeks and measures financial returns and social returns.

I think they're both right. It just pulls out the fact that there's a breadth to this. So much of this field depends on where you sit.⁶

Jeffrey Cyr from the National Association of Friendship Centres echoed a recurring theme amongst witnesses that social finance has the potential to serve as an additional social policy instrument in Canada that drives social innovation and complements, enhances or extends the scope of existing social programs in order to deliver an even greater social impact, rather than a means of replacing existing social programs. Many witnesses, including Mr. Cyr, described social finance as a policy tool with potential to better address specific, complex social challenges in new and innovative ways.

Let's jump into social finance, which I see as part of a suite of mechanisms and structures required to facilitate social innovation. Of course social innovation is, at heart, about catalyzing and creating systems change.

For us, one thing is clear. The complexity of the problems around us, most acutely in the lives of urban indigenous people in this country, will not be solved by traditional ways of acting. The systems of today, frankly, are not built to handle the problems of today....

Social innovation and social finance represent tremendous tools with which to build on these strategic relationships to develop new or, just as importantly, to scale up and scale out existing initiatives so they can have broader impact.⁷

Witnesses appearing before the Committee approached social finance from a variety of perspectives and, as will be described below, highlighted a variety of tools and business models that fall under this broad concept. However, the Committee heard that social finance models share a key feature that is different from traditional funding models: whereas grants or donations provide a "one-off" source of funding, social finance attempts to achieve something "more sustainable and more long-lasting."⁸

The Committee heard that the social finance market, like any financial market, is a combination of demand (for capital to finance initiatives), supply (of investment capital), and intermediaries (connecting demand and supply sides of the market). As Siobhan Harty of ESDC explained:

As with other capital markets, the social finance marketplace is made up of three broad components. There is the supply side that provides the capital. There are a number of players that are active in this area, including foundations, financial institutions, and

6 HUMA, *Evidence*, 2nd Session, 41st Parliament, 28 April 2015, 1530 (Kieron Boyle, Head, Social Investment and Finance, Government of the United Kingdom).

7 HUMA, *Evidence*, 2nd Session, 41st Parliament, 31 March 2015, 1530 (Jeffrey Cyr, Executive Director, National Association of Friendship Centres).

8 HUMA, *Evidence*, 2nd Session, 41st Parliament, 17 February 2015, 1630 (Siobhan Harty).

private investors, to name a few. There is the demand side that comes from a range of both non-profit and for-profit organizations that includes charities, non-profit organizations, social enterprises, cooperatives, and social purpose businesses. In the middle there are intermediaries, those agents that try to bring together the two sides of the market: supply and demand. These intermediaries work to facilitate deals by providing expertise for the development of the supply and demand side, and to enable the efficient growth of the overall market.⁹

The Committee heard that interest in social finance is being driven by both the supply and demand sides of the market. From the supply side of the social finance market (e.g., governments, foundations, financial institutions), the Committee heard that investors are increasingly interested in using their resources in ways that offer both a return on investment and positive social impacts. As Ms. Harty noted:

We're seeing a different spirit, if I can use that term in the financing world, in people who want to make an investment and not achieve just a financial return. These individuals – call them social impact investors or people who want to support social enterprise – are really bringing a different expectation to that market and to this area of policy in asking how they can use their money to achieve a social good.¹⁰

From the demand side of the social finance market (e.g., charities, non-profit organizations, social enterprises), the Committee heard about a need for new approaches to address the difficult social and economic challenges that have resisted change through traditional means of funding. Carole Gagnon of United Way Ottawa spoke of this dynamic in the following terms:

Traditional ways in which we have been funding social issues are experiencing tremendous transformation. Many factors will continue to pressure government funding in the area of social service spending.

...

We certainly view private capital investment as an opportunity for new conversations with our long-time donors, many of whom we already speak to in investment terms. The potential to attract new stakeholders to our work is there as well and will require greater engagement of all sectors.¹¹

The Committee also heard from several intermediaries operating in Canada's social finance marketplace. These include organizations that work with investors and assist in generating capital for social finance, work to improve the capacity of demand-side actors to participate in the social finance market, and generate research and data to support the measurement and evaluation of social finance initiatives. Tim Jackson of the MaRS Discovery District, a registered charity that works to promote social finance in both the demand and supply sides of the market, also described the potential of social finance to introduce new funds to address important social issues:

9 Ibid., 1530.

10 Ibid., 1630.

11 HUMA, *Evidence*, 2nd Session, 41st Parliament, 24 March 2015, 1540 (Carole Gagnon, Vice-President, Community Services, United Way Ottawa).

In simple terms, the challenges we face as [a] society need a new approach. You as parliamentarians are dealing with budget constraints particularly around things like health care and social services. I think you would acknowledge the innovative approach we have taken as a country toward things like our entrepreneurial approach to business, our entrepreneurial approach to innovation, requires that same type of approach to deal with some of these large social issues, whether we're talking about homelessness or poverty reduction. We think it requires a new, innovative approach and it requires us to access some funds that are not currently available in the space.¹²

While broad consensus existed among witnesses about the need for new approaches to address persistent social and economic challenges through new partnerships and sources of financing, the particular form that social finance initiatives should take to meet this challenge varied. The next section of this chapter will describe the main types of social finance instruments raised by witnesses, and summarize the discussion regarding the potential role of social finance in Canada's social service sector.

B. Social Finance Tools and Business Models

Social finance is linked to the broader policy goal of improving social outcomes. This objective distinguishes social finance from traditional funding models for social programs (which focus on shorter term outputs), and other types of investments (which seek to maximize profits). Private capital may be used to further the goal of improving social outcomes in multiple ways, and the following section will discuss the three types of social finance tools and business models most commonly raised in the evidence: social impact bonds (SIBs), social investment funds, and social enterprises.

1. Social Impact Bonds

One approach to social finance – known as “outcomes-based finance” or “pay-for-performance” – directly links the provision of program funding to the achievement of measurable, proven social outcomes. Options under this approach include an instrument known as a “social impact bond” (SIB), which ESDC has defined as:

... an instrument for funding projects where a prearranged amount of money is paid out if performance results are achieved. SIBs combine a pay-for-performance element with an investment-based approach: private investors provide up-front capital to fund interventions, and can expect to get back their principal investments and a financial return if the results are achieved.¹³

Although structures for specific instruments vary, SIBs are generally contractual arrangements through which investors provide multi-year funding to service providers to deliver a program or service, and government agrees to repay the investors' capital plus an agreed-upon return if the program achieves its stated social outcome goals. As Meghan Joy of Ryerson University explained:

12 HUMA, *Evidence*, 2nd Session, 41st Parliament, 19 February 2015, 1530 (Tim Jackson, EVP Corporate and Community Development, MaRS Discovery District).

13 Human Resources and Skills Development Canada, *Harnessing the Power of Social Finance*, Ottawa, May 2013.

Basically it begins with government identifying a social policy field where it would like to pay for particular outcomes.... Government then would typically contract an intermediary organization who manages the SIB project and actually prepares the bond instrument. It prepares the desired project results, the costs, the savings, as well as the rate of return to investors should the social project achieve those pre-arranged outcome targets. The intermediary would then issue the bond to private investors, who provide the upfront or the immediate project capital. This is where the social finance element, the impact investing element, comes in.¹⁴

The Committee heard that SIBs have the potential to improve the funding and delivery of social programs by finding efficiencies, spurring private sector innovation, and transferring the risk of funding social innovation to the private sector. However, as will be discussed below, several witnesses advanced critiques of SIBs and their potential to improve on existing funding and delivery models.

Lars Boggild of Finance for Good told the Committee that there are currently 44 SIBs live globally.¹⁵ The first SIB was launched in 2010 in Peterborough, U.K., for a project aimed at reducing the recidivism rates of short-sentence male offenders. Originally envisioned as a seven-year initiative, the Committee heard that the pilot project was cancelled partway through as the prison system moved toward greater privatization of rehabilitation services, and the full results of the SIB were never evaluated.¹⁶ As John Loxley of the University of Manitoba stated, "the whole thing was wrapped up far too early for it to be called a success."¹⁷

Kieron Boyle indicated that the U.K. has launched a total of 31 SIBs in five policy areas: "health, reoffending, youth unemployment, children at risk and ... adoption." Mr. Boyle told the Committee that the full results of these pilot projects are not yet available and, if they are deemed successful, there remains some question as to whether, at this early stage, their success could be fully attributed to the SIB model:

All the early indications from the social impact bonds are that they are achieving better outcomes than the counterfactual, what would have happened anyway. What we don't know yet is whether that is something that would happen if it were replicated wider or whether this is some sort of pilot halo effect because there's a degree of attention and focus upon them.¹⁸

The Committee heard that Canada's first SIB was launched in Saskatchewan last year, to establish a home to provide mothers and their children with safe and affordable accommodation. As Donald Meikle of the Saskatoon Downtown Youth Centre (which is

14 HUMA, *Evidence*, 2nd Session, 41st Parliament, 23 April 2015, 1640 (Meghan Joy, Doctor of Philosophy Candidate, Ryerson University).

15 HUMA, *Evidence*, 2nd Session, 41st Parliament, 26 May 2015, 1535 (Lars Boggild, Vice-President, Eastern Canada, Finance for Good).

16 HUMA, *Evidence*, 2nd Session, 41st Parliament, 23 April 2015, 1645 (John Shields, Professor, Ryerson University, Department of Politics and Public Administration).

17 HUMA, *Evidence*, 2nd Session, 41st Parliament, 26 March 2015, 1540 (John Loxley, Professor, Department of Economics, University of Manitoba).

18 HUMA, *Evidence*, 2nd Session, 41st Parliament, 28 April 2015, 1625 (Kieron Boyle).

implementing the project) explained, his organization looked to SIBs as an alternative source of project funding:

The options for us to fund this home were to wait for up to a year and a half to get into the funding cycle with still no promises, to try to raise the needed dollars with an organization that already needs to raise about \$100,000 per year to keep our doors open, or to go with a new and innovative way of funding called the social impact bond that bases funding on outcomes.¹⁹

Dale McFee, Deputy Minister of Correctional Services with the Government of Saskatchewan, told the Committee that this SIB is valued at a relatively low \$1 million and did not involve an intermediary.²⁰ Investors on the project include a housing development corporation and a credit union.²¹

The Committee heard that ESDC is currently involved in a pilot project incorporating the SIB model in the area of adult literacy and essential skills. Ms. Harty explained that this pilot project:

... will run for 18 months, approximately. It has two populations: one of employed Canadians and one of non-employed Canadians. In both cases, interventions are applied to increase their literacy and essential skills levels, with the objective of their having stronger labour market attachment. These are en route. They're currently being finalized in terms of the partnerships and the negotiations.²²

Jean-Pierre Voyer of the Social Research and Demonstration Corporation, which was retained as the independent evaluator on the pilot project, noted that one aspect of the pilot proposes to enrol unemployed Canadians in an essential skills training program, and is "testing what would be considered a true social impact bond model in which private investors will recover their initial investment plus a financial return of up to 15%, if the training is successful." The other part of the pilot addresses skills training for those who are already employed, in which private sector employers will be reimbursed for up to 50% of training costs, if this training achieves target outcomes. Mr. Voyer further explained that this aspect of the pilot is "a departure from a formal SIB, because the investor is not motivated by return on capital investment per se but by the prospect of economic returns from a better-trained and more productive workforce as well as reimbursement of training expenses."²³

While governments have begun to experiment with the SIB model in Canada, to date no evaluations have been completed to demonstrate the actual potential of the SIB model in Canada or elsewhere. The Committee heard from witnesses who were involved

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- 19 HUMA, *Evidence*, 2nd Session, 41st Parliament, 12 May 2015, 1550 (Donald Meikle, Executive Director, Saskatoon Downtown Youth Centre Inc.).
 - 20 HUMA, *Evidence*, 2nd Session, 41st Parliament, 12 May 2015, 1605 (Dale McFee, Deputy Minister, Corrections and Policing, Ministry of Justice, Government of Saskatchewan).
 - 21 HUMA, *Evidence*, 2nd Session, 41st Parliament, 12 May 2015, 1555 (Donald Meikle).
 - 22 HUMA, *Evidence*, 2nd Session, 41st Parliament, 14 May 2015, 1610 (Siobhan Harty).
 - 23 HUMA, *Evidence*, 2nd Session, 41st Parliament, 12 May 2015, 1630 (Jean-Pierre Voyer, President and Chief Executive Officer, Social Research and Demonstration Corporation).

in the development of SIB instruments and expressed interest in contributing to their use in Canada.²⁴ However, as will be described below, the Committee also heard from witnesses who advanced critiques of the SIB model and urged the federal government to apply this model with caution, if at all. Looking at the currently available evidence on the model and the experience of SIBs internationally, these witnesses expressed scepticism about the potential of SIBs to become a viable funding model for social programs in Canada.

First, some witnesses argued that the SIB model is unlikely to make programs more efficient or reduce government costs or budgets, but rather bring different financial and administrative costs to government. These include short-term overhead costs associated with developing in-house skills and expertise in the social finance market, and costs to retain the necessary professional services from lawyers, accountants and evaluators. Barret Weber from the Parkland Institute described social impact bonds as “cumbersome, expensive, requir[ing] a lot of upfront capital, and whose results are speculative at best.”²⁵

In addition, as witnesses such as Andrew McNeill of the National Union of Public and General Employees noted, rates of return also vary by contract, and can sometimes represent a significant financial cost to government:

... social impact bonds are an expensive way to borrow money. For example, the first social impact bond project in Peterborough, England, to reduce recidivism is expected to provide a rate of return of between 7.5% and 13% per year. Based on a survey by the MaRS Discovery District and Deloitte Canada, expectations of potential investors in social impact bonds here in Canada are very similar. By contrast, the federal government was paying an average of 2.37% to borrow money in 2013-14, which is roughly a third of the minimum amount Peterborough social impact investors are likely to receive.²⁶

Second, some witnesses argued that, given the potential financial risks associated with the SIB model to investors if the program fails to achieve the outcomes established by the government, investors will likely gravitate toward proven programs, and populations that are the least vulnerable and therefore most likely to succeed and generate positive outcomes (also referred to as “cherry-picking” or “cream-skimming”).²⁷ In addition, according to David Juppe of the Maryland Department of Legislative Services, SIBs for more vulnerable populations or more innovative types of programs will be more expensive, as “[i]nvestors are going to demand a higher rate of return because there's higher risk.”²⁸

24 HUMA, *Evidence*, 2nd Session, 41st Parliament, 19 February 2015, 1615 (Tim Jackson), and HUMA, *Evidence*, 2nd Session, 41st Parliament, 28 April 2015, 1655 (Adam Spence, Founder and Chief Executive Officer, SVX).

25 HUMA, *Evidence*, 2nd Session, 41st Parliament, 12 May 2015, 1640 (Barret Weber, Research Manager, Parkland Institute).

26 HUMA, *Evidence*, 2nd Session, 41st Parliament, 12 March 2015, 1530 (Andrew McNeill, National Representative, National Union of Public and General Employees). See also HUMA, *Evidence*, 2nd Session, 41st Parliament, 12 March 2015, 1540 (Margot Young, Senior Research Officer, Canadian Union of Public Employees).

27 HUMA, *Evidence*, 2nd Session, 41st Parliament, 12 March 2015, 1540 (Margot Young).

28 HUMA, *Evidence*, 2nd Session, 41st Parliament, 12 May 2015, 1545, (David Juppe, Senior Operating Budget Manager, Maryland Department of Legislative Services).

The third main critique of the SIB model advanced by witnesses involved challenges associated with program evaluation. In particular, as John Shields of Ryerson University noted, an evidence-based approach would require rigorous evaluation methods involving comparisons between randomly selected subject groups and control groups from the wider population. He noted that early evaluations of the Peterborough SIB, while generally positive, did not involve “a random sample; it was actually volunteers. That had the effect of biasing the sample, so that one would expect more positive results from the way the sample was selected.”²⁹ However, the issue of outcome measurement and appropriate data collection is best left to the intermediaries and is outside the scope of government.

Beyond these technical critiques of SIBs, witnesses also remarked on challenges surrounding the complexity of the model,³⁰ and noted that SIBs may distract from other forms of social finance requiring the attention of the federal government.³¹

2. Social Investment Funds

Many witnesses also discussed social investment funds, a type of social finance tool that pools capital from various sources and makes this capital available to demand-side actors, such as service delivery organizations and social enterprises. The Committee heard that such funds provide access to capital to organizations that may not otherwise be able to obtain funds from traditional loans.

While broadly linked to the goal of improved social outcomes, social investment funds differ from SIBs in that funding for these initiatives is not contingent on the proven achievement of outcomes. Rather, these tools resemble more traditional debt and equity financing instruments, but with a heightened social purpose and less emphasis on generating market-rate returns. For example, Andy Broderick of Vancity Credit Union spoke about its Resilient Capital program, a partnership with the Vancouver Foundation, which raised \$15 million from a variety of public and private sources to make loans to organizations with a social purpose. He stated:

Resilient is one of a number of funds across Canada—there aren't very many, probably eight or 10—that are attempting to provide capital to social enterprises, non-profits, businesses that are working to improve the environment. They could be for-profits as long as they have a mission base to them.... In Canada it's about a \$500-million market, probably a little under that. In the western economic world, it's about \$50 billion and growing considerably.³²

The Committee was also told about the Chantier de l'économie sociale Trust in Québec – a social investment fund created for the purpose of supporting social economy

29 HUMA, *Evidence*, 2nd Session, 41st Parliament, 23 April 2015, 1645 (John Shields).

30 HUMA, *Evidence*, 2nd Session, 41st Parliament, 10 March 2015, 1545 (Andy Broderick, Vice-President, Community Investment, Vancity Community Investment and Resilient Capital).

31 HUMA, *Evidence*, 2nd Session, 41st Parliament, 24 February 2015, 1645 (Michael Toye, Executive Director, Canadian Community Economic Development Network).

