CARTERS
BARRISTERS
SOLICITORS
TRADEMARK AGENTS

CHARITY LAW BULLETIN NO. 354

OCTOBER 29, 2014

EDITOR: TERRANCE S. CARTER

REPORT ON MOBILIZING PRIVATE CAPITAL FOR PUBLIC GOOD

By Terrance S. Carter[*]

A. INTRODUCTION

In September 2014, Canada's National Advisory Board to the Social Impact Investment Taskforce, in conjunction the MaRS Centre for Impact Investing, released "Mobilizing Private Capital for Public Good: Priorities for Canada," a thoughtful and comprehensive report directed at Canadian governments with recommendations to advance impact investment (the "Report"). The Report grew out of an international initiative launched in June 2013 at the G8 Social Impact Investment Forum in London, England. The Report by the Taskforce builds upon the 2010 Report "Mobilizing Private Capital for Public Good: Canadian Task Force on Social Finance," which had made seven recommendations to mobilize new sources of capital, create an enabling tax and regulatory environment, and build a pipeline of investment-ready social enterprises.[1]

The Report is intended to improve the well-being of all Canadian communities through innovative public policy with four key recommendations. Underlying each of these recommendations is an emphasis on impact investment and the important role that Canadian governments need to play in furthering impact investment in Canada. Impact investment, or social finance, is generally described in the Report as the practice of directing private capital into projects whose aim is to deliver measurable

[*] Terrance S. Carter, B.A., LL.B., Trade-Mark Agent, is the managing partner of Carters, and counsel to Fasken Martineau DuMoulin LLP on charitable matters. He would like to thank Bart Danko, B.Sc., M.E.S., J.D., Student-At-Law, for his assistance in preparing this *Bulletin.*

[1] See *Charity Law Bulletin No. 335*, *Report on Impact Investing in Canada*, by Terrance S. Carter, for more information on impact investing in Canada, online at: http://www.carters.ca/pub/bulletin/charity/2014/chylb335.htm.

social outcomes. Two immediate priorities identified in the Report include enabling impact investment and social entrepreneurship in the charitable and non-profit organization (NPO) sector, and catalyzing impact investment through capital matching, investor incentives, and outcomes payments.

B. OVERVIEW

Impact investing has a long history in Canada; the first recorded instances of impact investment include the emergence of credit unions in the early 1900s. Impact investment differs from traditional socially responsible investment in that it involves investors positively seeking initiatives to create social outcomes, rather than screening out initiatives that may have negative social effects. It also uniquely encourages collaboration between non-profit, public, and private entities.

The Report is divided based on two areas of priority:

1. Addressing legislative and policy barriers to social entrepreneurship and impact investment in the charitable and non-profit sector, with a focus on the *Income Tax Act* (ITA); and

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

These areas of priority inform the rest of the Report, which is divided into Parts 1 and 2. Part 1 focuses on recommendations for the federal government, while Part 2 is applicable to the federal government, provincial governments, and other stakeholders.

C. PART 1

Part 1 is called *Rethinking the Non-profit/For-profit Divide: Income Tax Act Barriers to Social Entrepreneurship and Impact Investment in the Non-profit and Charitable Sector*. It provides recommendations to increase impact investment in the non-profit and charitable sector with two categories of recommendations that focus on the ITA.

The first category of recommendations aims to *Enable Charity and NPO Social Enterprise Activity*, which includes recommendations to:

1. 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.

2. 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.

The second category of recommendations aims to *Unlock Foundational Capital for Impact Investing*, which includes the following recommendations:

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

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

3. 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.

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

D. PART 2

Part 2 of the Report is called *Catalyzing Impact Investing: The Opportunity for Governments*. It reflects on global examples of governmental impact investment initiatives and how they might inform the Canadian experience. Through this analysis, this Part of the Report encourages intergovernmental cooperation and adoption of tools including capital matching, credit enhancements, guarantees, tax incentives, and outcomes-based financing. The two major recommendations in this Part are to:

1. Establish an impact investing matching program, paired with appropriate incentives.

- For instance, an impact investing matching program could take the form of a fund capitalized by the government and co-invested with private investors, or a 'fund of funds', which could provide the scale necessary to attract larger institutional investors. Incentives are also recommended, which includes, for example, tax credits and first loss capital.

2. Establish an outcomes payment fund.

- This approach targets investment towards projects that have been proven to have the most impact as well as projects identified as having the potential for superior social outcomes. The Report identifies that a flexible approach to establishing contracts is vital in supporting these kinds of projects. For example, a contract where payments are based on price per outcome. Overall, in the case out an outcomes payment fund, the bigger the fund is, the stronger the market signal it creates, which results in a greater overall impact.

In order for these above recommendations to be successful, however, the Report indicates that input from various stakeholders outside of the government is essential, particularly from current and potential impact investors, including NPOs and charities. By combining knowledge of global examples and the recommendations of domestic stakeholders, the Report identifies that Canadian governments will be able to maximize the amount of private capital directed towards impact investing.

E. CONCLUSION

Impact investment offers a unique opportunity to advance the Canadian social fabric. The impact investment market is growing quickly. This Report highlights the need for Canadian governments to situate themselves at the forefront of this process. This is especially important because governments are uniquely able to accelerate the growth of impact investment on a broad level. It is therefore hoped that the worthwhile recommendations contained in the Report are given serious consideration by all levels of government in Canada.

The full Report is online at: http://www.marsdd.com/wp-content/uploads/2014/09/MaRS-National_Advisory_Board_Report_EN.pdf

For comparison purposes, the summary to a report done in the United Kingdom, also researching social investment by charities, is available online at: http://lawcommission.justice.gov.uk/docs/cp216_charities_social_investment_recommendations_summary.pdf

CARTERS
Carters Professional Corporation / Société professionnelle Carters
Barristers · Solicitors · Trade-mark Agents / Avocats et agents de marques de commerce
www.carters.ca **www.charitylaw.ca** **www.antiterrorismlaw.ca**
Ottawa · Toronto
Mississauga · Orangeville
Toll Free: 1-877-942-0001