Canada's Social Finance Opportunity: Driving Innovation and Results

Pre-Budget Submission

MaRS Centre for Impact Investing
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EXECUTIVE SUMMARY

To foster inclusive economic growth, the Government of Canada should 1) support businesses merging profit and social purpose, 2) foster outcomes-oriented service delivery across a range of areas, including education, training, and employment, and 3) clear a path for innovation in the social sector. Canada's social finance market can advance these objectives.

Building from the MaRS Discovery District's February 2016 pre-budget submission, we recommend that the Government consider the following social finance commitments in its 2017 Budget:

1. Catalyze investment in social enterprises
   a. **Launch a capital matching program that follows and de-risks private investment into impact investment funds**
   b. **Explore unclaimed assets as a source of capital for impact investment**

2. Foster outcomes-oriented service delivery
   a. **Launch a national outcomes fund to pay for social services based on their outcomes**

3. Allow charities and non-profits to maximize their impact
   a. **Prioritize the non-profit and charitable sector modernization agenda**

1. Catalyze investment into social enterprises

Issue: Inclusive growth is a key objective of the Innovation Agenda. Social enterprises promote inclusive growth through business models aimed at social goals. They are developing new approaches to reduce carbon emissions, improve health, and increase access to work and learning. Support for these social enterprises is critical to inclusive growth.

Considerations:

- There is growing interest in social enterprise among Canadian entrepreneurs, particularly young entrepreneurs. About 70 percent of MaRS ventures report that they aim to deliver a social or environmental impact. A growing cadre of impact investors in Canada and around the world – including foundations, philanthropists, corporations, and financial institutions – want to align financial return with social impact. This trend could significantly increase the capital available for social enterprises. As Canada's sector representative on the G8 Social Impact Investment Taskforce, the MaRS Centre for Impact Investing witnessed global momentum in social finance.
- Impact investment funds in affordable housing, charitable sector loans, clean technology and other sectors are growing across the country. These funds, however, remain small. The Government could play a vital role in accelerating market growth through a capital matching initiative.
- The next stage of Canada's Venture Capital Action Plan (VCAP) could take a more focused approach, targeting high-growth sectors that seek public benefit. Canada's impact investment market, which lags behind the United States and United Kingdom markets, is ripe for growth. The Government could take a phased impact investment approach that follows the market, uses government funding to lower risk, and ties funding to data reporting requirements calibrated to provide insight into program impacts and market growth, gaps and opportunities.
    - **Phase 1:** Match private investment in impact investment funds. By strategic use of first-loss capital and other tools, public money can reduce investor risk and thereby spur private investment. A matching fund could move money into priority sectors more quickly than a fund-of-funds. Canadian impact

funds have already collected hundreds of millions to invest in Canadian and international social enterprises. Matching capital could help these funds reach scale.

- **Phase 2:** Explore unclaimed assets as a source of capital for impact investment. While further work is required to design the optimal approach, the opportunity is clear.
  - The Bank of Canada holds $626 M in unclaimed bank balances and other assets. The Bank keeps these unclaimed assets for thirty years if under $1,000 and for one hundred years if over $1,000. It invests the assets in Government of Canada debt while it waits for asset owners to claim them. If an asset remains unclaimed at the end of its term, the Bank transfers it to the Consolidated Revenue Fund. About 70% of assets remain unclaimed when their terms expire.
  - The Government cannot spend unclaimed assets during the assets' custodial terms. The Government could, however, invest the assets to maximize public benefit. Devoting a portion of unclaimed assets to impact investing would turn the money toward social goals and attract private capital into the social finance market while preserving the assets' value for owners or the Consolidated Revenue Fund.
  - To comply with the prohibition on Bank of Canada positions in private-sector securities, the Government of Canada could establish a trust to which the Bank would lend unclaimed assets. A reserve worth about 40% of unclaimed assets held back at the Bank of Canada would cover claims from asset owners.
- **Phase 3:** Launch an impact investment fund-of-funds, capitalized by unclaimed assets and in partnership with financial institutions, corporations, and provincial governments. Big Society Capital, the UK capital wholesaler backed by unclaimed assets and bank equity, has signed deals worth £261 M and leveraged another £326 M into the UK impact investment market. A similar vehicle in Canada could help the market grow large enough to attract institutional investors, such as pension funds.

Recommendations:

a. **Launch a capital matching program:** Match private investment in impact investment funds on a dollar-for-dollar basis, potentially taking a first loss position alongside investments from selected investors. Government money would follow private money, moving more capital into social enterprises in sectors such as health, clean technology, and work and learning.
b. **Explore unclaimed assets as a source of capital for impact investment**: Investigate the possibility of investing unclaimed assets held by the Bank of Canada into the impact investment market. As of December 2015, the Bank of Canada held $626 M in unclaimed assets.