32 HUMA, *Evidence*, 2nd Session, 41st Parliament, 28 April 2015, 1630 (Andy Broderick).

enterprises.³³ This fund can provide loans of up to \$3.5 million, and was capitalized in part by the federal government and contributions from labour-sponsored funds.³⁴

Colette Harvey of the Caisse d'économie solidaire Desjardins described the social finance activities of her financial institution, noting that it "makes up more than 40% of the total volume of social financing" in Quebec, and is "a very active member of Cap finance, the Réseau de la finance solidaire et responsable." She further noted that the assets of the Caisse have doubled to \$737 million over the last 10 years, "and its loans to social businesses have increased by 122% over the same period," which are generally underwritten "to support the activities and development of social projects."³⁵

Sandra Odendahl of the Royal Bank of Canada (RBC) informed the Committee that, in 2012, RBC launched a social finance initiative involving, in part, the use of \$10 million from the RBC Foundation to "invest in early-stage companies with a social or an environmental mission."³⁶

In addition, Shawn Murphy of Cooperatives and Mutuals Canada told the Committee that member-owned cooperatives have several social investment funds operating across the country, which are "designed to serve a particular geographical region or a particular sector in the co-op movement." By way of example, he highlighted the Arctic Co-operative Development Fund, which was "established in 1986 to provide financial services to cooperatives across Canada's Arctic," and which has grown from an initial \$10 million investment into a \$45 million investment fund.³⁷

3. Support for Social Enterprises

Many witnesses also discussed various forms of social enterprise business models. A social enterprise is, generally, an "organization or business that uses the market-oriented production and sale of goods and/or services to pursue a public benefit mission."³⁸ It could take the form of a charity, a non-profit organization, a for-profit corporation, a co-operative, or a hybrid corporation (where legislation creating such hybrid corporations has been enacted).³⁹

33 HUMA, *Evidence*, 2nd Session, 41st Parliament, 24 February 2015, 1655 (Jacques Charest, President, CAP Finance, Le Réseau de la finance solidaire et responsable).

34 HUMA, *Evidence*, 2nd Session, 41st Parliament, 26 February 2015, 1535 (François Vermette, Director of Development, Social Economy Working Group).

35 HUMA, *Evidence*, 2nd Session, 41st Parliament, 10 March 2015, 1550 (Colette Harvey, Director, Cooperative Project Support, Caisse d'économie solidaire Desjardins).

36 HUMA, *Evidence*, 2nd Session, 41st Parliament, 10 March 2015, 1530 (Sandra Odendahl).

37 HUMA, *Evidence*, 2nd Session, 41st Parliament, 26 March 2015, 1630 (Shawn Murphy, Government Relations Consultant, Co-operatives and Mutuals Canada).

38 Canadian Task Force on Social Finance, *Mobilizing Private Capital for Public Good*, December 2010, p. 4.

39 Canada's National Advisory Board to the Social Impact Investment Task Force, *Mobilizing Private Capital for Public Good: Priorities for Canada*, MaRS Discovery District, September 2014, pp. 11–12.

While not strictly a form of impact investment, social enterprises are closely related as vehicles through which social finance tools can operate. For example, financial support for social enterprises can involve providing loans and other financing at below-market rates to help these enterprises pursue their social objectives.

The Committee heard from witnesses engaged in social enterprises that have leveraged funding from both public and private sources to generate positive social impacts within their communities. For example, Steve Cordes of Youth Opportunities Unlimited, an organization created in order to help youth with limited education and no work experience, noted in particular how this social enterprise leverages public funding:

With earned revenues, for every dollar that's invested from public funds, the organization is actually earning \$2 in addition to that. The federal funding right now represents about a third of the investments coming into our social enterprises.⁴⁰

The Committee heard about the important impacts that social enterprises can have in communities. Courtney Bain, a client of Youth Opportunities Unlimited (YOU), shared her experience with the Committee :

I'm Courtney. I'm 24, and I've been involved with YOU since I was 18. The journey has been a long road and it wasn't always successful, but YOU didn't give up on me. I started doing the skills training program this September, and I finished in February. Through this time, they gave me the skills that I needed. I had never worked in a kitchen before, and I am leaving this kitchen to manage my own. I am now managing my own local restaurant.

Without YOU, I would probably still be homeless and on social assistance. They gave me the skills that I needed.

...

It's giving me great opportunities. If it could do this much for me, think about how many other people it could help out as well.⁴¹

The Committee heard from organizations either interested in or already involved in social enterprise, including the Peel Multicultural Council, ABC Life Literacy, and Crossing All Bridges Learning Centre.⁴² Some of these organizations expressed a need for greater access to private funding sources. For example, the Committee heard that ABC Life Literacy has been funded by private, public and donated dollars throughout its 25-year history, and is now turning to social entrepreneurship to fill a gap in funding. ABC Life Literacy's UP project, which provides essential skills training in the workplace, operates under a social enterprise business model. ABC Life Literacy expressed a need

40 HUMA, *Evidence*, 2nd Session, 41st Parliament, 12 March 2015, 1635 (Steve Cordes, Executive Director, Youth Opportunities Unlimited).

41 HUMA, *Evidence*, 2nd Session, 41st Parliament, 12 March 2015, 1640 (Courtney Bain, Representative, Youth Opportunities Unlimited).

42 HUMA, *Evidence*, 2nd Session, 41st Parliament, 24 March 2015, 1530 (Naveed Chaudhry, Executive Director, Peel Multicultural Council); HUMA, *Evidence*, 2nd Session, 41st Parliament, 12 March 2015, 1645 (Gillian Mason, President, ABC Life Literacy Canada); HUMA, *Evidence*, 2nd Session, 41st Parliament, 12 March 2015, 1700 (Debbie Brown, Executive Director, Crossing All Bridges Learning Centre).

for “patient capital” in order to cover for expenses incurred before the project starts generating revenues.⁴³ Crossing All Bridges Learning Centre also indicated that they are in need of start-up funding in order to get a social enterprise project off the ground.⁴⁴

C. Role of Social Finance in Canada

As described above, social finance is an approach to mobilizing multiple sources of capital that has the potential to deliver sustainable social outcomes and economic returns, by developing multi-stakeholder partnerships and leveraging expertise in the social and financial spheres. While many witnesses expressed interest in participating in the development and implementation of social finance tools, many also indicated that they are not necessarily appropriate for all social challenges or target populations. As will be summarized below, testimony heard by the Committee included some current and planned initiatives at the provincial and federal levels, as well as a broader discussion of the appropriate role of social finance in providing funds for the social services sector.

Departmental officials described the current social finance market in Canada as “nascent” but with potential for growth. The size of the social finance market in Canada is currently estimated to be \$2.2 billion,⁴⁵ but could, according to ESDC, grow in the range of \$30 billion in 10 years, “if all parts of the market move forward together in an optimal situation.”⁴⁶

Siobhan Harty discussed the Department's May 2013 report which followed a national call for concepts for social finance initiatives:

[J]ust over 150 concepts were received over several months from across the country. What we did in the report is just profile some of them. None of them were funded. We were interested in getting a sense of whether Canadians had a familiarity with social finance and whether they had some ideas about innovative approaches that could be used in the context of social and labour market interventions at the local level.⁴⁷

In addition to the pilot project outlined previously, the Department noted its involvement “in a micro-loan project to look at helping recent immigrants achieve foreign credential recognition so that they can engage in their professional activity in Canada and be part of the labour market.”⁴⁸ Ms. Harty also noted the recent announcement in Budget 2015 of a “social finance accelerator initiative” to be led by the Department,⁴⁹ and which is “expected to involve advisory services, mentorship, brokering, and investor

43 HUMA, *Evidence*, 2nd Session, 41st Parliament, 12 March 2015, 1645 (Gillian Mason).

44 HUMA, *Evidence*, 2nd Session, 41st Parliament, 12 March 2015, 1700 (Debbie Brown).

45 Canada's National Advisory Board to the Social Impact Investment Taskforce, *Mobilizing Private Capital for Public Good: Priorities for Canada*, September 2014, p. 25.

46 HUMA, *Evidence*, 2nd Session, 41st Parliament, 17 February 2015, 1535 (Siobhan Harty).

47 Ibid., 1615.

48 Ibid., 1535.

49 *Economic Action Plan 2015*, 21 April 2015, p. 271.

introductions to help fast-track promising social finance ventures to a greater stage of investment readiness.”⁵⁰

Witnesses also offered examples of government-supported social finance initiatives that are or may soon be taking place across Canada. In addition to Saskatchewan’s SIB, other noted examples included the Government of Nova Scotia’s consideration of an equity tax credit and the establishment of Community Economic Development Investment Funds,⁵¹ and the Government of British Columbia’s introduction of the “community contribution company” – a hybrid corporation that, according to the department, “has tried to find a way in between traditional business and traditional charities.”⁵²

Though the social finance market in Canada is currently small, many witnesses discussed the potential of social finance to represent a new and growing source of funding for social programs and services. This discussion included the role of social finance vis-à-vis government funding, and the types of initiatives potentially best suited to social finance interventions. It also included a discussion of the potential effects of social finance on the role and functions of service delivery organizations.

Some witnesses expressed concern that relationships with investors could affect the ability of social service organizations to preserve their missions and retain their independence in their operations.⁵³ Others noted that the degree of organizational autonomy would depend on the source of capital and how the social finance instrument is structured. As Norm Tasevski of Purpose Capital stated:

As an example, one of the groups that we work with is the angel investment community. By angel investors, I'm referring to individuals who would finance or take the highest risk associated with a particular investment. In some cases, I've seen angel investors who are completely passive with regard to an investment. They just put their capital in, and let the entrepreneur be the entrepreneur.

In fact, with some models, there's more autonomy for that type of investor than you would ever get with a government funded granting program or a charitable program ... but in a lot of ways, the level of involvement that's needed in order to satisfy the conditions of a grant can often create barriers to autonomy for a lot of groups⁵⁴

Siobhan Harty noted that the experience with social finance instruments internationally is that preserving the mission of the organization is a fundamental consideration:

50 HUMA, *Evidence*, 2nd Session, 41st Parliament, 14 May 2015, 1530 (Siobhan Harty).

51 HUMA, *Evidence*, 41st Parliament, 2nd Session, 19 February 2015, 1535 (Tim Jackson).

52 HUMA, *Evidence*, 2nd Session, 41st Parliament, 17 February 2015, 1535 (Siobhan Harty).

53 HUMA, *Evidence*, 2nd Session, 41st Parliament, 26 May 2015, 1550 (Sally Guy, Policy and Communications Coordinator, Canadian Association of Social Workers).

54 HUMA, *Evidence*, 2nd Session, 41st Parliament, 10 March 2015, 1715 (Norm Tasevski, Co-Founder and Partner, Purpose Capital).

I'm looking to other countries that are more advanced than Canada in using social finance models ... I guess it depends on the mission of the organization, but everything I've heard is about how to allow these kinds of organizations to preserve their mission. It's so fundamental, so how do you do that? That question of mission is fundamental to everything that we're looking at. I've never heard that social finance as a form of financing in and of itself would have a detrimental effect on the ability of an organization to retain control of its mission.⁵⁵

The Committee heard testimony from many witnesses indicating that social finance is intended as a complementary or additional source of funding for social programs. Viewed in this way, social finance provides a means to "leverage different sources of funding to address complex social challenges."⁵⁶ As Adam Spence of Social Venture Connection (SVX) stated: "Social finance does not replace good public policy, good public investments, or good philanthropy, but it is a necessary complement to these approaches."⁵⁷

Some witnesses emphasized the potential for social finance to lessen the financial burden on government, with the perspective of being able to do more with available public funds. As Stanley Hartt of Norton Rose Fulbright Canada observed:

I agree that this is not intended at all to replace government funding for certain non-governmental organizations' charitable activities or public welfare activities, but in fact it certainly does take some of the burden off government if, alongside government, there can be private sector entities that are investing in social ventures with predictable, measurable outcomes, and they are doing this using private sector funding.

...

When you mobilize private capital for public good, you reduce the pressure on government and enable them to do, perhaps, more with their available funds. There is no part of this that recommends government do less.⁵⁸

Similarly, Kieron Boyle echoed the notion that social finance can have a role in the social sector by increasing the number of stakeholders interested in achieving social impacts:

At its core, one of the things that I believe social investment has the potential and capacity to do is to broaden the sense of partnership over who is trying to achieve social impact. I think that is a laudable aim and I think that can be achieved.⁵⁹

In addition, Sunil Johal of the Mowat Centre highlighted the primary role that governments play in the social finance context:

55 HUMA, *Evidence*, 2nd Session, 41st Parliament, 17 February 2015, 1625 (Siobhan Harty).

56 Ibid., 1535.

57 HUMA, *Evidence*, 2nd Session, 41st Parliament, 28 April 2015, 1640 (Adam Spence).

58 HUMA, *Evidence*, 41st Parliament, 2nd Session, 19 February 2015, 1545 (Stanley Hartt, Counsel, Norton, Rose, Fulbright Canada).

59 HUMA, *Evidence*, 41st Parliament, 2nd Session, 28 April 2015, 1620 (Kieron Boyle).

... I think it's very important to recognize that governments still play the *primus inter pares*, the first among equals, role in terms of setting direction and deciding what those difficult social problems are. Governments should still be very heavily involved in this. I don't think this is an area we want to outsource, solving difficult problems, to the private sector.⁶⁰

Others cautioned that widening the responsibility for social services into the private sector could lead to the replacement of federal funding or service delivery in some circumstances. Acknowledging the financial pressures on the social services sectors everywhere, Jean-Pierre Voyer noted:

The instruments of social enterprise, social finance, social impact bonds all fulfill different objectives, but in general if the thinking is to use them to replace an established government program whose specific objective is to serve the population I think that's the wrong point to start with. But if these tools are used to trigger innovation in social policy ... and if they trigger more efficient service delivery ... government or even non-profit organizations are not always a model of efficient service delivery.

If we can find ways to improve that without depriving them of funding, but if they're funded differently, so be it. The literature isn't conclusive. That doesn't mean that it's a bad way to go. We just have to go there with caution....⁶¹

The Committee also heard that social finance presents the advantage of offering longer term funding, which is well-suited to preventative approaches.⁶² Indeed, a cited advantage of social finance is its ability to offer long-term funding, potentially allowing service providers to step away from yearly renewals which can be difficult when outcomes are not immediately apparent:

It's true that a lot of organizations speak to the fact that short-term contracts are very difficult to manage and the financing that comes with them is not stable. They have to apply on a pretty frequent basis to get access to new grants or new funding. In fact, social finance wants to address that head on. Social finance wants to be able to move away from those short-term contracts.⁶³

Some witnesses noted that social finance can be used to encourage and support social innovation. For example, Bruce Dewar of LIFT Philanthropy Partners stated that: "[s]ocial finance has an enormous potential to encourage social innovation in our country, by creating new opportunities for investors and social purpose organizations, or SPOs, to partner in innovative projects and take their great ideas to scale at a new level across this country."⁶⁴

60 HUMA, *Evidence*, 41st Parliament, 2nd Session, 26 March 2015, 1600 (Sunil Johal, Policy Director, University of Toronto, Mowat Centre).

61 HUMA, *Evidence*, 2nd Session, 41st Parliament, 12 May 2015, 1705 (Jean-Pierre Voyer).

62 HUMA, *Evidence*, 2nd Session, 41st Parliament, 17 February 2015, 1540 (Siobhan Harty).

63 Ibid., 1545.

64 HUMA, *Evidence*, 2nd Session, 41st Parliament, 24 February 2015, 1530 (Bruce Dewar, President and CEO, LIFT Philanthropy Partners).

In addition, Tim Richter of the Canadian Alliance to End Homelessness highlighted the potential of SIBs in particular to fund “newer or emerging interventions or when an intervention is applied to a government system for the first time and where risk can be transferred to the investor.”⁶⁵ Similarly, Kieron Boyle noted that, in the experience of the U.K. Government, SIBs had been used as “a way of bringing innovation into the system, of essentially testing out ideas that they have a broad sense might work but not an absolute sense” and as “a way of financing upfront interventions paid for by savings down the line, and essentially see this as the tool to enable them to do early intervention.”⁶⁶

Notwithstanding its potential benefits, some witnesses expressed scepticism about the potential of social finance instruments to fund social innovation in all circumstances. For example, commenting on outcomes-based financing models in particular, David Juppe noted that incentives built in to the model might actually discourage innovation:

Because of this concept of a performance-based return on investment, I think rather than encouraging innovation, social impact bonds or pay for success will actually encourage a flight to quality. Investors are going to want to see programs that work and programs that are successful.⁶⁷

Concern was also expressed by Marie-France Kenny of the Fédération des communautés francophones et acadienne du Canada, who noted that private capital may not as effectively take into account the needs of minority communities, and that “[m]inority francophone and Acadian communities don’t have access to as large of a funding pool as majority communities.”⁶⁸

65 HUMA, *Evidence*, 2nd Session, 41st Parliament, 26 March 2015, 1640 (Tim Richter, President and Chief Executive Officer, Canadian Alliance to End Homelessness).

66 HUMA, *Evidence*, 2nd Session, 41st Parliament, 28 April 2015, 1600 (Kieron Boyle).

67 HUMA, *Evidence*, 2nd Session, 41st Parliament, 12 May 2015, 1545 (David Juppe).

68 HUMA, *Evidence*, 2nd Session, 41st Parliament, 23 April 2015, 1540 (Marie-France Kenny, President, Fédération des communautés francophones et acadienne du Canada).

CHAPTER TWO: BUILDING A REGULATORY FRAMEWORK FOR SOCIAL FINANCE

Charities and non-profit organizations are important actors in the social service sector whose ability to engage in market-based activities (e.g. invest and earn profits) is directed by federal taxation legislation and regulations. In particular, the federal government has authority over the taxation benefits of non-profit organizations and charities under the *Income Tax Act* (ITA).⁶⁹ Some of the federal rules governing non-profits and charities are included in the ITA and its regulations, while others flow from Canada Revenue Agency (CRA) policy.

Commenting on the current taxation rules with respect to charities, government officials noted that the ITA “aims to strike a balance between allowing charities to engage in business activities ... as a source of revenue while ensuring that charities ultimately remain focused on their charitable purposes and activities.”⁷⁰

However, some witnesses observed that the activities of social finance, which blend charitable/non-profit and private sector activities, are not accurately reflected in current taxation regulations. For those charities and non-profit organizations that wish to engage in entrepreneurial and social finance activities, these rules may, in some cases, act as a barrier to these activities. As Sarah Doyle of the MaRS Discovery District noted:

This is primarily about regulations and guidance that originate from the *Income Tax Act*, which we would view as being somewhat out of date. They don't take into account the value of these emergent trends of social entrepreneurship and impact investment.⁷¹

Witnesses identified four key aspects of current taxation law and policy as potential barriers to the growth of entrepreneurial and social finance activity among charities and non-profit organizations. Each of these issues is discussed below, along with a brief explanation of the current taxation rules that apply to registered charities and non-profit organizations.

