
Social Impact Bonds:
Addressing Key Stakeholder Issues
A Canada Perspective

Social Innovation Generation
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Background

Social Innovation Generation (SiG) has convened a Task Force on Social Finance to recommend policy and approaches to government, foundations, and the private sector to determine how best to catalyze the creation of a financial marketplace serving charities, non-profit organizations and social enterprises in the non-profit and for-profit realms. As part of this exploration, SiG has commissioned a series of specific work on different aspects of social finance to ensure that the Task Force has concrete examples and policy options to recommend.

Included in this exploration were Social Impact Bonds. SiG has already completed a background paper on SIBs at the request of Human Resources and Skills Development Canada. [The paper](#) provides a summary of work being done internationally, describes the general scope of a SIB and outlines some next steps in SIB work for Canada. In addition, Tim Draimin and Adam Jagelewski developed a workshop and subsequent paper with Community Living BC to review the possibilities for a SIB in the disability space in British Columbia.

Both these efforts pointed to the need to identify potential pilots as a means to access needed supports, tools and infrastructure to develop SIBs in Canada.

Since mid-September, we have held discussions with a number of individuals and organizations on Social Impact Bonds. Our purpose was: to understand the landscape of current activity in Canada; to gather issues that should be considered as part of the review; to determine how best to support the burgeoning possible pilots in Canada and to determine if a credible pilot example could be brought forward.

Our report was not intended to be an overview of the total SIB space, but to document key issues (and possible ways to address them) and to articulate (based on our own experience and those of other potential SIB pilots) the resources we believe are necessary to effectively move forward to SIB pilots in Canada. While work on tools and potential pilots is ongoing, this paper provides an overview of some of the key issues raised by different stakeholders about SIBs and some of the possible ways to mitigate issues as we pursue next steps in any potential pilots or programs.

Potential Issues to be Addressed in SIB programs or pilots

Each of these issues can and must be addressed through the review of any potential SIB pilot. They are important guides when thinking about a potential SIB marketplace. Like so many new ideas, SIBs have excited the imagination of government, potential investors and some possible sector participants. While the following issues are by no means exhaustive (and many have likely been addressed in detail in other papers), they

represent the most immediate concerns raised by all three potential stakeholder groups in SIB development in Canada.

Model/Process Issues

Who will act as the intermediary? How do we ensure they have expertise in the potential pilot subject matter areas?

In the UK, significant development financing was available to create a team of individuals with both financial and subject matter expertise. Even at the beginning of our scoping exercise, all parties we met asked: who will assist in the development, who will be responsible for delivery, and who will be the third party to hold the bond funds?

In Canada, organizations are emerging to meet this need. In particular, MaRS has created a hub of information, through research and connection with both the UK Social Finance group and a variety of interested organizations throughout Canada. It has strong rapport with government and a business practice devoted to social innovation.

Potential perverse consequences (need to understand how to balance cost savings metrics with social outcomes)

There is significant concern by all parties about the potential of perverse consequences as a result of SIBs. In particular, there is great concern about the possibility of offloading of government programs or pursuit of the cost saving side of the SIB and the potential negative consequences to social impact. As a UK SIB blog put it:

The other, darker, interpretation is that this model is a route to mass privatization of public services, to incremental service quality reductions as charities are forced out and bigger scale private providers move in on the new income area and then start to 'game the systems' in the same way as has occurred in the Welfare to Work programmes, and to more a limited extent perhaps, in GP's and NHS Trusts' manipulation of targets. As a result, this interpretation goes, people on the receiving end of the new systems will suffer. (Beyond Big Society: Social Impact Bonds and the post-Conservative state, Nov 2010).

Of all the potential issues raised about SIBs, this one is the most pervasive. Every new social innovation must rise to the challenge of potential perverse consequences. While clearly governments who are determined to privatize services will do so with or without a SIB, the fear and the concern are real. The question to be addressed is how to ensure that the necessary supports, quality of service and outcomes for individuals and communities can be safeguarded by a SIB model.

To address this concern, organizations evaluating potential SIBs should consider a full list of potential perverse consequences and their potential mitigation as part of any proposal for a SIB. In particular, one way to ensure this is to require that the potential

clients or their representatives be involved in the development of the impact metrics that will measure outcomes. This helps ensure that the outcomes are beneficial for the end user, and not just the agency or group involved in the execution. Finally, social impact outcome measures themselves will likely include preservation of supports or services that are essential basis for prevention and innovation. Certainly in the healthcare field in Canada, access to universal health services are the basis upon which any prevention programme would be built.