2. Foster outcomes-oriented service delivery

Issue: The Government has committed to build a Social Innovation and Social Finance Strategy, to dedicate a fixed percentage of program funds to experiment with new approaches, to measure what works, and to focus funding on effective services. These commitments demand a heightened focus on outcomes and an openness to new forms of multi-sector partnership.

Considerations:

- Public spending on social services is in the billions, but there is limited information on the impacts of these services. That deficit suggests a missed opportunity to help all

Canadians realize their potential in economic participation, health, and wellbeing. Public spending often suffers from:

- A focus on outputs rather than outcomes – for example, how many people attended an employment program rather than how many people become employed;
- Silos between government departments and service providers that fail to recognize the cross-cutting nature of social challenges, and that encourage a program-centered rather than a client-centered perspective; and
- Limited data on population needs and program impacts, as well as limited investment in social sector R&D to design new approaches and determine what works.

- Governments around the world are turning to outcomes-based funding models to address these challenges. These models allow service providers to access capital based on a government commitment to pay for outcomes, and allow governments to test or expand services without taking on financial risk. The risk transfer to investors can make longer-term and larger-scale funding more attractive. This model emphasizes rigorous measurement of what works.
    - The MaRS Centre for Impact Investing is working with the Public Health Agency of Canada and the Heart and Stroke Foundation to launch a pay-for-success contract based on a healthy lifestyle program for pre-hypertensive seniors. Six private investors have agreed to provide working capital for this program.
- A national outcomes fund would catalyze the development of outcomes-based approaches to service delivery. In the United Kingdom, the Department of Work and Pensions launched a £30 M fund to pay for outcomes related to education, training and employment of disadvantaged youth. The department published a rate card listing maximum prices for each target outcome. The rate card led to a competitive bidding process and new partnerships between service providers. Ten outcomes contracts (or "social impact bonds") were launched as a result and many are already showing results.
- An outcomes fund could potentially live within a broader innovation platform set at arms-length from government, similar to Grand Challenges Canada (GCC). GCC is a non-profit organization funded by the Government of Canada and dedicated to supporting bold ideas in global health. In addition to paying for specific outcomes, this platform could facilitate social sector R&D through end-user design, behavioural economics and other new approaches. A dedicated, independent platform would cultivate a strong culture of innovation and smart risk-taking, insulated from traditional government processes and political pressures. Alternatively, an innovation platform could be built into a central agency – such as the Privy Council Office – as a shared resource for the whole of government.

Recommendation:

a. **Launch a national outcomes fund:** Pay for social services based on results. Focus on one or more priority policy areas, such as barriers to employment or mental health and homelessness.

3. Allow charities and non-profits to maximize their impact

Issue: The Government has committed to modernize the rules governing the charitable and non-profit sector. This agenda is critical to achieve the Government's innovation and inclusive growth objectives. Charities and non-profits are important allies in developing new solutions, delivering social services, and enhancing opportunities for Canadians and their communities. A renewed partnership with the sector requires an updated regulatory framework. In particular, Canada's regulatory environment has not kept pace with the trends of social entrepreneurship and impact investment, recognized as valuable tools for more effectively and efficiently addressing social and environmental challenges.

Considerations:

- Non-profit organizations and charities are increasingly turning to entrepreneurial approaches to maximize their impact, and many foundations are looking to align their investments more closely with their charitable mandates. However, current rules, especially rules in the *Income Tax Act* and related guidance, inhibit this activity.
- The MaRS Centre for Impact Investing convened Canada's National Advisory Board to the G8 Social Impact Investment Taskforce. The Board set out specific recommendations to accelerate the growth of Canada's impact investment market in its 2014 report *Mobilizing Private Capital for Public Good: Priorities for Canada*. In particular, the report recommended modernizing the rules governing the non-profit and charitable sector to:
  - Allow charities and a sub-set of non-profits with clear public benefit objectives to pursue more business activities exempt from income tax, and to pursue other business activities subject to income tax.
  - Allow charities to provide a private benefit where it is necessary to achieve a broader public benefit.
  - Allow charities to make below-market investments where the investments advance their charitable objectives.
- A fourth recommendation, to allow charities to invest in limited partnerships, has recently passed into law. This change has been welcomed by the sector and is facilitating the flow of capital into social-purpose ventures, projects and funds, which are often structured as limited partnerships.

Recommendation:

a. **Prioritize the non-profit and charitable sector modernization agenda:** Enable a wider range of social finance and social enterprise activity in the non-profit and charitable sector, building from the recommendations of Canada's National Advisory Board to the G8 Social Impact Investment Taskforce in its report, *Mobilizing Private Capital for Public Good: Priorities for Canada*.

Conclusion

This brief describes social finance opportunities to advance an inclusive growth agenda. These opportunities would expand socially-oriented capital, draw on multi-sector partnerships, and stimulate both economic and social sector innovation.

The MaRS Centre for Impact Investing is committed to supporting the Government of Canada as it shapes a strategy for economic growth and social wellbeing in the broadest possible partnership with Canadians, businesses, and communities.

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