A. Carrying on a Related Business

The ITA recognizes three types of charities: private foundations, public foundations, and charitable organizations. Two types of charities – public foundations and charitable organizations – are permitted to conduct business activities under certain conditions but, as will be described in a later section of this report, private foundations are not permitted to conduct any business activities.

69 *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.).

70 HUMA, *Evidence*, 2nd Session, 41st Parliament, 14 May 2015, 1535 (Miodrag Jovanovic, Director, Personal Income Tax, Tax Policy Branch, Department of Finance).

71 HUMA, *Evidence*, 2nd Session, 41st Parliament, 19 February 2015, 1540 (Sarah Doyle, Senior Policy Advisor, MaRS Discovery District).

The ITA states that charitable organizations and public foundations can lose their registration if they carry on “a business that is not a related business of that charity.”⁷² Charitable organizations and public foundations may therefore, by implication, carry on a “related business” without risk of losing their tax exempt status.⁷³ The CRA defines a “related business” as either a business that is “linked to a charity’s purpose and subordinate to that purpose,” or a business that is “run substantially by volunteers” (which may or may not be related to the charity’s purpose).⁷⁴ As Stanley Hartt explained:

A hospital can run a gift shop or a parking lot and apply their revenues to the hospital’s budget, but it would run afoul of our laws if the commercial activity were more substantial or ambitious, even if the proceeds were all expressly directed to the good works for which the charity was founded.⁷⁵

The Committee heard that there is no limit to the revenues that a public foundation or a charitable organization can raise through a related business.⁷⁶ However, the restrictions on the business activities of public foundations and charitable organizations may, by their nature, limit the amount of revenue that can be generated by these charities.

An official of the Department of Finance indicated that, with the exception of private foundations, charities that wish to engage in *unrelated* business can establish a separate entity – usually a corporation – that would then carry out the unrelated business, provided there is a clear separation between the income generated by the separate entity and the charity.⁷⁷ The income generated by the separate corporation would be taxed, but up to 75% of said income could be sent back to the charity to support its charitable activities.⁷⁸

The Committee heard that some charities establish separate legal entities in order to carry on unrelated business activities to generate profits for a charitable purpose. For example, Éric Hébert-Daly of the Canadian Parks and Wilderness Society described the legal requirements for his organization to purchase a profit-generating building:

The kind of model that I’m talking to you about, the idea of a building, means that you have to end up creating a for-profit corporation that gives 100% of its profits, essentially, to the charity as a gift. It’s a bit of an odd model, but that’s what it ends up having to be in order to make it easy for a charity, for example, to be able to carry out a profit-making venture. There are probably places around charities, in terms of the *Income Tax Act* and

72 *Income Tax Act*, sections 149.1(2)(a) and 149.1(3)(a).

73 Private foundations, the third possible designation for charities, are not allowed to carry on any business activity. They are discussed in the following section.

74 Canada Revenue Agency, *What is a Related Business?*, Policy Statement CPS-019, 31 March 2003 and Canada Revenue Agency, *Summary Policy, CSP-R05, Business Activity*, 25 October 2002.

75 HUMA, *Evidence*, 2nd Session, 41st Parliament, 19 February 2015, 1545 (Stanley Hartt).

76 HUMA, *Evidence*, 2nd Session, 41st Parliament, 14 May 2015, 1620 (Cathy Hawara, Director General, Charities Directorate, Legislative Policy and Regulatory Affairs Branch, Canada Revenue Agency).

77 HUMA, *Evidence*, 2nd Session, 41st Parliament, 14 May 2015, 1535 (Miodrag Jovanovic).

78 *Ibid.*, 1600.

other places, where there could be ways to break down some of those barriers so that charities can actually make that work.⁷⁹

Given the limitations on the scope of business activities in which charities can engage, and noting that a lack of clarity in the application of the tax rules has held back the development of social finance among charities, some witnesses suggested that taxation rules should allow charities to engage in business activities without jeopardizing their registered status under the ITA. While these witnesses acknowledged that allowing tax-exempt charities to do business could create an unfair competitive advantage, they maintained that such concerns could be addressed by taxing the business activities of charities above a certain threshold. Sarah Doyle suggested that federal tax rules should allow charities and non-profits (discussed below) to engage in greater business activities:

[W]e think that charities and a subset of non-profits that have clear public benefit objectives should be allowed to engage in any kind of business activity without fear of penalty. We further think that some of those activities should be tax-exempt and some should be subject to income tax in order to deal with potential concerns about unfair competitive advantage.⁸⁰

Some witnesses suggested in particular that federal legislation allow for a “hybrid” (i.e., for-profit and non-profit) corporation with a social purpose that would be taxable under certain conditions. Stanley¹ Hartt, for example, suggested “a hybrid standard whereby business activities beyond those currently tolerated by our system would be taxed, subject to certain *de minimis* rules, but the charity would not be exposed to losing its registered status.”⁸¹

B. Investing in Limited Partnerships

As noted above, while charitable organizations and public foundations may carry on a “related business,” the ITA bars private foundations from carrying on “any business.”⁸² The CRA states that “[a] charity that becomes a limited partner in a partnership is carrying on a business and is not simply making an investment, even though the charity plays no active role in the business.”⁸³

Consequently, private foundations cannot hold an interest in a partnership, and few charitable organizations and public foundations are in a position to hold interests in a limited partnership because they can only engage in related businesses. Limited

79 HUMA, *Evidence*, 2nd Session, 41st Parliament, 31 March 2015, 1605 (Éric Hébert-Daly, National Executive Director, National Office, Canadian Parks and Wilderness Society).

80 HUMA, *Evidence*, 2nd Session, 41st Parliament, 19 February 2015, 1540 (Sarah Doyle).

81 HUMA, *Evidence*, 2nd Session, 41st Parliament, 19 February 2015, 1545 (Stanley Hartt).

82 *Income Tax Act*, section 149.1(4)(a).

83 Canada Revenue Agency, *What is a Related Business?*, Policy Statement CPS-019, 31 March 2003. See also Canada Revenue Agency, *Private Foundations and Investment Portfolios*, Policy Commentary CPC-023, 1 August 2002.

partnerships are used as investment vehicles to pool funding, but also to structure social impact investments.⁸⁴

The Committee heard that the rules on limited partnerships precluded charities from making investments in social enterprises that are limited partnerships. Witnesses from private foundations and other investors in particular expressed concern about this restriction and suggested that charities should be allowed to make such investments. For example, Stephen Huddart of The J. W. McConnell Family Foundation noted:

I think the first thing is that it would be very helpful to clarify the regulatory environment here. This field is moving very slowly, because a lot of obstacles are there. I'll mention one, which is the limited partnership rule. That, I can tell you, has prevented us from getting involved in or seeing develop a number of very promising initiatives because people just don't understand, and they can't afford the necessity of building a trust structure to allow an impact investment to be made.⁸⁵

In Budget 2015, the federal government announced its intention to permit charities to invest in limited partnerships in order to allow charities to diversify their investment portfolios and to engage in social impact investments.⁸⁶ Specifically, the proposal is to amend the ITA such that a charity will not automatically be considered to be carrying on a business, solely because it invests in a limited partnership.⁸⁷ The investment would need to remain a passive one: the measure would only apply if the charity holds 20% or less of the interest in the limited partnership, and if the charity deals at arm's length with the partners of the limited partnership.⁸⁸

Finance officials further explained that, since there are many social impact investments that are structured as limited partnerships, this proposed measure has the potential to make additional funds available for social enterprise projects in Canada.⁸⁹ Adam Spence, testifying shortly after the announcement was made, stated that "[w]e certainly welcome the recent announcement allowing foundations to invest in limited partnerships. It is a good first step toward reducing these limits."⁹⁰

C. Program-Related Investments

Program-related investments (PRIs) are non-conventional investments made with the goal of furthering a charitable purpose, and do not necessarily yield a market rate of return. A witness from the CRA indicated that charities can make PRIs in non-profit

84 *Budget 2015*, 21 April 2015, p. 455.

85 HUMA, *Evidence*, 2nd Session, 41st Parliament, 24 February 2015, 1605 (Stephen Huddart, President and Chief Executive Officer, The J. W. McConnell Family Foundation).

86 *Budget 2015*, 21 April 2015, p. 271.

87 Ibid. pp. 496-97 (Notice of Ways and Means Motion to Amend the *Income Tax Act* and other Tax Legislation).

88 Ibid., p. 455.

89 HUMA, *Evidence*, 2nd Session, 41st Parliament, 14 May 2015, 1540 (Miodrag Jovanovic).

90 See for example HUMA, *Evidence*, 2nd Session, 41st Parliament, 28 April 2015, 1645 (Adam Spence).

organizations or private business through the purchase of shares, loans, loan guarantees, or leases of lands and buildings.⁹¹

Witnesses, foundations in particular, discussed the limitations around the possibility of making below market-rate investments, or PRIs. While one witness mentioned that the government's recognition that PRIs can serve to meet required disbursements quotas (the minimum amount a charity is required to spend on its own charitable programs or on gifts to qualified donees)⁹² was helpful,⁹³ another witness suggested that the PRI environment is still murky and requires further clarity.⁹⁴ According to Ian Bird of the Community Foundations of Canada, PRIs are still a barrier that members of his organization face.⁹⁵

Adam Spence of SVX, which operates out of the MaRS Centre for Impact Investing indicated that foundations need to be able to make below market-rate investments in order to advance their charitable objectives:

We certainly welcome the recent announcement allowing foundations to invest in limited partnerships. It is a good first step toward reducing these limits. We also believe foundations should be allowed to make below-market rate investments, where appropriate, to advance their charitable objectives, ensuring no part of these investments, or any associated opportunity costs, would be considered as gifts to non-qualified donees. These kinds of investments at below-market rate are needed.

Early-stage social enterprises or non-profit organizations seeking capital may not be able to offer risk-adjusted market returns. Many of these kinds of social finance arrangements require capital with different risk and return expectations for different investors. For example, a foundation might take a first-loss position in a fund or infrastructure project to leverage additional capital.⁹⁶

A new guidance was issued by the CRA in July 2012 entitled *Community Economic Development Activities and Charitable Registration*.⁹⁷ In the Guidance, the CRA broadened the context in which charities can engage in PRIs. Whereas a prior guidance limited PRIs to qualified donees (i.e., mostly other charities), the new guidance indicates that charities can engage in PRIs involving non-qualified donees as well. In such cases, however, the PRI must be towards a "program over which the investor charity maintains ongoing direction and control, so that the program is the investor charity's own activity."⁹⁸

91 Canada Revenue Agency, *Community Economic Development Activities and Charitable Registration*, Policy Guidance CG-014, 26 July 2012; HUMA, *Evidence*, 2nd Session, 41st Parliament, 14 May 2015, 1545 (Cathy Hawara).

92 Canada Revenue Agency, *Charities and giving glossary*.

93 HUMA, *Evidence*, 2nd Session, 41st Parliament, 24 February 2015, 1620 (Stephen Huddart).

94 HUMA, *Evidence*, 2nd Session, 41st Parliament, 19 February 2015, 1600 (Ian Bird, President, Chief Executive Officer, Community Foundations of Canada).

95 Ibid., 1635.

96 HUMA, *Evidence*, 2nd Session, 41st Parliament, 28 April 2015, 1645 (Adam Spence).

97 Canada Revenue Agency, *Community Economic Development Activities and Charitable Registration*, Policy Guidance CG-014, 26 July 2012.

98 Ibid.

D. Generating a Profit

Non-profit organizations are defined under the ITA as “a club, society or association” that is not a registered charity and is “organized and operated exclusively for social welfare, civic improvement, pleasure or recreation or for any other purpose except profit,” and whose income (with a narrow exception) is not “payable to, or ... otherwise available for the personal benefit of, any proprietor, member or shareholder thereof...”⁹⁹

As the above definition indicates, in order to be considered a non-profit organization under the ITA, and thus qualify for a tax exemption, the organization must be exclusively organized and operated for an objective other than profit.¹⁰⁰ The CRA states that non-profit organizations may make profits that are “incidental and arise from activities that are undertaken to meet the organization’s non-profit objectives.”¹⁰¹

The Committee heard that current tax code requirements do not allow non-profit organizations to generate revenues for the purpose of saving or re-investing back into their organization. Cathy Taylor of the Ontario Nonprofit Network told the Committee:

Current interpretation of the *Income Tax Act* prevents non-profit organizations from generating revenue – not creating profit, but generating revenue that they can put back into their mission as part of their organization – as well as maintaining cash reserves.¹⁰²

Jeffrey Cyr expressed similar concerns:

I'm a not-for-profit organization. I can't maintain a profit and I can't put it back in under the current tax rules governing not-for-profits. I have to come out with a zero balance every year. I have a \$49-million budget. Coming out with a zero balance is tricky business sometimes....

[W]e need to have a way to invest back into those community-based organizations so that they can generate revenue and use it for social good. Otherwise, we get trapped in our own financial systems. That's where social finance can come in handy.

I think there's work here within the federal government and CRA that needs to be done.¹⁰³

Ms. Taylor suggested that the ITA be interpreted to provide that “[r]evenue that is reinvested in the mission of the organization is not profit.”¹⁰⁴ Furthermore, in their written submission to the Committee, the Credit Union Central of Canada recommended that the ITA should be clarified to allow non-profits with a clear social and/or environmental purpose to generate significant revenues from business activities not directly related

99 *Income Tax Act*, section 149(1)(l). See also HUMA, *Evidence*, 2nd Session, 41st Parliament, 14 May 2015, 1540 (Cathy Hawara).

100 HUMA, *Evidence*, 2nd Session, 41st Parliament, 14 May 2015, 1540 (Cathy Hawara).

101 Canada Revenue Agency, *Non-Profit Organization Risk Identification Project Report*, February 2014.

102 HUMA, *Evidence*, 2nd Session, 41st Parliament, 24 February 2015 (Cathy Taylor, Executive Director, Ontario Nonprofit Network).

103 HUMA, *Evidence*, 2nd Session, 41st Parliament, 31 March 2015, 1610 (Jeffrey Cyr).

104 HUMA, *Evidence*, 2nd Session, 41st Parliament, 24 February 2015, 1640 (Cathy Taylor).

to their core mission, if such revenues are used to advance said core mission.¹⁰⁵ Currently, and as noted above, the ability of non-profits to generate a profit is restricted to revenues that are incidental and arise from "activities that support the organization's not-for-profit objectives."¹⁰⁶ According to the Credit Union Central, such measures would have a positive impact:

By allowing non-profits to have a supporting and independent revenue stream these organizations will be better funded and in a stronger position to demonstrate to credit unions and other lenders that they can, for example, repay a loan at regular intervals or leverage assets to provide security for a loan.¹⁰⁷

As with the tax rules governing charities, some witnesses suggested that the creation of a hybrid or dual purpose corporation at the federal level could benefit non-profit organizations seeking to expand their business activities. Stephen Huddart noted that this hybrid model has been applied in other jurisdictions, including within Canada:

The key point is to allow a corporate vehicle to exist which is a hybrid, for-profit and not-for-profit corporation, and which can have share capital, but has a social purpose. That's one recommendation that has been put in place in several countries. Indeed, even in Canada, in Nova Scotia and British Columbia, we have this type of corporation that is able to attract capital for a social purpose.¹⁰⁸

However, noting that other types of initiatives might better facilitate the business activities of charities and non-profits, Ms. Taylor stated:

[W]e would encourage you to wait and see, around the concept of a dual purpose or hybrid corporate legislation at this time. There's so much else that will provide more return for the time invested. We have new corporate legislation for the non-profit sector at the federal level. Many provincial governments are adopting new legislation for their non-profit sector at the provincial level. Quite frankly, the last thing we need right now is another piece of legislation to try to figure out what that dual purpose or hybrid piece looks like.¹⁰⁹

105 HUMA, *Submission to the House of Commons Standing Committee on Human Resources, Skills and Social Development and the Status of Persons with Disabilities*, Brief submitted by the Credit Union Central of Canada, 23 April 2015.

106 Canada Revenue Agency, *Non-Profit Organization Risk Identification Project : Questions and answers*.

107 Ibid.

108 HUMA, *Evidence*, 2nd Session, 41st Parliament, 24 February 2015, 1620 (Stephen Huddart).

109 HUMA, *Evidence*, 2nd Session, 41st Parliament, 24 February 2015, 1635 (Cathy Taylor).

CHAPTER THREE: MEASURING SOCIAL IMPACT

As social finance is broadly aimed at improving social outcomes, evidence and measurement of such outcomes will play an important part of any social finance project moving forward. The Committee heard that proper measurement of social outcomes and a strong evidence base are essential to the implementation of social finance tools, and could ultimately lead to more effective social programming. However, as will be outlined below, witnesses also described difficult challenges associated with developing appropriate metrics and evaluating the outcomes generated by social finance interventions.

