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Dear Olivia

Social Ventures Australia - Social Enterprise Investment Fund

We are instructed that Social Ventures Australia (**SVA**) would like to establish a Social Enterprise Investment Fund (**SEIF**), to help social enterprises obtain long term or ongoing funding and other business support. We understand that SVA will be making submissions to the Productivity Commission in response to the Commission's draft report on the contribution of the not-for-profit sector.

Set out in this letter is a high level summary of some of the key legal issues involved in establishing a fund like the SEIF.

1. Introduction

A fund, like the SEIF, which aims to provide long term support to social enterprises, may be involved in the following activities:

- receiving funding from investors for which the investor may either seek a tax deduction or a return on their investment;
- holding and investing those funds received until they are provided to the social enterprises;
- distributing funds to the social enterprises either as grants or loans;
- facilitating 'soft debt' funding by financial institutions and other high net worth investors directly to the social enterprises; and
- providing practical support and guidance on the day to day management of the social enterprises.

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2. Financial services regulation

A fund, like the SEIF is likely to be involved in providing a range of financial services for which it would need to hold an Australian financial services licence (**AFSL**), subject to any available relief or exemption. A person is required hold an AFSL if they carry on a financial services business in Australia. Financial services which the SEIF or its operator might provide include:

- personal financial product advice to the social enterprises;
- general financial product advice to investors;
- dealing in financial products (either by dealing in interests in the SEIF or arranging for another person to deal in financial products);
- operating a registered management investment scheme (if the SEIF was required to be registered); and
- custodial and depository services.

Holders of an AFSL, must comply with the licence's conditions, related provisions of the *Corporations Act 2001* (Cth) (the **Corporations Act**) and ASIC regulatory requirements, including: capital adequacy requirements, compliance and risk management, personnel skill and training; and various reporting obligations. The regulatory and compliance cost involved can be significant.

3. Disclosure

The Corporations Act requires that an offering of financial products to retail investors must be accompanied by a product disclosure statement or prospectus. Whatever form the SEIF takes it will involve offering financial products to investors or donors, ideally including people who would be characterised under the Corporations Act as retail investors. The cost and time involved in preparing disclosure documents that comply with the Corporations Act requirements is also significant.

4. Exemptions

Not surprisingly, the Corporations Act is not primarily concerned with fundraising activities of not for profit organisations and there are various exemptions that mean the Corporations Act will not apply with its full force to not for profits. Similarly, the Australian Securities and Investments Commission (**ASIC**) has provided several exemptions to facilitate some fundraising by charities.

In this context, ASIC has issued Class Order 02/184 Charitable Investment Schemes - Fundraising (the **Class Order**) which provides exemptions from the fundraising, managed investment scheme, debenture and licensing requirements of the Corporations Act for a charitable body or trustee when operating a charitable investment scheme. ASIC says in the related Regulatory Guide 87 that its exemptions for charitable investment schemes:

recognise that some investors may want to assist a charity to fulfil its purpose.....For some of those investors, financial profit to the investor is not the primary consideration in making

the investment and therefore the investor does not expect or seek point-of-sale disclosures in compliance with the Corporations Act or the protection of the fundraising, managed investment, debenture or licensing or provisions normally required by the Corporations Act.

The effect of the Class Order is that a fund, such as the SEIF, with some conditions, is able to access exemptions from some of the licensing and disclosure obligations that would otherwise be imposed by the Corporations Act.

(a) Financial services regulation

The Class Order provides exemptions that would allow SEIF or its operator to undertake a most of the activities set out in section 2 without needing to hold an AFSL. However, the relief provided by the Class Order does not cover all of these activities. This means that without further legislative change or special ASIC exemption, SEIF or its operator would either need either need an AFSL or would be unable to:

- advise social enterprises about issuing equity to investors or about investing in financial products, such as insurance;
- arrange for social enterprises to issue equity to investors; or
- issue financial products other than debentures or interests in a managed investment scheme (a unit trust).

(b) Disclosure

The Class Order provides an exemption from needing to prepare a regulated disclosure document for the issue of interests in a managed investment scheme or debentures and also the requirement to inform investors of some material changes and significant events in the circumstances of the fund¹.

If the SEIF or its operator wanted to offer financial products, other than units in a managed investment scheme or debentures, to retail investors it would be required to prepare a regulated disclosure document under Part 7.9 or Part 6D of the Corporations Act. This is because the issue of financial products, other than units in a managed investment scheme or debentures, goes beyond the relief provided by the Class Order.

5. Taxation

In order to attract gifts from the public, a fund, such as the SEIF, would need to be specifically listed as a Deductible Gift Recipient in the Tax Act. The process for such applications is well established but clear support from the Government is necessary for such applications to be progressed successfully. Therefore Government support from the outset would need to be provided.

Given the blended nature of the funding sources and the prospect of some financial returns being derived by a fund such as the SEIF, the fund would need to be tax exempt. It is not clear that a fund such as the SEIF would necessarily qualify under the existing categories

¹ The Class Order does not provide relief from the misleading and deceptive conduct provisions of the Corporations Act which relate to the publication of any disclosure document or promotional material by the SEIF.

and therefore, it would be necessary for the Government to legislate specifically to provide exemption from tax for the a fund such as the SEIF.

6. 'Soft-debt' funding

As discussed above, the fund may provide assistance to a social enterprise by providing access to sources of 'soft debt' funding. It is envisaged that a fund such as the SEIF may facilitate the provision of soft debt funding from finance institutions, such as banks, or high net worth investors, with the social enterprise being responsible for any liabilities.

Whilst there are no regulatory barriers to the provision of 'soft-debt' funding, there are some considerations which may need to be taken into account when agreeing the terms of the 'soft debt' funding including:

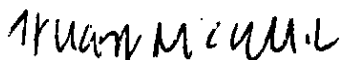
- the nature and scope of the security provided by the social enterprise to the debt provider, particularly where a project has multiple debt providers or the social enterprise has more than one project; and
- the establishment of inter-creditor arrangements where a social enterprise has multiple debtors, each of whom may have agreed to provide the soft debt on different terms.

Depending on the role a fund, such as the SEIF takes, if it is acting in an 'arranging' role, brokering the loans, consideration will need to be given to the contractual arrangements including disclaimers and indemnities, which will be required to protect the fund from any potential liability.

7. Consumer credit

A fund, such as the SEIF, may be involved in providing credit to the social enterprises. However, it is unlikely that the Consumer Credit Code, or the soon to be enacted National Consumer Credit Protection licensing regime will to apply to the activities that such a fund may undertake. Further consideration will need to be given to this issue once the activities that such a fund may undertake are finalised.

Yours sincerely



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