A. Improving Social Outcomes

Siobhan Harty indicated that rigorous use of metrics to determine whether the agreed upon outcomes are achieved is essential to ensure effective use of resources and accountability when using public funds.¹¹⁰ Furthermore, when accompanied by the appropriate metrics and evaluation methods, focusing on social outcomes could lead to a better idea of which interventions and programs work.¹¹¹

With regard to the measurement currently taking place in ESDC, Ms. Harty indicated that ESDC has the data and the skill set to measure outcomes, and that such a measurement model could be applied in other sectors without necessitating an important increase in resources.¹¹² In addition, with regard to the Department's potential for future action on outcomes measurement, Ms. Harty emphasized the following:

[F]or instance, in my directorate we do poverty measurement. We measure labour market outcomes ... We have a research function that allows us to determine what the risk factors are for somebody who might have a poor labour market outcome, what the risk factors are for a young adult who's going to drop out of high school or post-secondary education. There's a large body of research in this country and internationally that would allow us to measure those things.¹¹³

Witnesses also indicated that there would be value in knowing when programs are not successful, or whether any change has occurred, in order to determine the extent of additional resources needed.¹¹⁴

Notwithstanding the value of measuring outcomes, the Committee heard that there are particular challenges associated with doing so. Some witnesses noted that social

110 HUMA, *Evidence*, 2nd Session, 41st Parliament, 17 February 2015, 1530 (Siobhan Harty).

111 HUMA, *Evidence*, 2nd Session, 41st Parliament, 19 February 2015, 1610 (Sarah Doyle).

112 HUMA, *Evidence*, 2nd Session, 41st Parliament, 14 May 2015, 1605 (Siobhan Harty).

113 Ibid.

114 See for example HUMA, *Evidence*, 2nd Session, 41st Parliament, 31 March 2015, 1620 (Jeffrey Cyr).

outcomes take more time to measure than program outputs, and require shifting perspective toward the longer term.¹¹⁵ Mr. Jeffrey Cyr remarked that:

There are a ton of indicators you can measure all across the board, everything from increased economic participation and better schooling to how [clients] adjust in society. There are ways. It's not rocket science to do it, but it takes a lot of effort and you have to build systems very thoughtfully at the outset.¹¹⁶

To illustrate the challenges associated with measuring outcomes, Mr. Cyr spoke of a leadership program and the complexity of determining whether the program has in fact created a leader. He observed that the measurement of these types of outcomes is difficult in the relatively short term of a typical government cycle. He expressed the need for a longitudinal measurement system, one that would establish the short-, medium- and long-term changes that are targeted.¹¹⁷ Of a similar view, Tim Richter indicated that measuring outcomes would require tracking individuals over time to determine whether or not they fell back into homelessness.¹¹⁸

Although discussing SIBs particularly, Professor John Shields outlined the importance of measuring outcomes over outputs, as well as the significant investment associated with such measurement:

Data is, I think, absolutely critical. To know if they're [SIBs] going to be effective or not, we're going to need substantial data. That means, obviously, far more than counting bums in seats. It means actually using statistics from organizations like Stats Canada, being able to attach those to projects, trying to evaluate the outcomes of things like recidivism within the larger context of other factors happening within society. This requires, I think, some significant type of investment, in terms of the analysis and the importance of evidence-based data. That is a challenge with SIBs, but I think it's a challenge more generally in terms of evaluating the outcomes of programs.¹¹⁹

Echoing these concerns, James Mulvale of the University of Manitoba suggested that governments instead draw on existing research to develop evidence-based approaches and improve the current public finance model.¹²⁰

115 HUMA, *Evidence*, 2nd Session, 41st Parliament, 24 March 2015, 1620 (Bill Crawford, Executive Director, Eden Community Food Bank); and HUMA, *Evidence*, 2nd Session, 41st Parliament, 31 March 2015, 1615 (Jeffrey Cyr).

116 HUMA, *Evidence*, 2nd Session, 41st Parliament, 31 March 2015, 1620 (Jeffrey Cyr).

117 Ibid. 1615.

118 HUMA, *Evidence*, 2nd Session, 41st Parliament, 26 March 2015, 1715 (Tim Richter). A similar example was given by Jeffrey Cyr regarding the need to track people's lives to show certain types of outcomes: HUMA, *Evidence*, 2nd Session, 41st Parliament, 31 March 2015, 1615 (Jeffrey Cyr).

119 HUMA, *Evidence*, 2nd Session, 41st Parliament, 23 April 2015, 1715 (John Shields).

120 HUMA, *Evidence*, 2nd Session, 41st Parliament, 26 May 2015, 1545 (James Mulvale, Dean and Associate Professor Faculty of Social Work, University of Manitoba).

Witnesses also noted that focusing on social outcomes requires an appreciation of qualitative impacts, in addition to strictly quantitative results, which may be more difficult to demonstrate in terms of returns to investors.¹²¹

In an attempt to address these measurement challenges, some witnesses suggested that social finance initiatives should target projects that generate outcomes more susceptible to measurement, such as “[f]inding work for otherwise unemployable people, preventing recidivism, housing people who would otherwise be unhoused.”¹²² However, as Andrew McNeill of the National Union of Public and General Employees argued, most social problems are influenced by many factors, making it hard to determine whether a specific program has had the desired social impact.¹²³

Indeed, even with outcomes that are susceptible to measurement, causal relationships are often difficult to establish. As Sharon Mayne Devine of the Honourable William G. Davis Centre for Families explained, while one can measure the number of murders in a given region where a safe centre exists for victims of violence, it is difficult to assess whether it is the presence of the safe centre that directly contributed to preventing the crimes. Obtaining such data would require significant resources.¹²⁴

The Committee heard that all parties to a social finance project should be involved in deciding which outcomes to measure.¹²⁵ Once outcomes are agreed upon, some witnesses indicated that evaluating whether outcomes are achieved would best be done by an independent third party.¹²⁶

The Social Research and Demonstration Corporation (SRDC), a non-profit independent social policy research organization, is an example of such a third party. As noted previously, ESDC contracted SRDC to be an independent evaluator on two social finance essential skills training projects, where “private investors pay for the training up front and are repaid by the government if the training is successful in achieving pre-established outcomes.”¹²⁷ As the evaluator, SRDC designed the evaluation, but involved the proponents and intermediaries of the projects from the outset. Benchmarks were determined based on evidence from previous essential skills training programs.¹²⁸

The projects evaluated by SRDC illustrate the challenges in measuring social outcomes. In the above skills training projects, repayment is triggered based on gains in

121 HUMA, *Evidence*, 2nd Session, 41st Parliament, 26 March 2015, 1615 (Sunil Johal).

122 HUMA, *Evidence*, 2nd Session, 41st Parliament, 19 February 2015, 1620 (Stanley Hartt).

123 HUMA, *Evidence*, 2nd Session, 41st Parliament, 12 March 2015, 1530 (Andrew McNeill).

124 HUMA, *Evidence*, 2nd Session, 41st Parliament, 23 April 2015, 1625 (Sharon Mayne Devine, Chief Executive Officer, The Honourable William G. Davis Centre for Families).

125 HUMA, *Evidence*, 2nd Session, 41st Parliament, 17 February 2015, 1550 (Siobhan Harty).

126 Ibid., 1555.

127 HUMA, *Evidence*, 2nd Session, 41st Parliament, 12 May 2015, 1630 (Jean-Pierre Voyer).

128 HUMA, *Evidence*, 2nd Session, 41st Parliament, 12 May 2015, 1715 (Sheila Currie, Principal Research Associate, Social Research and Demonstration Corporation).

literacy skills, measured before and after training. The gains in literacy skills are used as a proxy for labour market outcome success. These gains in literacy are intermediate outcomes, and not directly associated with measurable cash savings to government.¹²⁹

B. Developing Appropriate Metrics

Metrics are tools to define and measure the outcomes sought. The Committee heard that they are “critical to success and ... they need to be identified from the start and must show value or savings to government.”¹³⁰

According to witnesses from the Mowat Centre, the evidence base currently available to actors in the social finance marketplace is a patchwork at best. They indicated that a valuable role for government would be to “invest in better evidence and measurement to support promising opportunities for program innovation and support the long-term development of evidence-based policies.”¹³¹

Tools to measure social impact, and specifically the ability to ensure that they remain constant, were identified as a challenge by an official of the Saskatchewan government.¹³² Adam Spence explained the assessment of impact as having three components: a standard of impact, a plan for improvement, and appropriate metrics:

I think, secondly, beyond the standard there's also having metrics, reportable metrics, or data points that are going to be able to demonstrate the change that exists among the enterprises and organizations that you're working with. There are taxonomy or translation devices, including the impact reporting and investment standards of the global impact investing network, which can be used in this regard. There are many local examples that have been generated by Canadian enterprises and non-profit organizations.¹³³

Some witnesses described the tools they have developed to measure the impacts generated by their work. For example, Vickie Cammack of Planned Lifetime Advocacy Network and Tyze Personal Networks told the Committee that her organization looks at “measuring the individual's experience, their outcomes, and the economic efficiency of the application. Those three pieces are really key.”¹³⁴ Jeffrey Cyr shared with the Committee that they have created a system where they proceed to a 20-minute intake session with a client to measure where they stand on a given outcome – in that particular case, public speaking and engagement – using various indicators. This short intake can be repeated at different points in time to measure change.¹³⁵ In addition, Preston Aitken of Enactus Canada explained:

129 HUMA, *Evidence*, 2nd Session, 41st Parliament, 12 May 2015, 1635 (Jean-Pierre Voyer).

130 HUMA, *Evidence*, 2nd Session, 41st Parliament, 12 May 2015, 1530 (Dale McFee).

131 HUMA, *Evidence*, 2nd Session, 41st Parliament, 26 March 2015, 1530 (Sunil Johal).

132 HUMA, *Evidence*, 2nd Session, 41st Parliament, 12 May 2015, 1530 (Dale McFee).

133 HUMA, *Evidence*, 2nd Session, 41st Parliament, 28 April 2015, 1655 (Adam Spence).

134 HUMA, *Evidence*, 2nd Session, 41st Parliament, 26 February 2015, 1700 (Vickie Cammack, Founding Chief Executive Officer of Tyze Personal Networks and Co-Founder, Planned Lifetime Advocacy Network).

135 HUMA, *Evidence*, 2nd Session, 41st Parliament, 31 March 2015, 1620 (Jeffrey Cyr).

As an organization, we have implemented our own standardized metrics using research on such existing frameworks as IRIS and the sustainable livelihoods model. That has been invaluable, as we now have a common framework and language for our Enactus teams to show our impact. We can aggregate and better understand our data nationally. However, these standards do not necessarily align with other organizations, as there are no common standards.¹³⁶

In addition to metrics related to the immediate users of a given social finance project, measuring broader community impact can be challenging for organizations. Ms. Devine spoke of the difficulty of measuring large-scale impact for an entire community:

When we look at larger-scale impacts, for a very large community, it's a challenge to measure some of those impacts. Doing that kind of impact study also requires dollars and investments of money. Sometimes we're asked to do that measuring, on the one hand, but we're not given the resources we would need to actually do the kind of study or the kind of work we need to do in order to demonstrate that impact. On the micro-level, we can demonstrate it. At a larger community-based level, we're just now beginning to be able to do that.¹³⁷

Some witnesses stated that common standards or a universal measurement mechanism for measuring and reporting social impact in Canada would be necessary. Such a national standard for measurement would, the Committee heard, allow for impact comparison on a common baseline throughout the country.¹³⁸

Witnesses also made reference to the United Kingdom's Unit Cost Database, which provides the "cost" for taxpayers of over 600 social outcomes. As Tim Jackson explained:

The United Kingdom has posted on its cabinet office website the cost of 600 outcomes, everything from how much it costs to keep a single mother together with her child, to how much it costs to incarcerate a 16-year-old, to how much it costs to incarcerate a 45-year-old for the third time. They've essentially said to the private sector and to foundations, "Here is what we think it costs the taxpayers. If you can do it more cheaply, make us an offer on a bond."¹³⁹

Some witnesses suggested that the federal government could play a similar role in Canada by providing uniform information about the monetary value of such outcomes. Knowing the costing structure of social outcomes would allow stakeholders interested in the social finance marketplace to assess the monetary value of a given intervention in terms of cash savings to the government.¹⁴⁰

136 HUMA, *Evidence*, 2nd Session, 41st Parliament, 26 February 2015, 1645 (Preston Aitken, Director, Programs, Enactus Canada).

137 HUMA, *Evidence*, 2nd Session, 41st Parliament, 23 April 2015, 1625 (Sharon Mayne Devine).

138 HUMA, *Evidence*, 2nd Session, 41st Parliament, 26 February 2015, 1645 (Preston Aitken); HUMA, *Evidence*, 2nd Session, 41st Parliament, 24 March 2015, 1545 and 1620 (Bill Crawford); HUMA, *Evidence*, 2nd Session, 41st Parliament, 24 February 2015, 1625 (Wayne Chiu, Chief Executive Officer, The Trico Group).

139 HUMA, *Evidence*, 41st Parliament, 2nd Session, 19 February 2015, 1615 (Tim Jackson).

140 HUMA, *Evidence*, 2nd Session, 41st Parliament, 10 March 2015, 1605 (Sandra Odendahl), and HUMA, *Evidence*, 41st Parliament, 2nd Session, 19 February 2015, 1615 (Tim Jackson).

The Committee heard that such outcomes-based values are particularly useful in the context of creating SIB agreements. For example, Kieron Boyle described how the U.K. Government had applied outcomes-based metrics to assess the costs and progress of a recently established £30 million social impact bond aimed at preventing youth unemployment. With respect to establishing the cost of the intervention, Mr. Boyle explained that:

What it was doing was intervening in youths aged 14 to 17 to improve things like their school attendance and their grades, because we know there's a very high correlation between those sorts of outcomes among those aged 14 to 17 and the risk of somebody becoming unemployed at age 18 to 21.

...

Essentially we have done a lot of data matching to say, if you achieve those sorts of things, what is the likelihood that somebody becomes employed or unemployed at age 18? That's around our knowing how much we save when somebody's employed at 18 versus unemployed at age 18. We've been able to put a price on those outcomes occurring for ages 14 to 17. We then put that out to the market, and predominately social enterprises and social sector organizations have said they can achieve that. The way in which they're achieving it is even in the sorts of ways that you're saying.¹⁴¹

Mr. Boyle further noted that the overall process of defining and evaluating progress toward the achievement of positive outcomes on this SIB is "a strictly and tightly defined process where the public managers will look at the outcomes ... they're trying to achieve proof of those outcomes, and also the amount that they're willing to pay for those outcomes." More specifically, he noted that, "these first social impact bonds that have been set up ... [are] heavily evaluated so they will be spotting the longer term outcomes for these youths."¹⁴²

Finally, David Juppe cautioned against using a "fixed cost per case" when evaluating savings. Based on his research of SIBs, Mr. Juppe advised that such an approach could risk overstating the savings. He provided the example of the fixed cost per year of housing an inmate, which includes both fixed costs for operating the facility, and the variable cost associated with food and supplies for that given inmate.¹⁴³ Preventing an individual from being incarcerated would not save the government the entire fixed cost associated with that individual, since the facility would continue to operate.

141 HUMA, *Evidence*, 41st Parliament, 2nd Session, 28 April 2015, 1610 (Kieron Boyle).

142 Ibid.

143 HUMA, *Evidence*, 2nd Session, 41st Parliament, 12 May 2015, 1545 (David Juppe).

CHAPTER FOUR: BUILDING KNOWLEDGE AND CAPACITY

Many witnesses highlighted the need to build the technical capacity of organizations to participate in social finance as an important issue in the social finance marketplace.¹⁴⁴ The Committee heard that building capacity in the social finance context largely refers to “helping prepare or mak[ing] the investees more investable.”¹⁴⁵ Some witnesses also raised the issue of supporting intermediaries and supply side actors to build capacity in order to better participate in this sector.

Suggested measures to help build capacity were mostly related to supports for social enterprises and service delivery organizations. As Bill Crawford of the Eden Community Food Bank stated:

The bottom line is that social finance in Canada is still relatively unknown. In the non-profit and charitable sectors there would need to be a lot more education on social finance and an easy-to-step-into opportunity for organizations to test the waters; basically more business-minded people with a heart for social development, where business and charity combine, to be able to work together.¹⁴⁶

Funds dedicated to the specific purpose of developing capacity among demand-side actors were raised by several witnesses.¹⁴⁷ Kieron Boyle highlighted two recent programs that the U.K. Government had undertaken in this area, noting that “[t]he demand side is a more crucial area from my perspective in terms of the distinct role government can play, we focus a lot on capacity building, specifically to enable organizations to take on investment.” First, he indicated that an “investment and contract readiness fund”, valued at £15 million, was piloted to provide larger and more established organizations with:

... some ground support to build up the sorts of business models or financial planning or back-office capabilities that would enable an investor to place money into them. For that pilot every £1 of government grant we put in succeeded in unlocking over £27 of private investment, which if nothing else has made it—and I've checked—the most successful U.K. business support program out there.¹⁴⁸

Mr. Boyle also noted that the U.K. Government had supported earlier-stage social ventures through a number of “social incubators”, which he described as “essentially business accelerators that were typically combining public money and then private money,

144 See e.g. HUMA, *Evidence*, 2nd Session, 41st Parliament, 26 March 2015, 1535 (Jamie Van Ymeren, Policy Associate, Mowat Centre). See also HUMA, *Evidence*, 2nd Session, 41st Parliament, 24 February 2015, 1550 (Wayne Chiu); and HUMA, *Evidence*, 2nd Session, 41st Parliament, 24 March 2015, 1615 (Carole Gagnon).

145 HUMA, *Evidence*, 2nd Session, 41st Parliament, 10 March 2015, 1540 (Andy Broderick).

146 HUMA, *Evidence*, 2nd Session, 41st Parliament, 24 March 2015, 1550 (Bill Crawford).

147 HUMA, *Evidence*, 2nd Session, 41st Parliament, 26 March 2015, 1535 (Jamie Van Ymeren).

148 HUMA, *Evidence*, 2nd Session, 41st Parliament, 28 April 2015, 1535 (Kieron Boyle).

often from large corporates, and putting that into accelerated programs for very early stage organizations that were looking to have a social impact.”¹⁴⁹

In Canada, the Committee heard that “what works” centres can be useful in synthesizing and disseminating information on interventions that work. Technical assistance labs were suggested as useful to offer training, advice and support for impact evaluation.¹⁵⁰ As Sunil Johal noted:

If the federal government wants to move into this space, I think it's absolutely critical that it plays a role in providing that critical support of infrastructure in terms of a “what works” centre and technical assistance labs, so that we're not seeing all of these contracts and opportunities going just to the largest [not-for-profit] service provider.¹⁵¹

Debbie Brown of Crossing All Bridges Learning Centre added that while urban centres have fairly well-established social enterprise “hubs” (for example, the MaRS Discovery District), rural hubs are needed for smaller, more isolated communities and their projects. This would help smaller organizations to seek out partnerships and funding.¹⁵²

Some witnesses also identified a need to build capacity among intermediaries and supply side actors in the Canadian social finance market. The Committee heard that there is a need to “create programs that will give social workers business skills and give potential investors social value perspectives.”¹⁵³ In addition, Andy Broderick told the Committee that:

[I]t really is time to begin to focus on how to build the capacity in the sector by gravitating investment around successful groups, groups that have shown the capacity to move money out. Measure it on moving money out and managing money effectively in the same way you would with a private sector intermediary. You really want to build strong intermediaries that have a good track record. They don't exist yet. They're starting to exist, but I think that's of fundamental importance.¹⁵⁴

In an effort to address identified and emerging capacity needs in this area, Budget 2015 committed to implementing a social finance accelerator initiative aimed at helping to develop promising social finance proposals. According to budget documents, ESDC will implement the initiative to help such proposals become investment-ready through “workshops, advisory services, mentorship, networking opportunities and investor introductions.”¹⁵⁵

149 Ibid.

150 HUMA, *Evidence*, 2nd Session, 41st Parliament, 26 March 2015, 1535 (Jamie Van Ymeren).

151 HUMA, *Evidence*, 2nd Session, 41st Parliament, 26 March 2015, 1555 (Sunil Johal).

152 HUMA, *Evidence*, 2nd Session, 41st Parliament, 12 March 2015, 1655 (Debbie Brown).

153 HUMA, *Evidence*, 2nd Session, 41st Parliament, 26 February 2015, 1545 (David LePage, Chair, Social Enterprise Council of Canada).

154 HUMA, *Evidence*, 2nd Session, 41st Parliament, 28 April 2015, 1635 (Andy Broderick).

155 *Economic Action Plan 2015*, p. 271.

Several witnesses observed that there are currently programs geared towards small and medium enterprises that should be made accessible to charities or non-profits. For example, Ian Bird told the Committee:

There's a skilling up, a training up of those organizations so that they're ready to come forward with their business plans. That's fundamentally no different from the kind of thing that goes on all the time right now with small and medium-sized enterprises. There are extensive programs across governments, and as public-private efforts to skill up those small and medium-sized enterprises. Right now charities, public-purpose non-profits, don't have access to those programs.¹⁵⁶

Some witnesses noted that giving charities and non-profit organizations access to existing programs for the private sector would be straightforward, could happen in a short period of time, and would not involve new resources.¹⁵⁷ In addition, David LePage from Social Enterprise Council of Canada noted that many existing programs are not in fact officially closed to non-profits, and mentioned Industry Canada's Canada Business Network as a program that could be expanded.¹⁵⁸ Similarly, Jacques Charest of CAP Finance observed:

... the easiest way is if we consider ourselves businesses and cover all the products and investment support measures intended for private businesses. We often see programs that are for businesses in category 1. Why are they not for NPOs or cooperatives? It's because that's the way things are. There are also programs for the capital and the shares of a company, but since there are none for social economy enterprises, we must find an equivalent.¹⁵⁹

Additionally, the representative for Enactus Canada noted that many post-secondary education institutions are not providing training in the areas of social finance and social entrepreneurship. This witness suggested that programs and initiatives should be put forward to train the future generation of social entrepreneurs and social finance actors.¹⁶⁰

156 HUMA, *Evidence*, 2nd Session, 41st Parliament, 19 February 2015, 1600 (Ian Bird). See also HUMA, *Evidence*, 2nd Session, 41st Parliament, 24 February 2015, 1640 (Cathy Taylor); and HUMA, *Evidence*, 2nd Session, 41st Parliament, 24 February 2015, 1700 (Jacques Charest).

157 HUMA, *Evidence*, 2nd Session, 41st Parliament, 24 February 2015, 1640 (Cathy Taylor); HUMA, *Evidence*, 2nd Session, 41st Parliament, 24 February 2015, 1645 (Michael Toye).

158 HUMA, *Evidence*, 2nd Session, 41st Parliament, 26 February 2015, 1545 (David LePage).

159 HUMA, *Evidence*, 2nd Session, 41st Parliament, 24 February 2015, 1700 (Jacques Charest).

160 HUMA, *Evidence*, 2nd Session, 41st Parliament, 26 February 2015, 1645 (Preston Aitken).

CHAPTER FIVE: DEVELOPING THE SOCIAL FINANCE MARKET

A key consideration for many witnesses was how to generate capital for social finance and build investor confidence in this new market. An important part of this discussion, particularly from witnesses from the supply and intermediary sides of the market, focused on the need to mitigate risks to investors and provide incentives to invest in social finance initiatives.

Many witnesses discussed possibilities surrounding various types of funds (i.e., pools of capital) to encourage impact investment and secure against losses in this new market. Other possible federal actions raised by witnesses included the development of government social procurement practices, and non-financial measures to help improve market information and otherwise mitigate risks to investors. Each of these options for developing the social finance market will be discussed below in turn.

A. Financing and Tax Measures

Witnesses discussed a variety of possible financing instruments in which the federal government could invest to support social finance initiatives, and leverage additional investments from a variety of sources.

In this regard, the Committee heard that various options exist for the federal government to supply capital to encourage the development of the social finance market. Noting the potential role of the federal government in providing “catalytic capital” to support social finance, Adam Spence stated:

The concept is simple: catalytic investments are those that trigger the future flow of capital to a desired company, asset class, sector, or geography. We would recommend that the government establish an impact investing matching program as catalytic capital to support existing and new funds through direct co-investment, credit enhancements, or incentives. In addition, grants may also be required to support the development of intermediaries that would unlock new investment.¹⁶¹

Similarly, Norm Tasevski noted the potential of “catalytic capital funds” to support social finance activities. Under this type of fund, different types of investors (i.e., those focused primarily on social impacts and those focused on financial returns) would invest in the same opportunity at varying levels of risk. As Mr. Tasevski explained:

Catalytic capital structures bring together different categories of investors, what we would call the social first investor and the finance first investor, into the same investment opportunity. One investor category invests capital and agrees to absorb a certain preset level of loss. In doing so other investment groups reduce the risk associated with the overall investment opportunity. Due to the reduced risk an investor group receives a

161 HUMA, *Evidence*, 2nd Session, 41st Parliament, 28 April 2015, 1645 (Adam Spence).

return that is more in line with their risk return expectations, which is typically the market rate.¹⁶²

The Committee heard that Big Society Capital – an independent financial institution in the UK created to make investments in social investment funds – illustrates a policy shift “from [a] government providing large direct investment funds to [a] government setting up a social investment wholesaler that was independent of government.”¹⁶³ Describing the institution as a “wholesale social investment fund”, Mr. Boyle further explained:

The way it predominantly works is by being a cornerstone investor in social investment funds and those social investment funds themselves specialize in certain areas, with different types of lending to different organizations.

...

It's now supported over a hundred front-line organizations. When it was set up there were about eight funds in the U.K. and there are now over 30 of those funds.¹⁶⁴

Big Society Capital was initially capitalized with £600 million, of which £200 million came from four banks, and £400 million came from dormant bank accounts that were transferred to the institution through the passage of legislation.¹⁶⁵ While some witnesses suggested that a similar measure could be implemented in Canada, Stanley Hartt pointed out that dormant bank accounts here are translated into the Consolidated Revenue Fund after 10 years, and so their use to capitalize the social finance market “would represent an actual cost to the government.”¹⁶⁶

The Committee heard that another alternative known as an “outcomes payment fund” has been applied in the U.K. to support outcomes-based finance initiatives. In particular, the U.K. Department for Work and Pensions had established this fund, which prioritizes certain social outcomes and establishes amounts that the government is willing to pay for the achievement of these outcomes. As Sarah Doyle explained:

This is something that was initiated in the U.K. Their Department for Work and Pensions, for example, has created a fund that identifies a set of youth employment outcomes that the government is willing to pay for. It set maximum prices that the government is willing to pay. This type of model can then allow the market to respond with innovative solutions. We think that has strong potential to be replicated in Canada across a range of different issue areas.¹⁶⁷

The U.K. also instituted tax benefits within the social sector in order to encourage more investment of private capital in the social finance market. Mr. Boyle told the Committee that “the majority of the tax benefits that we've advantaged to this area within

162 HUMA, *Evidence*, 2nd Session, 41st Parliament, 10 March 2015, 1645 (Norm Tasevski).

163 HUMA, *Evidence*, 2nd Session, 41st Parliament, 28 April 2015, 1555 (Kieron Boyle).

164 Ibid., 1610.

165 Ibid.

166 HUMA, *Evidence*, 2nd Session, 41st Parliament, 19 February 2015, 1550 (Stanley Hartt).

167 HUMA, *Evidence*, 2nd Session, 41st Parliament, 19 February 2015, 1540 (Sarah Doyle).

the U.K. have actually been about replicating within the social sector the same sorts of tax reliefs that work for purely commercial organizations.” He further noted that “[i]t’s a 30% tax relief on people’s income tax to the same kind of qualifying amount,” and “capital gains and similar other capital losses can be deferred through this tax relief.”¹⁶⁸

Other options for bringing capital into the social finance market were discussed by witnesses. Tim Jackson noted that options for government investment could include matching funds to build on investments from other sources. He suggested that the government could support a “fund-of-funds” arrangement, under which it would make capital available to fund intermediaries, which would in turn make the impact investments:

[W]e think the federal government has a role to play in putting capital to work alongside others’ investment, not doing this alone but being an impetus for others. What do I mean by that? It means that you could follow the example you’ve done on things like the venture capital action plan, what Nova Scotia did with their community economic development investment funds, and what the Government of Canada and the Government of Quebec did with the Chantier de l’économie sociale, where government said they would not be the only player in the marketplace but would match private sector, foundation, or charity financing. You could put in place a matching program, or you could put in place a fund-of-funds program, where you actually provide a significant amount of money that then could go to intermediaries, who would then invest it in the impact investing space.¹⁶⁹

Witnesses also suggested that the federal government support impact investment by providing capital to secure loans made in the social finance arena. Some witnesses asked the federal government to consider supporting “credit enhancement funds” to provide first-loss capital to impact investors. As explained by Sandra Odendahl:

In banking, this [credit enhancement] means guarantees. This is first-loss capital. It basically means backstopping investment money into a sector where you want to see investment. In particular, this is important for de-risking some of the riskier, early-stage-type investing that smaller retail investors, who can’t afford to lose a lot of money but who might want to participate in social finance, might be more inclined to do it if it were somehow backstopped to some extent.¹⁷⁰

Others suggested that existing federal small business financing programs could be expanded to provide loan guarantee investments to support social enterprises as well. For example, Brian Emmett of Imagine Canada told the Committee that he would like to see “the government treat charities and non-profits more as small businesses and be eligible for the small business financing program and the Business Development Bank’s small business loans.”¹⁷¹ Similarly, Magnus Sandberg of Social Capital Partners stated that:

168 HUMA, *Evidence*, 2nd Session, 41st Parliament, 28 April 2015, 1615 (Kieron Boyle).

169 HUMA, *Evidence*, 41st Parliament, 2nd Session, 19 February 2015, 1535 (Tim Jackson).

170 HUMA, *Evidence*, 41st Parliament, 2nd Session, 10 March 2015, 1535 (Sandra Odendahl).

171 HUMA, *Evidence*, 41st Parliament, 2nd Session, 26 February 2015, 1720 (Brian Emmett, Chief Economist, Canada’s Charitable and Nonprofit Sector, Imagine Canada).

[W]e think it would be very, very interesting to explore already existing government programs aimed at the private sector and add a social twist to it. One example is the Canada small business financing program. The government is essentially guaranteeing up to 80% of the loan provided by financial institutions to small and medium-sized organizations that the banks wouldn't necessarily otherwise provide loans to because they're too risky. Imagine if on top of that we add a social twist, whether it's hiring, it's environmental solar panels on the roof of the businesses, or what have you, we think that could be a very interesting model.¹⁷²

B. Social Procurement

Witnesses suggested social procurement as a means through which the government could support social enterprises and help develop the social finance market. The Committee heard that social enterprises need greater access to the demand side: by having access to more customers, they can grow their businesses and increase social impact. In this way, witnesses suggested, social procurement can foster this growth without incurring additional costs to government. As David LePage noted:

Government can create significant social impact at no added cost, no loss of quality, and create a true value and dividend for Canadian taxpayers through social purchasing programs.¹⁷³

François Vermette of the Social Economy Working Group indicated that the tendering process of all levels of government is currently designed in a way that excludes social enterprises.¹⁷⁴ He suggested including “social clauses” within requests for proposals for government contracts and procurement policies in order to foster opportunities to subcontract to social enterprises.¹⁷⁵ Mr. LePage further explained the potential partnerships and positive social outcomes that could be generated by this process:

Now, if there were social policies built into that contract, they would look at opportunities to subcontract to social enterprises that are creating training opportunities in communities across Canada, because all of those government buildings, whether they're in Yellowknife, Quebec, or Toronto, have a lot of different opportunities to engage partners. You have the private sector contractor being able to unbundle and look at social clauses based on a government contract and then working with social enterprises to actually deliver the services, which would result in training. It becomes a government, private sector, and community sector partnership, using social enterprise to meet everyone's needs.¹⁷⁶

Cathy Taylor noted that a “social procurement action plan” would encourage companies who secure government contracts to engage social enterprises and therefore leverage government’s purchasing power to strengthen communities.¹⁷⁷

172 HUMA, *Evidence*, 2nd Session, 41st Parliament, 10 March 2015, 1635 (Magnus Sandberg, Vice-President and General Manager, Social Capital Partners).

173 HUMA, *Evidence*, 2nd Session, 41st Parliament, 26 February 2015, 1545 (David LePage).

174 HUMA, *Evidence*, 2nd Session, 41st Parliament, 26 February 2015, 1550 (François Vermette).

175 Ibid., 1555.

176 HUMA, *Evidence*, 2nd Session, 41st Parliament, 26 February 2015, 1555 (David LePage).

177 HUMA, *Evidence*, 2nd Session, 41st Parliament, 24 February 2015, 1640 (Cathy Taylor).

Finally, Kieron Boyle noted that the development of legislation – known as the *Social Value Act* – has required that public sector “commissioners of services” within the U.K. consider the social value of services, in addition to the economic and short-term cost issues. He further explained that:

... the idea [is] that for many commissioners thinking about value in the round, this often means they're getting better value for money than just a very short-term focus on the cost of a service when commissioning it. We feel that things like that are just as important as these initiatives around crowding in finance.¹⁷⁸

Commenting on a recent review of the U.K. *Social Value Act*, Wayne Chiu of The Trico Group noted that it had found “three barriers to realizing the potential of the act: awareness and take-up are mixed, there is a lack of definition of social value, and measurement of social value is not being developed.” In his view, this indicated a broader need to develop better evaluation methods and evidence of social impacts in this sphere.¹⁷⁹

C. Non-Financial Measures to Support the Social Finance Market

Witnesses appearing before the Committee also identified non-financial measures to build investor confidence in the social finance market. In particular, witnesses noted that the federal government may have a role to play in clarifying rules and expectations around fiduciary duty and due diligence in the social finance context, and in sharing market information among actors and across jurisdictions.

1. Duties of Investors

First, some witnesses from the supply side of the social finance market (e.g., banks, foundations) mentioned the need to clarify expectations around the fiduciary duty incumbent upon institutional investors who are investing in the social finance market. For example, Kieron Boyle noted that “fiduciary duty [and] the responsibilities of trustees, ... and on what basis they are allowed to invest, and what things they can think about other than pure financial returns”¹⁸⁰ are complicated questions in the U.K. as well. In addition, Sandra Odendahl noted that the:

... government can play a role in supply [through] clarifying the fiduciary duty of institutional investors. The way it stands right now is that trustees of pension funds and endowments in Canada, depending on the jurisdiction, are uncertain if they are breaching their fiduciary duty by investing for social impact rather than strictly for returns.¹⁸¹

Sarah Doyle and Ian Bird also indicated that while many impact investments could be considered prudent investments from a traditional financial perspective, others may have significant merit and be in line with a foundation's charitable objectives but may be

178 HUMA, *Evidence*, 2nd Session, 41st Parliament, 28 April 2015, 1540 (Kieron Boyle).

179 HUMA, *Evidence*, 2nd Session, 41st Parliament, 24 February 2015, 1550 (Wayne Chiu).

180 HUMA, *Evidence*, 2nd Session, 41st Parliament, 28 April 2015, 1540 (Kieron Boyle).

181 HUMA, *Evidence*, 2nd Session, 41st Parliament, 10 March 2015, 1535 (Sandra Odendahl).

expected to return less than market rate. They suggested that where there is such an alignment between the investment and the foundation's objectives, foundations should be able to invest at below-market rates.¹⁸²

In addition, some witnesses spoke about the importance of due diligence (financial and social) in the social finance sector. The Committee heard that due diligence in the social enterprise and social finance sector can look quite different than the protocols in place in the private sector, including informal networks. For example, Evan Saugstad of the Northern Development Initiative Trust noted that "[w]hen you get down into your small communities, most of your local politicians know everybody, or they can ask somebody who knows about somebody. We have an incredible unofficial due diligence network."¹⁸³

Magnus Sandberg of Social Capital Partners, a non-profit that plays an intermediary role between the private sector and organizations seeking to place job-seekers with barriers to employment, noted how his organization conducts both social and financial due diligence processes for potential projects. With respect to social due diligence, he explained that his organization seeks to determine, for example, whether the business that seeks to employ individuals with various difficulties would be a good place for candidates to work, whether there are many entry-level positions, if the pay escalation is adequate, and so on.¹⁸⁴

2. Information Sharing

Finally, some witnesses expressed the need for better information sharing and coordinating within the social finance market, and have suggested that the federal government could play an important role in this respect. Departmental officials noted that while direct oversight from the federal government may be challenging given jurisdictional issues, sharing information and lessons learned would be a valuable role for the federal government to play:

The federal government, I think, can play multiple roles, as national governments do, from the perspective of different markets. It might be information sharing; when information doesn't travel, that is a market impediment, so the national level government could certainly share information.¹⁸⁵

David LePage suggested that the federal government could facilitate cross-sector discussions more effectively than single actors from one sector. He noted that "... government is in a unique role to facilitate and encourage, to initiate, and to partner on cross-sector engagement" among government, the private sector, and the community sector. He further recommended that the federal government encourage dialogue among

182 HUMA, *Evidence*, 2nd Session, 41st Parliament, 19 February 2015, 1545 (Sarah Doyle), and 1600 (Ian Bird).

183 HUMA, *Evidence*, 2nd Session, 41st Parliament, 31 March 2015, 1600 (Evan Saugstad, Chair, Northern Development Initiative Trust).

184 HUMA, *Evidence*, 2nd Session, 41st Parliament, 10 March 2015, 1710 (Magnus Sandberg).

185 HUMA, *Evidence*, 2nd Session, 41st Parliament, 17 February 2015, 1620 (Siobhan Harty).

these actors, noting that “[i]f I invite corporations to a table, I might get a response. If the government convenes a meeting, we get a tremendous response.”¹⁸⁶

ESDC’s national call for concepts for social finance was cited as an example of the government’s ability to bring together actors from different sectors. The outcome of this “call for concepts” yielded a report entitled *Harnessing the Power of Social Finance* in May 2013 which helped to build an understanding of social finance.¹⁸⁷ Michael Toye of the Canadian Community Economic Development Network emphasized the importance of a collaborative approach between private sector institutions and community groups and applauded ESDC for its efforts in that direction:

We would commend Employment and Social Development Canada for having created a round table of stakeholders to do just that and we encourage its continuation as the social finance landscape evolves.¹⁸⁸

In keeping with the suggestion that the government could play a coordinating role, Cathy Taylor added that the government has a responsibility to define the concepts relevant to the social finance market, such as the social enterprise. This responsibility would also provide an opportunity to align and coordinate with the provincial governments.¹⁸⁹

The Committee also heard that non-governmental actors can play a role in effective information sharing. Sandra Odendahl of the Royal Bank of Canada spoke of their efforts at “translating” the social finance concepts in order to present them in a language that is familiar to the traditional finance and investment community.¹⁹⁰

186 HUMA, *Evidence*, 2nd Session, 41st Parliament, 26 February 2015, 1545 and 1610 (David LePage).

187 Human Resources and Skills Development Canada, *Harnessing the Power of Social Finance*, Ottawa, May 2013.

188 HUMA, *Evidence*, 2nd Session, 41st Parliament, 24 February 2015, 1645 (Michael Toye).

189 HUMA, *Evidence*, 2nd Session, 41st Parliament, 24 February 2015, 1635 (Cathy Taylor).

190 HUMA, *Evidence*, 2nd Session, 41st Parliament, 10 March 2015, 1600 (Sandra Odendahl).

CONCLUSION

While social finance as a general concept is not new, interest and momentum around social finance has grown around the world in recent years. This is no less true in Canada, where the federal government has developed a variety of social finance initiatives, including the recent budget announcement of a social finance accelerator initiative intended to help develop promising social finance proposals.

In the course of the study, the Committee heard testimony from a variety of stakeholders, including governments, businesses, not-for-profits, charities and foundations involved in developing the body of knowledge and record of experience with social finance in Canada. Many viewed social finance as a potentially important tool in addressing complex societal issues in new and innovative ways, and involving partnerships among a broader set of stakeholders with different skills and expertise.

Testimony from witnesses revealed a general consensus for the potential of social finance to tackle persistent challenges, but varied with regards to the ways in which social finance tools should operate. Their testimony centred around regulatory changes that would allow charities and non-profits greater flexibility to engage in revenue-generating activities, the necessity and challenges of measuring social outcomes using adequate metrics, the need to build capacity within the market, and the government's role – both financial and otherwise – in developing the social finance market.

These are fundamental components of establishing a new and emerging market for social finance in Canada. The Committee believes that many of these issues are worthy of further study and careful consideration in order to establish a solid foundation on which to base social finance initiatives in the future.

The recommendations in this report stem from a range of actors operating within the social finance market, including stakeholders from the demand and the supply sides, as well as the intermediaries. Our recommendations seek to build on the potential associated with social finance mechanisms and address some of the challenges that the witnesses highlighted to the Committee throughout this study. The recommendations provide measures the federal government can undertake in order to establish a stronger foundation for this emerging market.

RECOMMENDATIONS

RECOMMENDATION 1

The Committee recommends that Employment and Social Development Canada build on the work of Canada's National Advisory Board to the G-8 Social Impact Investment Taskforce by creating an advisory panel, involving stakeholders from the public, private, non-profit and charitable sectors, to help define a national strategy on the development of the social finance marketplace in Canada.

RECOMMENDATION 2

The Committee recommends that Employment and Social Development Canada with other departments examine the structure and fund sourcing of catalytic capital funds in other jurisdictions and make recommendations with respect to how such a fund might best be established in Canada.

RECOMMENDATION 3

The Committee recommends that the federal government consider legislative and policy measures, as appropriate, to allow charities greater flexibility to conduct business activities for the purpose of re-investing profits back into their charitable missions.

RECOMMENDATION 4

The Committee recommends that the Department of Finance and the Canada Revenue Agency review current regulations with respect to the profit-generating activities of non-profit organizations, and consider options to allow some non-profits with a clear social purpose to generate surplus revenues in some circumstances.

RECOMMENDATION 5

The Committee recommends that the Department of Finance and the Canada Revenue Agency conduct a review of current policies with respect to program-related investments, with a view to improving the communication and/or clarity of these measures, as necessary.

RECOMMENDATION 6

The Committee recommends that Employment and Social Development Canada work with the provinces and relevant stakeholders to create national guidelines for defining and measuring the impacts of social finance projects in order to ensure reliable and consistent standards for social outcome measurement across Canada.

RECOMMENDATION 7

The Committee recommends that the federal government expand eligibility criteria for existing programs to support small- and medium-sized enterprises, such as Industry Canada's Canada Business Network, to expressly include charities and non-profit organizations working in the field of social finance, where appropriate, and consider the creation of programs aimed at developing the technical capacity of these actors to participate in the social finance market.

RECOMMENDATION 8

The Committee recommends that Employment and Social Development Canada, in collaboration with relevant federal departments and agencies, explore social procurement.

RECOMMENDATION 9

The Committee recommends that Employment and Social Development Canada continue to encourage cross-sector collaboration on social finance by convening regular meetings of stakeholders from the for-profit and the non-profit and charitable sectors, in order to encourage partnership development and to share information and best practices.

APPENDIX A LIST OF WITNESSES

Organizations and Individuals	Date	Meeting
Department of Employment and Social Development Siobhan Harty, Director General Social Policy Directorate, Strategic Policy and Research Branch Blair McMurren, Director Social Innovation, Strategic Policy and Research Branch	2015/02/17	42
Community Foundations of Canada Ian Bird, President Chief Executive Officer MaRS Discovery District Sarah Doyle, Senior Policy Advisor Tim Jackson, EVP Corporate and Community Development	2015/02/19	43
Norton Rose Fulbright Canada Stanley Hartt, Counsel		
Canadian Community Economic Development Network Michael Toye, Executive Director	2015/02/24	44
CAP Finance, Le Réseau de la finance solidaire et responsable Jacques Charest, President		
LIFT Philanthropy Partners Bruce Dewar, President and Chief Executive Officer		
Ontario Nonprofit Network Cathy Taylor, Executive Director		
Ottawa Community Loan Fund Michael Oster, President		
The J.W. McConnell Family Foundation Stephen Huddart, President and Chief Executive Officer		
The Trico Group Wayne Chiu, Chief Executive Officer		
Enactus Canada Preston Aitken, Director Programs	2015/02/26	45
Imagine Canada Brian Emmett, Chief Economist Canada's Charitable and Nonprofit Sector		

Organizations and Individuals	Date	Meeting
Planned Lifetime Advocacy Network Vickie Cammack, Co-founder Founding Chief Executive Officer of Tyze Personal Networks Al Etmanski, Co-founder Founding Partner of Social Innovation Generation Social Economy Working Group François Vermette, Director of Development Social Enterprise Council of Canada David LePage, Chair	2015/02/26	45
Caisse d'économie solidaire Desjardins Colette Harvey, Director Cooperative Project Support Purpose Capital Norm Tasevski, Co-Founder and Partner Royal Bank of Canada Sandra Odendahl, Director Corporate Sustainability and Social Finance Social Capital Partners Magnus Sandberg, Vice President and General Manager Vancity Community Investment Andy Broderick, Vice-President Community Investment	2015/03/10	46
ABC Life Literacy Canada Gillian Mason, President Canadian Union of Public Employees Archana Rampure, Senior Officer Margot Young, Senior Research Officer Crossing All Bridges Learning Centre Debbie Brown, Executive Director Sherrie Marshall, Manager of Operations National Union of Public and General Employees Andrew McNeill, National Representative Youth Opportunities Unlimited Courtney Bain, Steve Cordes, Executive Director	2015/03/12	47

Organizations and Individuals	Date	Meeting
Eden Community Food Bank Peter Costello, Director of Operations Food Skills	2015/03/24	48
Eden Community Food Bank Bill Crawford, Executive Director		
Peel Multicultural Council Naveed Chaudhry, Executive Director Jagdeep Kailey, Manager Settlement Services		
United Way Ottawa Carole Gagnon, Vice President Community Services		
Canadian Alliance to End Homelessness Tim Richter, President and Chief Executive Officer	2015/03/26	49
Co-operatives and Mutuels Canada Shawn Murphy, Government Relations Consultant		
Mowat Centre Sunil Johal, Policy Director University of Toronto Jamie Van Ymeren, Policy Associate		
University of Manitoba John Loxley, Professor Department of Economics		
Canadian Parks and Wilderness Society Éric Hébert-Daly, National Executive Director National Office	2015/03/31	50
National Association of Friendship Centres Yancy Craig, Director Strategic Development Jeffrey Cyr, Executive Director		
Northern Development Initiative Trust Evan Saugstad, Chair		
As an individual Meghan Joy, Doctor of Philosophy Candidate Ryerson University John Shields, Professor Ryerson University, Department of Politics and Public Administration	2015/04/23	51

Organizations and Individuals	Date	Meeting
Fédération des communautés francophones et acadienne du Canada Diane Côté, Director Community and Government Liaison Marie-France Kenny, President	2015/04/23	51
The Honourable William G. Davis Centre for Families Rob El-Sayed, Manager Fund Development and Communications Sharon Mayne Devine, Chief Executive Officer		
Government of the United Kingdom Kieron Boyle, Head Social Investment and Finance SVX Adam Spence, Founder and Chief Executive Officer Vancity Credit Union Andy Broderick, Vice-President Community Investment, Resilient Capital	2015/04/28	52
As an individual David Juppe, Senior Operating Budget Manager Government of Saskatchewan Dale McFee, Deputy Minister Corrections and Policing, Ministry of Justice Parkland Institute Barret Weber, Research Manager Saskatoon Downtown Youth Centre Inc. Donald Meikle, Executive Director Social Research and Demonstration Corporation Sheila Currie, Principal Research Associate Jean-Pierre Voyer, President and Chief Executive Officer	2015/05/12	54
Canada Revenue Agency Cathy Hawara, Director General Charities Directorate, Legislative Policy and Regulatory Affairs Branch Bryan McLean, Director Policy, Planning and Legislation Division, Charities Directorate, Legislative Policy and Regulatory Affairs Branch	2015/05/14	55

Organizations and Individuals	Date	Meeting
Department of Employment and Social Development Siobhan Harty, Director General Social Policy Directorate, Strategic Policy and Research Branch Blair McMurren, Director Social Innovation, Strategic Policy and Research Branch Department of Finance Miodrag Jovanovic, Director Personal Income Tax, Tax Policy Branch	2015/05/14	55
Finance for Good Lars Boggild, Vice-President Eastern Canada Justin Bertagnolli, Partner Canadian Association of Social Workers Sally Guy, Policy and Communications Coordinator James Mulvale, Dean and Associate Professor Faculty of Social Work, University of Manitoba	2015/05/26	56

APPENDIX B LIST OF BRIEFS

Organizations and Individuals

Canadian Community Economic Development Network

Center for Law and Social Policy of Washington

Credit Union Central of Canada

Philanthropic Foundations Canada

Finance for Good

Youth Opportunities Unlimited

REQUEST FOR GOVERNMENT RESPONSE

Pursuant to Standing Order 109, the Committee requests that the government table a comprehensive response to this Report.

A copy of the relevant *Minutes of Proceedings* (Meetings Nos. 42 to 52, 54 to 56 and 58) is tabled.

Respectfully submitted,

Phil McColeman

Chair

HOUSE OF COMMONS / CHAMBRE DES COMMUNES

Exploring the Potential for Social Finance in Canada

Dissenting Opinion – New Democratic Party

16/06/2015

Dissenting opinion of the Official Opposition NDP, submitted as part of the Standing Committee on Human Resources, Skills and Social Development and the Status of Persons with Disabilities study on the potential for social finance in Canada.

The Official Opposition members of the HUMA Committee would like to thank all the witnesses who appeared before them as part of the study on exploring the potential for social finance in Canada.

The NDP agrees with the intent to explore new forms of social innovation, but it wishes to register its disagreement with the Committee's recommendations. It is unfortunate that the final report on the study presents an unbalanced view of the potential for social finance, one that does not reflect the concerns; the dire, appropriate and constructive warnings; or the appeals for caution voiced by many of the witnesses who appeared before the Committee.

Social finance and its instruments such as social impact bonds (SIBs) have the potential to greatly influence how the Government of Canada administers its social programs. The NDP believes that these issues warrant further examination and documentation than they have received to date before their implementation is considered nationally.

I. Role of social finance and its emergence

Social finance initiatives involve mobilizing private capital to invest in social programs as a way to diversify funding sources. The social finance marketplace is made up of three components. There is the supply side, which includes players interested in providing capital, such as financial institutions, foundations and private investors. The demand side includes organizations looking for sources of funding, such as charities, not-for-profit organizations and social enterprises. Then there are intermediaries, the third type of player whose role is to bring the two other components together.¹

The NDP recognizes that these initiatives can play an important role in community economic development, particularly by investing in social enterprises or cooperatives.

However, the NDP notes that there is a growing trend towards applying social finance and its instruments to public services, which would lead to a privatization of social programs.

This trend was first observed in the U.K., when social finance appeared. John Shields from Ryerson University pointed out that social finance and SIBs in particular "...were very much part of Big Society in the U.K., which was about ... cutting various types of social programs, and then expecting philanthropy, local governments, and non-profit organizations to fill some of those gaps."²

Some witnesses provided the Committee with evidence that this trend is also observable in Canada and that, far from being purely experimental in its approach, the federal government is in the process of applying social finance and its instruments to its programs.

¹ Siobhan Harty, Director General, Social Policy Directorate, Strategic Policy and Research Branch, Department of Employment and Social Development, HUMA No 42, 17 February 2015.

² John Shields, Ryerson University, United Kingdom, HUMA No 51, 23 April 2015.

Marie France Kenney, President of the Fédération des communautés francophones et acadienne, said that "...a push is currently on to adopt social finance in a slew of government programs and initiatives The perception is that the government is trialling the model in a very limited and exploratory manner through pilot projects. The reality, however, is quite different. The fact of the matter is that Employment and Social Development Canada and other federal institutions have already changed how they deliver their grants and contributions programs, bringing them more in line with the social finance model."³

The NDP believes that the application of social finance must be limited to appropriately targeted groups. Employment and Social Development Canada officials responsible for developing social finance policy concluded: "... that social finance isn't necessarily suitable for every social issue or for every target population."⁴

The NDP is skeptical of the implication that there is consensus for applying social finance solutions to federal social programs given the supposed beneficial impact these solutions would have on the cost and effectiveness of these programs.

Interest in social finance and related instruments such as SIBs certainly stems from dwindling public funding for not-for-profit organizations and social programs, as several witnesses pointed out.

David Juppe, Senior Operating Budget Manager with the Department of Legislative Services for the Maryland General Assembly, said: "One of the reasons I think social impact bonds have become more popular recently is that since the recession of 2008 the government in the United States, and state governments especially, have not seen a robust economic recovery, as was hoped.... This is one mechanism for providing additional funding for government services without government providing the funding up front."⁵

Barret Weber, Research Manager with the Parkland Institute, echoed this view: "In the current tax-cutting frenzy among governments of the day, there's a keen interest to find solutions to the underfunding of social problems."⁶

Employment and Social Development Canada officials did not hesitate to establish that one of the goals of social finance is to cut government expenditures: "A mature social finance marketplace ... would unlock new sources of capital for community organizations [and would provide] realized savings for governments."⁷

³ **Marie France Kenney**, President of the Fédération des communautés francophones et acadienne, HUMA No 51, 23 April 2015.

⁴ **Siobhan Harty**, Director General, Social Policy Directorate, Strategic Policy and Research Branch, Department of Employment and Social Development, HUMA No 42, 17 February 2015.

⁵ **David Juppe**, Senior Operating Budget Manager with the Department of Legislative Services for the Maryland General Assembly, United States, HUMA No 54, 12 May 2015.

⁶ **Dr. Barret Weber**, Research Manager, Parkland Institute, HUMA No 54, 12 May 2015.

⁷ **Siobhan Harty**, Director General, Social Policy Directorate, Strategic Policy and Research Branch, Department of Employment and Social Development, HUMA No 42, 17 February 2015.

The trend toward developing social finance is resulting in policy choices focused on cutting spending, thereby forcing not-for-profits involved in delivering social programs to diversify their funding sources in order to maintain service levels.

This certainly raises a whole range of risks, issues and concerns for which we do not have the proper perspective to perform an objective analysis.

II. Risk of cost overruns

The NDP believes that public funds should be managed properly and used effectively, and it wishes to emphasize that there is a risk of cost overruns for governments that choose to fund their social programs through social finance and instruments such as SIBs in particular. This risk should not be underestimated, as it is inherent in the structure of social finance and its instruments.

First of all, the government must guarantee a certain rate of return to encourage investors to support social finance instruments, which adds to the cost of delivery. Andrew McNeill explained the situation clearly: "One of the misconceptions we see is that social finance is being viewed as free money, and all too often when we hear social finance discussed for public services, it's portrayed as a new source of revenue. What is ignored is the fact that while people investing in social finance are willing to accept a lower rate of return to accomplish social objectives, they still do expect some return on their investment, and the ways to use social finance to fund public services, such as social impact bonds, will add new costs to the delivery of public services."⁸

In addition, investors expect a much higher rate of return on SIBs than the Government of Canada currently pays to borrow money. "The first social impact bond project in Peterborough, England ... is expected to provide a rate of return of between 7.5% and 13% per year. Based on a survey by the MaRS Centre for Impact Investing and Deloitte Canada, expectations of potential investors in social impact bonds here in Canada are very similar. By contrast, the federal government was paying an average of 2.37% to borrow money in 2013-14, which is roughly a third of the minimum amount Peterborough social impact investors are likely to receive."⁹ This gap between the expected rate of return on SIBs and the Government of Canada bond rate show that SIBs are an expensive way to borrow.

As David Juppe pointed out, there are currently no limits on the rate of return on SIBs: "From what I can see, the rate of return is not limited in any way. As we know, in the bond market, risk is measured by interest rates. The riskier it is that repayment may not materialize, the higher the interest rate a government is going to pay on a capital bond. The social impact bonds or pay for success is a form of borrowing. If the program works then government will pay this rate of return, which happens to be whatever was negotiated, whether 10%, 15%, or 20%. There appear to be no limits on that amount."¹⁰

⁸ Andrew McNeill, National Representative, National Union of Public and General Employees, HUMA No 47, 12 March 2015.

⁹ Andrew McNeill, National Representative, National Union of Public and General Employees, HUMA No 47, 12 March 2015.

¹⁰ David Juppe, Senior Operating Budget Manager with the Department of Legislative Services for the Maryland General Assembly, United States, HUMA No 54, 12 May 2015.

Social finance and instruments such as SIBs may lead to cost overruns because the government and recipient agencies would have to establish new layers of administration to manage them.

Managing social finance, and SIBs in particular, would also require the introduction of new intermediaries and mechanisms to deal with the complex and cumbersome procedures — both of which add to management costs. “First, there are the intermediary organizations that are required to find investors and to find an organization or business to deliver the service and oversee the service.”¹¹ Second, “[t]he agreements under which social impact bonds operate are a second layer of administration.”¹²

The advocates of SIBs believe that the savings to government make up for the difficulties in implementing these instruments. However, the potential savings may be overestimated. David Juppe explained that while SIBs may lead to savings in the variable operating costs of government programs, the same is not true for fixed costs, which are higher. “In our research we have found in many cases that the proposed savings are overstated. ... [I]f advocates are proposing that the savings are going to be the full fixed and variable costs divided by the caseload, that’s overstating the savings.”¹³

Lastly, there is a significant risk that any potential savings will be offset by the funds that the government must set aside so that it can reimburse financiers for their full investment plus the rate of return. David Juppe noted this issue when studying the use of SIBs in Massachusetts.¹⁴ He refers to the concept as “funding logistics,” a situation in which actual costs are delayed rather than significant savings being achieved.

¹¹ Andrew McNeill, National Representative, National Union of Public and General Employees, HUMA No 47, 12 March 2015.

¹² Andrew McNeill, National Representative, National Union of Public and General Employees, HUMA No 47, 12 March 2015.

¹³ David Juppe, Senior Operating Budget Manager with the Department of Legislative Services for the Maryland General Assembly, United States, HUMA No 54, 12 May 2015.

¹⁴ Ibid.

III. Operational risks

Social finance poses a number of significant operational risks that should be identified. These risks involve the demand side of the social finance marketplace in particular and could lead the government not complying with its obligations.

To begin with, not-for-profit organizations that want to access social finance and instruments like SIBs must have the material and human resources and the technical abilities to solicit and obtain this financing. As Barret Weber explained, "[S]ince this new financing model is based on markets and competition, which are not areas the not-for-profit sector is accustomed to dealing with, non-profit agencies find themselves having to hire or contract professional staff whose tasks include writing grant applications."¹⁵ In future, the organizations that already have significant financial and technical resources may be the only ones able to attract investment, to the detriment of other organizations.

To address this imbalance, the proponents of social finance and SIBs suggest that organizations receive government funding to strengthen their capacity to attract investors in the social finance marketplace. The NDP believes it is illogical to make cuts to social programs in the name of curbing government spending, and then subsidize charitable organizations to help them attract private investors.

Lastly, the NDP is concerned that the desire to mitigate risk will significantly influence the type of social programs that investors support. As Andrew McNeill noted, "Minimizing risk also means that investors are going to be unwilling to fund innovations in service delivery. Under the model for social impact bonds, if the agreed-upon outcomes aren't achieved, investors lose their original investment. Again, it would be hard to find anybody who is willing to put money into a project if they feel it's likely that they're going to lose their original investment."¹⁶

On the subject of risk mitigation, investors may tend toward what David Juppe calls a "flight to quality": "[R]ather than encouraging innovation, social impact bonds or pay for success will actually encourage a flight to quality. Investors are going to want to see programs that work and programs that are successful" in order to ensure a return on their investment.¹⁷ What this means is that only the programs deemed the most successful, and therefore profitable, will attract investors and offer a reasonable rate of return.

¹⁵ Dr. Barret Weber, Research Manager, Parkland Institute, HUMA No 54, 12 May 2015.

¹⁶ Andrew McNeill, National Representative, National Union of Public and General Employees, HUMA No 47, 12 March 2015.

¹⁷ David Juppe, Senior Operating Budget Manager with the Department of Legislative Services for the Maryland General Assembly, United States, HUMA No 54, 12 May 2015.

IV. Critical mass

Critical mass — the presence of a sufficiently large target population — is a key condition for attracting social finance investors. However, in Canada, the existence of small communities that lack critical mass is an important consideration when implementing national policies that involve social finance, particularly in the case of minority language communities.

Marie-France Kenny explained this issue to the Committee in very clear terms: "Official language minority communities will feel the impact of an approach where requests for proposals are based on major projects and private sector contributions. The government runs the risk of creating an environment where, instead of having access to French-language services that fit their needs, francophone communities will, at best, receive bilingual services delivered by majority language organizations, or even services delivered by Quebec-based organizations with little understanding of our communities' needs."¹⁸

The NDP wishes to point out that, in situations like this, federal institutions are at significant risk of not meeting their obligations under Part VII of the *Official Languages Act*, which requires federal institutions to take positive measures to enhance the vitality of English and French linguistic minority communities and support their development.

V. Evaluation and accountability

Like all the witnesses who appeared before the Committee, the NDP believes that programs involving social finance must be subject to evaluation and accountability. Senior officials from Employment and Social Development Canada stressed this point and we concur: "[S]ocial finance also requires rigorous use of metrics and evaluation to determine if expected outcomes have been met, thereby ensuring effective use of resources and accountability for the use of public funds."¹⁹ However, it was clear by the end of this study that qualitative evaluation tools are not suitable for measuring the impacts of a program's social finance components.

In addition, the NDP is concerned about the way in which the desire for a return on investment could influence evaluation methods and results. David Juppe raised two points that speak to this concern.

The first is the pressure to produce a positive outcome: "Evaluation concerns that I have are first and foremost that, because you have this return-on-investment component, there is a greater pressure to produce results and you may have a situation where one study produces an outcome that's positive resulting in payment to the investors and to the service providers, but in many cases

¹⁸ Marie France Kenny, President of the Fédération des communautés francophones et acadienne, HUMA No 51, 23 April 2015.

¹⁹ Siobhan Harty, Director General, Social Policy Directorate, Strategic Policy and Research Branch, Department of Employment and Social Development, HUMA No 42, 17 February 2015.

in public policy it can take years and sometimes multiple observations and multiple studies to determine if a program is really successful or not.”²⁰

The second involves the composition of evaluation samples: “Also there’s the question of methodologies and whether or not there’s a treatment and control group and full randomization to ensure that fair and objective analysis and evaluation are completed. The U.S. Congress was considering social impact legislation last year in 2014, and I noticed in that legislation that they were considering allowing quasi-experimental designs, which may not require this sort of randomization.”²¹

The NDP is also troubled by the pervasive lack of transparency regarding the actual cost of implementing social finance. Many witnesses shared this concern, which was neatly summarized by Andrew McNeill: “Another concern is the loss of accountability. Contracts for services funded through social impact bonds are rarely made public. In fact, as far as I know there has not been a single contract made public. The public cannot find out the details of the services being provided or the details of the costs. This means that the public has no way of knowing whether they are receiving the services they’re paying for.”²²

VII. Conclusion

The NDP supports the intent to explore new forms of social innovation. However, given the lack of tangible evidence that social finance and social impact bonds lead to positive outcomes in the delivery of social programs, the NDP wishes to emphasize in this dissenting opinion that there are considerable risks to this approach.

The NDP recommends caution when introducing social finance to the Government of Canada’s social programs.

It also recommends that the subject be studied more extensively to determine the potential risks and benefits, and that pilot projects be conducted and evaluated. In order to arrive at a definitive conclusion, the NDP believes that new and more thorough analyses should be carried out using more advanced technical and research methods than were available to the Committee for the present study.

Lastly, given that introducing social finance, and instruments like social impact bonds in particular, could influence the implementation of federal social programs, the NDP maintains that this is an issue that requires public debate. The Canadian public must be properly informed of the approaches chosen by the federal government to finance and implement social programs. The NDP therefore recommends that public consultations be held before this type of initiative is implemented more broadly.

²⁰ David Juppe, Senior Operating Budget Manager with the Department of Legislative Services for the Maryland General Assembly, United States, HUMA No 54, 12 May 2015.

²¹ Ibid.

²² Andrew McNeill, National Representative, National Union of Public and General Employees, HUMA No 47, 12 March 2015.

SUPPLEMENTARY OPINION OF THE LIBERAL PARTY OF CANADA

We would like to thank all of the witnesses that appeared before the HUMA committee during the course of the *Exploring the Potential of Social Finance in Canada* study. The Liberal Party supports the intent of the study and its recommendations.

Throughout the study we heard from witnesses from Third Sector organizations (including charities, non-profits, co-operatives, and social purpose businesses) who are finding innovative ways to solve societal problems with limited resources. The Liberal Party seeks to ensure that all sectors, including the Third Sector, have access to capital to assist in solving the nation's social problems. We believe government should be active in facilitating and stimulating private investment for public good.

Social financing can have different meanings to different groups (e.g. for-profit vs. non-profit, investor vs. investee) depending on where they are along the spectrum of enterprises that operate in or contribute to the social economy. The Liberal Party believes social financing can be beneficial if it is used to assist organizations responding to a social need who are guided by a social conscience (i.e. social return rather than investment returns as the number one priority). It is our hope that the government be guided by this belief in defining its role in developing social financing measures.

We would like to take this opportunity to make some additional comments about certain issues raised in the Report.

Social Impact Bonds

As the Report notes, the Committee heard from a variety of witnesses who had concerns and criticisms regarding the use of Social Impact Bonds (SIBs).

It is important to ensure that the critiques and negative concerns of SIBs raised by stakeholders and witnesses are kept in mind when discussing this social finance mechanism. The government must ensure that the quality of social services does not decrease in the event of outsourcing. Additionally, the value for dollar for the government and the taxpayer should be clearly proven prior to the implementation or adoption of SIBs.

Dr. John Loxley made a fair point in critiquing the use of SIBs, *"I would argue that the first priority should be improving the funding and delivery of services in and by the public sector, and that should be a priority over pursuing and creating enabling environments for social impact bonds."*¹

It is clear that there are a many concerns about SIBs that must be addressed if such measures were to be implemented by government. In dealing with social services and the most vulnerable Canadians, it is important to ensure that the government prioritizes their needs and success above all.

¹ HUMA, Evidence, 2nd Session, 41st Parliament, 26 March 2015, 1540 (Dr. John Loxley, Professor, Department of Economics, University of Manitoba).

SUPPLEMENTARY OPINION OF THE LIBERAL PARTY OF CANADA

Government Program Data and Evaluation

Sunil Johal from the Mowat Centre makes a cogent point when he states that, “governments should invest in better evidence and measurement to support promising opportunities for program innovation and support the long-term development of evidence-based policies.”² It is imperative that the government have both the proper data and measurement criteria to evaluate the social impact and efficacy of its existing programs and services. The identification of data-based outcome targets is a necessary prerequisite for both the success of social financing and the effective delivery of government programs.

The evaluation of existing government programs continues to be in short supply. In 2010, departments spent on average less than 0.1 percent of direct program funds on evaluation.³ Similarly, as noted in the Report, Employment and Social Development Canada continues to measure *outputs*, despite having both the capacity and the existing data to measure *outcomes*.

The Liberal Party supports evidence-based policy and the development of broader and deeper evaluation criteria of existing programs in order for all stakeholders to make informed decisions. In this context, enhancing measurement and evidence tools for current government programs and services is necessary prior to engaging in the intricacies of social financing tools such as SIBs.

² HUMA, Evidence, 2nd Session, 41st Parliament, 26 March 2015, 1535 (Sunil Johal, Policy Director, University of Toronto, Mowat Centre).

³ Ibid.

ANNEX D

Social Finance Regulatory Recommendations from Stakeholders in Pre-Budget Submissions

1. Imagine Canada

- Establish a federal working group composed of government and sector representatives in order to: (a) assess federal business development initiatives, which could help charities and NFPs achieve financial sustainability and identify and address barriers to participation in these initiatives, and (b) identify and address Gs&Cs-related administrative policies that have a detrimental effect on organizations' financial sustainability.
- Extend the First Time Donor's Super Credit and implement the Stretch Tax Credit for Charitable Giving.

2. Philanthropic Foundations Canada

- Implement the proposed amendment to the *Income Tax Act* to allow charitable organizations and foundations to invest in limited partnerships.
- Clarify the CRA guidance governing program-related investment (PRI) by foundations.
- Create an advisory panel, involving stakeholders from the public, private, non-profit and charitable sectors, to help define a national strategy on the development of the social finance marketplace in Canada.
- Establish a consultative process with participation from the charitable and non-profit sector to conduct a review of the regulatory regime with respect to the definition of charitable purposes and activities, including advocacy.

3. Canadian Community Economic Development Network

- That social enterprises, non-profits, and co-operatives be given access to existing regulatory and tax measures and business development programs that are currently available to small and medium-sized enterprises, through awareness-raising efforts targeting government officials to ensure a level playing field for alternative forms of incorporation.

4. MaRS Centre for Impact Investing

- Implement the recommendations of Canada's National Advisory Board to the G7-based Social Impact Investment Taskforce to enable both social finance and social enterprise in the charitable and non-profit sector.

5. United Way Centraide Canada

- The federal government should encourage charitable philanthropy by implementing a 'stretch tax credit,' designed to incite Canadians to increase their level of giving.

6. Social Enterprise Council of Canada

- That the government "level the playing field" for social enterprises as a business within the existing policy, regulations and program framework.



s.21(1)(a)

s.21(1)(b)

s.18(d)

2016 NHQ 029421

UNCLASSIFIED
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**MEMORANDUM TO THE DEPUTY MINISTER OF EMPLOYMENT AND
SOCIAL DEVELOPMENT**

**UPDATE ON POTENTIAL ENGAGEMENT ON LEGAL AND
REGULATORY BARRIERS TO SOCIAL FINANCE
AND SOCIAL ENTERPRISE**

(FOR INFORMATION)

SUMMARY

BACKGROUND

A recent briefing note (2016 NHQ 026262) provided:

- 1) An overview of legal and regulatory barriers to social finance and social enterprise commonly raised by stakeholders, as well as recent measures taken by the Government of Canada

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18(d), 21(1)(a), 21(1)(b)

**of the Access to Information Act
de la Loi sur l'accès à l'information**

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UNCLASSIFIED



Kathryn McDade

Key Contact: Catherine Scott
1-819-654-2892

Attachment(s): 1

**Pages 170 to / à 189
are withheld pursuant to sections
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18(d), 21(1)(a), 21(1)(b)

**of the Access to Information Act
de la Loi sur l'accès à l'information**

2016 NHQ 014761
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MEMORANDUM TO THE SENIOR ASSISTANT DEPUTY MINISTER OF ISSD

**MEETING WITH MEMBERS OF THE NATIONAL IMPACT INVESTMENT
PRACTITIONERS TABLE – MARCH 18, 2016 12:00PM – 2:00PM
8th FLOOR BOARDROOM (8C143)**

(FOR INFORMATION)

SUMMARY

The purpose of this note is to prepare you for your afternoon meeting on March 18, 2016 with members of the Coordinating Committee of the National Impact Investment Practitioners Table (NIIPT).

This will be a continuation of the discussion from the morning of March 18, 2016 with Andrew Broderick and Lauren Dobell from the Vancity Credit Union, Patrick Duguay of the *Chantier de l'économie sociale*, and the Deputy Minister and the Associate Deputy Minister of Employment and Social Development. Briefing material for the morning is attached (Annex A).

Following a working lunch with Andrew, Lauren, Patrick, Catherine Scott, Blair McMurren and Susan Tolton, the afternoon discussion will begin at 1:00 p.m. with you as chair and with four people joining you by telephone. An agenda to help guide this discussion is attached (Annex B).

BACKGROUND

In December 2015, the NIIPT submitted a proposal to ESDC through a letter to Minister Duclos (Annex C). This letter included proposed measures on social finance for inclusion in Budget 2016 (these are summarized in Annex D). Further to this letter, in January 2016 Minister Duclos met with representatives from the Chantier de l'économie sociale, who also sit on the NIIPT's Coordinating Committee. The Chantier and the MaRS Centre for Impact Investing also made submissions related to social finance as part of the 2016 pre-Budget consultations (these are also summarized in Annex D).

In February 2016, you met with Andrew Broderick, Lauren Dobell and two other members of the NIIPT Coordinating Committee: Garth Davis of New Market Funds in Vancouver and Derek Ballantyne of the Community Forward Fund in Ottawa. The discussions were on the NIIPT's pre-Budget submissions and possible approaches

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for developing the Strategy. As a follow up to that meeting, the Department is holding meetings on Friday, March 18 with these stakeholders.

Following a morning meeting with the Deputy Minister and the Associate Deputy Minister of Employment and Social Development, you will host a working lunch with the visiting NIIPT members at 12:00 p.m. in the 8th floor Boardroom. The lunch will provide an opportunity to debrief from the discussion with Deputy Shugart and Associate Deputy Robidoux.

At 1:00 p.m. in the same location, you will chair a meeting with additional NIIPT Coordinating Committee members joining via teleconference: Nancy Neamtan of the *Chantier de l'économie sociale* (Montreal); Jane Bisbee from the Social Enterprise Fund, Edmonton; Garth Davis of New Market Funds in Vancouver; and, Dianne Kelderman from the Nova Scotia Co-operative Council. The biographies of all of the NIIPT participants and the membership of its Coordinating Committee (Annex E) are attached.

CURRENT STATUS

This afternoon meeting may be an opportunity for further in-depth discussion on three items:

- The Pre-Budget Proposals put forward by the NIIPT members
- The scope of the Social Innovation and Social Finance Strategy – what should be included; priorities
- An approach to engagement to co-create the Social Innovation and Social Finance Strategy

An agenda and questions to guide the discussion are attached (Annex B).

Catherine Scott

Key Contact: Susan Tolton
819-654-3891

Attachments:

Annex A - 2016 MSBU 003621

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Annex B - Agenda and questions

Annex C - Letter from VanCity (on behalf of NIPT Coordinating Committee)

Annex D - Summaries

Annex E - Biographies



s.21(1)(a)

2016 MSBU 003621

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**MEMORANDUM TO THE DEPUTY MINISTER OF EMPLOYMENT AND
SOCIAL DEVELOPMENT**

**MEETING WITH MEMBERS OF THE NATIONAL IMPACT INVESTMENT
PRACTITIONERS TABLE**

(FOR INFORMATION)

SUMMARY

The purpose of this note is to prepare you for your March 18, 2016, meeting with Andrew Broderick and Lauren Dobell from the Vancity Credit Union and Patrick Duguay of the *Chantier de l'économie sociale*. These organizations are members of the Coordinating Committee of the National Impact Investment Practitioners Table (the Table). An agenda (Annex A) and speaking points (Annex B) are attached. The biographies of meeting participants and the membership of the Table's Coordinating Committee (Annex C) are also attached.

The Table is a coalition of leading social finance practitioners that have recently been active in advocating for government action on social finance, including as members of Canada's National Advisory Board (NAB) to the G7-based Social Impact Investment Taskforce (the NAB's 2014 report is summarized in Annex D) and through submissions as part of the 2016 pre-Budget consultations (these are summarized in Annex E). The Table also wrote a letter to the Minister of Families, Children and Social Development on December 11, 2015 (Annex F).

BACKGROUND

The Social Finance Investment Fund Network was convened by Employment and Social Development Canada in 2013 with the objective of building a stronger social finance ecosystem in Canada. It received approximately \$65,000 in funding from the Department in 2013–2014. Since then, its members have continued meeting and collaborating under the name of the National Impact Investment Practitioners Table.

While the Table does include nearly all of the most high-profile and active social finance stakeholders across Canada, it does not include other types of stakeholders with an interest in and knowledge of social finance, such as the Social Enterprise Council of Canada, Imagine Canada, Co-operatives and Mutuels Canada, or academic experts.

The Table's Coordinating Committee is composed of six individuals, five of whom also served on the NAB. In September 2014, the NAB published a report which made policy recommendations for the Government of Canada to promote the development of the social finance market (these recommendations are summarized in Annex D).

In November 2015, members of the Table's Coordinating Committee began making outreach efforts to different Ministers and officials in various federal departments and agencies.

On December 11, 2015, Andrew Broderick, Vice President of Impact Market Development at the Vancity Credit Union, sent a letter to the Minister of Families, Children and Social Development on behalf of the Coordinating Committee (Annex F). This letter included proposed measures on social finance for inclusion in Budget 2016 (these are summarized in Annex E). Further to this letter, on January 15, 2016, Minister Duclos met with representatives from the *Chantier de l'économie sociale*, who also sit on the Table's Coordinating Committee. The *Chantier* and the MaRS Centre for Impact Investing also made submissions related to social finance as part of the 2016 pre-Budget consultations (these are also summarized in Annex E).

On February 10 and 11, 2016, ESDC senior officials met with Andrew Broderick, Lauren Dobell and two other members of the Table's Coordinating Committee, Garth Davis (Managing Director, New Market Funds) and Derek Ballantyne (CEO, Community Forward Fund). Meeting participants held wide-ranging and high-level discussions on the Table's pre-Budget submissions and possible approaches for developing the Strategy.

s.21(1)(a)

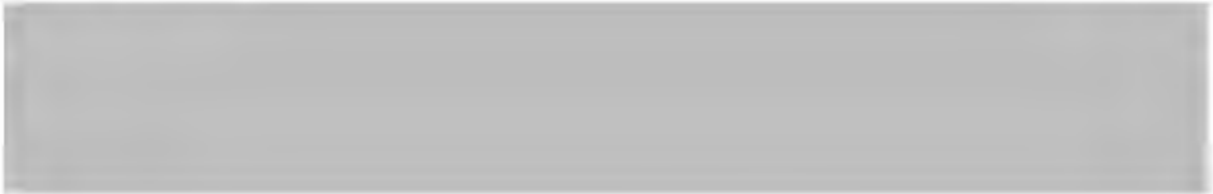
s.21(1)(b)

- 3 -

CURRENT STATUS



NEXT STEPS



Kathryn McDade

Key Contact: Catherine Scott
819-654-2892

Attachments: 7

c.c. Benoît Robidoux
Associate Deputy Minister of Employment and Social Development

ANNEX B

Meeting with the National Impact Investment Practitioners Table

Friday, March 18, 2016 1:00 - 2:00 p.m.

Phase IV (8C143)

AGENDA and PROPOSED QUESTIONS (note: some of the questions may have been raised during the morning session but could be revisited in further detail)

- 1. Welcome and Roundtable Introductions (including teleconference participants)** 1:00 – 1:05 p.m.
Kathryn McDade, Senior Assistant Deputy Minister, Income Security and Social Development
- 2. Discussion – pre-Budget proposals of the NIIPT members / December 11, 2015 Letter to Minister Duclos** 1:05 – 1:20 p.m.
All participants

 - Have you analyzed what the demand may be for your proposed \$250 million first-loss social finance fund?
 - To what extent would the fund be self-sustaining? Would it require ongoing Government support following the initial three years?
 - Stakeholders are also submitting proposals and requesting federal support for investment funds targeting specific sectors or types of community organizations, such as the Canadian Co-operative Investment Fund, which Vancity is also considering to support. Is there a need for both a large national investment fund and more sectoral ones? Where should the federal government focus its support to achieve greater impact?
- 3. Discussion – Scope of the Social Innovation and Social Finance Strategy** 1:20 – 1:40 p.m.
All participants

 - What do you see as being key elements of a Social Innovation and Social Finance Strategy? What should be included (top three priorities)?
 - In your view, what should not be included in the Federal Social Innovation and Social Finance Strategy?
 - Do you have perspectives on how the Strategy should take into account the social economy context in Quebec?
- 4. Discussion – Approach to stakeholder engagement for the Social Innovation and Social Finance Strategy** 1:40 – 2:00 p.m.
All participants

 - What strategies and measures could the Department consider to ensure that engagement is open, inclusive and representative?

ANNEX B

- Is the concept of a Steering Group which potentially shares ownership and accountability for the Strategy with the Government a realistic proposal? What are the conditions for success when using this type of approach?
- Which types of organizations, in your view, could form part of a Steering Group?

Vancity Centre
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vancity.com

11 December 2015

Jean-Yves Duclos
Minister of Families, Children and Social Development
House of Commons
Ottawa, Ontario
K1A 0A6

Re: Social investment finance funds and building social infrastructure

Dear Minister Duclos:

It is with great pleasure that we congratulate you on your appointment as Minister of Families, Children and Social Development. We are especially delighted to note your mandate to develop a strategy for social innovation and social finance, and to work in collaboration with civil society and stakeholders, including community organisations and the business sector, to address key challenges in building and enhancing vital social infrastructure.

Representing a network of organisations and institutions strongly committed to job creation, poverty reduction, social inclusion and community development, we see the mobilisation of private capital to serve these social purposes as critically important and sadly undeveloped. As a coalition of impact investment practitioners from across Canada, we have devised new approaches to social finance over the past decade, combining public and private capital to invest millions of dollars in the social economy and community, including housing, enterprise development and other social infrastructure. Compared to other jurisdictions and markets, however, Canada is only beginning to recognize the full potential of social finance in community investment. We must do more and move more quickly to foster vibrant, cohesive and sustainable communities. Attached please find a proposal for significantly increasing the access of Canadian communities to private capital for social and community infrastructure.

An activist federal government is crucial in rallying the resources, partners and political will, as seen with the innovative Social Economy Initiative introduced by Prime Minister Paul Martin in 2004. We are delighted that our new government is moving quickly to identify the strategies and tools to relaunch and accelerate this agenda. We are pleased to support this work with our knowledge, experience and commitment, and would welcome the opportunity to meet with you to discuss our proposal, which identifies three significant but easily-launched policy initiatives that would produce rapid results. They grow from an in-depth understanding of the social finance landscape across Canada, of the private and community partners who would join in the efforts, and of effective approaches that can be quickly deployed in the fields of social finance, social infrastructure and capacity-building for social innovation.

11 December 2015

Social investment finance funds and building social infrastructure

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We look forward to discussing how the exciting potential of this work can be fully deployed for the benefit of citizens and communities across Canada.

Yours truly,



R. Andrew Broderick
VP, Impact Market Development

For the Coordinating Committee of the *National Impact Investment Practitioners Table*:

Nancy Neamtan
Strategic Advisor, Chantier de l'économie sociale
Montreal

Derek Ballantyne
CEO, Community Forward Fund
Toronto

Jane Bisbee
Executive Director, Social Enterprise Fund
Edmonton

Garth Davis
Managing Director, New Market Funds
Vancouver

Tim Jackson
EVP Corporate and Community Development, MaRS Discovery District
Toronto

Dianne Kelderman
President & CEO, Nova Scotia Co-operative Council
Halifax

cc. The Honourable MaryAnn Mihychuk, Minister of Employment, Workforce Development
and Labour
The Honourable Amarjeet Sohi, Minister of Infrastructure and Communities

ANNEX D

**MEETING WITH MEMBERS OF THE NATIONAL IMPACT INVESTMENT
PRACTITIONERS TABLE: PRE-BUDGET 2016 SUBMISSION SUMMARIES**

1. The National Impact Investment Practitioners Table (via Andy Broderick, VP, Impact Market Development, Vancity Credit Union) submitted a proposal to the Department with three basic requests:
 - A \$250 million first-loss social finance fund deployed over three years with the goals of: leveraging private investment through target ratios of public to private capital; generating activities that create employment; creating robust social infrastructure; and creating regional social finance funds of sufficient scale and capacity to attract institutional capital;
 - A social infrastructure grant program that would use infrastructure funds to provide matching capital for infrastructure projects being financed with capital generated by the social finance fund; and
 - Support for capacity-building through training initiatives, knowledge transfer strategies and technical support programs that would build intermediaries and increase the business skills of social entrepreneurs.
2. The Chantier de l'économie sociale made a submission that largely echoed the National Impact Investment Practitioner / Vancity requests.
3. The MaRS Discovery District made recommendations in three main areas of their submission:
 - a) Advancing an Innovation Agenda
 - Create a national data-tracking framework to build evidence on gaps, opportunities, and program impacts in Canada's innovation economy.
 - Build a national network of innovation hubs, incubators and accelerators that shares data, programs, and best practices.
 - Create an innovation advisory committee to support the Minister of Innovation, Science and Economic Development.
 - b) Building a Social Innovation and Social Finance Strategy
 - Strike a multi-sector task force to co-create this strategy with the Government, with an emphasis on applying tools such as impact investment capital-matching programs, pay-for-success funds, and prototyping in priority policy areas across government.

ANNEX D

- Implement the recommendations of Canada's National Advisory Board to the G7-based Social Impact Investment Taskforce to enable both social finance and social enterprise in the charitable and non-profit sector.

c) Accelerating Open Data

- Engage stakeholders to identify data needs, design usable data formats, and develop new platforms for collaborative evidence collection.
- Work with privacy commissioners and regulators across Canada to develop a consistent approach to enabling citizen access to personal data held by governments.

March 18 Meeting with Members of the National Impact Investors Practitioners Table

Biography of Meeting Attendees (in-person and on phone)

Derek Ballantyne, CEO, Community Forward Fund

With a solid financial background in managing real estate investments and working with mutual funds, Mr. Ballantyne also brings deep knowledge of the nonprofit, charitable, social entrepreneurship, cooperative and foundation sectors at the local, provincial and federal levels. He is fluently bilingual.

At DKGI Inc. he provided consultant services to private, government and nonprofit clients in development of real estate and real estate investment and in development of market investment strategies. Mr. Ballantyne was Chief Operating Officer of Build Toronto, where he assisted in the establishment of the corporation, development of the first business plan, and execution of several large transactions and development initiatives. Prior to this, Derek was Chief Executive Officer of Toronto Community Housing, a large rental housing provider, with over \$6 billion in real estate assets in Toronto. Mr. Ballantyne was a founding Director of a \$430 M mutual fund and continues to participate in two investment committees for nonprofit organizations. Mr. Ballantyne sits on the board of the Laidlaw Foundation.

Jane Bisbee, Executive Director, Edmonton Social Enterprise Fund.

A journalist by trade, with a Bachelor's degree in Journalism from Carleton University, Jane has experience in the Canadian book and magazine publishing industries, newspaper and radio reporting and documentary film. A special focus of her career has been the creation of non-traditional funding mechanisms for small business, in particular the cultural industries, through work with the Association of Canadian Publishers, the Alberta Motion Picture Industries Association, and the Province of Alberta. As a freelance intellectual property developer she partnered with clients including the National Film Board of Canada, the Ontario Media Development Corporation, the Canada Media Fund, the Saskatchewan Arts Board and the Independent Production Fund. She is past president of the Edmonton International Film Festival and has served on many boards including the Manitoba Chamber Orchestra, the Canada Give the Gift of Literacy Foundation and the Alberta Foundation for the Literary Arts. She was presented with a lifetime achievement award in 2006 by Alberta's film industry.

Andy Broderick, VP Community Investment, Vancity

Andrew Broderick joined Vancity as Vice President, Community Investment in 2010. Prior to that, he served as Executive Managing Director of GreenSpace Developments, a New York

Annex E

based investment fund created to finance nonprofit-owned and LEED-certified office and program facilities. Between 1996 and 2009, Mr. Broderick worked first as Head of Development then as President (and CEO) of Housing Vermont, a company that develops and finances affordable housing. While there, he founded the Green Mountain Housing Equity Funds, raising over \$150 million in private equity that was invested in some two million sq. ft. of social purpose real estate.

Garth Davis, Managing Director, New Market Funds

Mr. Garth Davis is a Managing Director at New Market Fund. He served as a Vice President of Vancity Capital Corporation. Mr. Davis joined the Vancity Capital Corporation in 2010. Mr. Davis has leadership experience and roots in private equity, subordinated debt and leveraged finance. He has led investments involving growth equity, buyouts, recapitalizations and special situations in both the private and public markets. He has extensive experience building and managing high-performance investment teams and in leading change and creating value as an engaged, focused and active investor, board member, and shareholder representative. Mr. Davis was a Co-Founder and Managing Partner of Turtle Creek Private Equity Inc. in Toronto since 2007. He has primary responsibility for executing transactions and the ongoing management of the firm's portfolio investments. From 1998 to May 2007, Mr. Davis was a Partner at Scotia Merchant Capital Corporation and was responsible for assisting in its management and investing activities. Prior to joining the Merchant Bank, he spent his professional career at a major Canadian chartered bank and its investment dealer. Mr. Davis initially joined the bank in 1993 in its Global Credit Risk Management Group and in 1995, joined the investment dealer's Loan Syndications Group. He served as a Director of Automodular Corp., since 2001. He holds a M.A. in International Economics from the Paul H. Nitze School for Advanced International Studies, Johns Hopkins University; an M.S. from the London School of Economics and Political Science; and a B.A. degree from Simon Fraser University.

Lauren Dobell, Director, Strategic Partnerships, Vancity

Lauren Dobell (QUEEN'S, OXFORD) is Director of Strategic Partnerships for Vancity, Canada's largest financial cooperative, and remains awed by the breathtaking potential of capital mobilized in support of healthy communities characterized by economic inclusion, environmental sustainability and meaningful reconciliation. The credit union annually returns 30 per cent of its profits directly to its half-million members and their communities, while continuing an unprecedented journey to migrate the whole of a \$20+ billion "book" of funds under management to impact investment. Most exciting, from Lauren's perspective, is Vancity's advocacy work across sectors to help shape a truly enabling policy environment for progressive social finance and community impact investment. Her winding path to values-based

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banking includes forays into international development, academia, and public policy advising at all levels of government. "Canadian Councils" (for international cooperation, unity, learning) are a strangely recurring phenomenon in her resume.

Patrick Duguay, President of the Board of Directors, Chantier de l'économie sociale

M. Duguay est un acteur de cette économie au service des gens. Il nous présentera de façon concrète comment les entreprises d'économie sociale ouvrent des perspectives pour un développement plus durable.

Patrick Duguay est directeur général de la Coopérative de développement régional (CDR) Outaouais-Laurentides depuis 2001. Bachelier ès Science de l'Université de Montréal et diplômé de l'UQO, il a participé à la fondation de nombreuses coopératives dans divers secteurs d'activités. Fortement engagé dans la construction d'une économie plus humaine et centrée sur le développement des collectivités, il fait de la coopération sa pratique privilégiée.

Il a été président de la Société de diversification économique de l'Outaouais, membre Gouverneur de la Chambre de commerce de Gatineau et il siège à de nombreux conseils d'administration (c.a.) d'entreprises et d'organisations locales et régionales. Président du c.a. du Chantier de l'économie sociale, il a siégé au comité des fiduciaires de la Fiducie du Chantier de l'économie sociale et au Réseau d'investissement social du Québec (RISQ).

Dianne Kelderman, President and CEO, Nova Scotia Co-operative Council

Dianne Kelderman, one of the founding members of CCEDNet, is the president and CEO of the Nova Scotia Co-operative Council and President of Atlantic Economics, a firm specializing in economic analysis and development, related public policy and alternative finance. She was invited to participate on Canada's G8 National Advisory Board, to create Canada's Report for the G8 Social Impact Investment Task Force meeting in June 2014

Dianne's current managerial todo list encompasses a broad range of interests: six separate business entities with assets and projects over \$55 million: a \$40-million small business financing program for Nova Scotia's credit unions; Canada's first and only online health care clinic; a \$2-million equity investment fund; and, responsibility for innovation with Nova Scotia's co-operatives and credit unions. Dianne recently launched her online health care clinic (www.healthconnex.ca).

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Nancy Neamtam, Strategic Advisor, Chantier de l'économie sociale

The previous executive director of the Chantier, Ms Neamtan has been at the heart of the social economy movement for 30 years, working first as a community organizer, then as Executive Director of RESO (1989-1998), a community economic development corporation, devoted to the economic and social renewal of southwest Montreal and since 1998 with Chantier. She has received numerous local and international awards in recognition of her work. Nancy is a leading international figure in relation to social enterprise and the social economy.

From 1997 to 2007, she was the founder and President of the Board of Directors of RISQ (Réseau d'investissement social du Québec), a \$10 million investment fund dedicated to the non-profit and cooperative sector. Since November 2006, she has been President of the Fiducie du Chantier de l'économie sociale, a \$53 million patient capital investment fund for collective enterprises. She was also a member of the Canadian Task Force on Social Finance.

List of *National Impact Investment Practitioners Table* Coordinating Committee Members

Andrew Broderick
VP, Impact Market Development Vancity
Vancouver

Nancy Neamtan
Strategic Advisor, Chantier de l'économie sociale
Montreal

Derek Ballantyne
CEO, Community Forward Fund
Ottawa

Jane Bisbee
Executive Director, Social Enterprise Fund
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