These are not the only way to mitigate these issues, but they offer practical options to begin to deal with this concern.

Economic evidence base is in its infancy and will require careful review

While the social sector keeps clear records on outputs as required by many of their grants and contracts, few have evidence that truly reflects outcomes. Even in the health sector, where considerable work has been done on health economics and overall costs, much of the evidence may be output rather than outcome based and needs to be carefully reviewed to ensure can provide the desired social and economic impacts.

Some fields in the social sector are more advanced in their research development and have a mature field of experts to both develop and evaluate the economic impact metrics (health economics for example) that will allow a social impact bond contract to be devised. There are also a number of emerging groups who are working to develop some standard measurements that might provide a basis for economic measurement. Using this expertise, it will be possible to build a broader base of metric experts in a variety of fields.

True measurement of social impact is also in its infancy

At the recent SoCAP conference in California, several panels, announcements and discussion took place on outcome measurement and evaluation around “social impact” for financial investment. One well known, respected, mature organization received reviews by three impact measurement firms, each using a slightly different methodology to determine an overall rating for investment¹. All three of the organizations provided a different rating for the organization, based on different criteria that they deemed important; while all agreed that the organization was meeting its own objectives and outcomes within its organizational targets, only one asked if the type of intervention provided by the organization had a meaningful impact or effect on the social problem the organization was designed to mitigate. Their analysis said that the type of program delivered by this organization did not have significant impact and would not rate highly on their scale. However, even this rating group made clear that the comparisons they used to determine relative impact were not necessarily similar enough to provide a good

¹ Please note that none of the reviewers used the IRIS or GIIN systems, being piloted by Rockefeller and other partners in the US

determination. The audience was left wondering: which (if any) set of measures came closest to providing information they needed to reasonably describe and rate social impact.

Jed Emerson frequently points out, much of the social finance field is in its infancy, and as we learn, we get better. Without specific proposed applications or reasons to improve the field, there will be no purpose for this work. Social Impact Bonds could well provide one reason to improve the options for social impact measurement. In Canada, there are several organizations working to provide this information for nonprofits and charities who wish to use it to strengthen their organizational profile for funders and other audiences. SIBs could provide a valuable opportunity to enhance this growing field.

Outcomes may be outside the timeframe of a SIB

Most venture capital firms in the private sector have determined that investments, to be successful, must span at least 10 years. This is because the initial years of any start up organization are generally more costly due to the ramp up to full scale operation, and are unlikely to create the same rate of return as subsequent years. This is also true in the social sector, for social impact. Many types of interventions, particularly those that propose to deal with areas of significant interest and cost to government (like health care) often have a window of at least 10 years for real impact and can require as much as 25 years. This time frame is considerably longer than the 3-7 year window of the SIB. While some intervention programs, especially those who have an already developed intervention ripe for scalability can provide a return within this time frame, this difficulty persists for many emerging innovations.

There are clearly some pilot examples where returns can be realized within the 3-7 year time frame contemplated by the SIB. To mitigate this issue, developers will need to begin with more mature organizations who have experience evaluating potential programs, have a research base for their numbers and understand what type of interventions can be delivered within the life of a SIB.

Government issues

Why wouldn't government just fund prevention projects directly if a cost savings is involved?

Questions arose as to why government, when presented with a cost saving prevention opportunity, would not simply decide to fund the program directly, thereby achieving cost savings for themselves. According to UK Social Finance, the "promise" of the SIB is that, once the prevention or innovation has been proven to have economic and social

impacts (thereby removing risks), governments would fund them directly as part of their ongoing programs. It seems in this funding environment, it is unlikely that governments have the means or opportunity to “take risks” with new programs and even mature, well respected nonprofits are experiencing difficulty finding funding for new or even proven innovative prevention programs. SIBs potentially offer the opportunity to create effective programs that could become part of long term government strategy, after their initial promise has been proven in a pilot program.

Government has difficulty “running the SIB program” and needs to be brought to the table by another group

Many government agencies have expressed some interest in SIBs, but given their roles and responsibilities are concerned that they cannot bring the parties to the table themselves. They require an intermediary agency to do this convening work for them. Governments are interested in being part of the discussion, but even where they may have interest in developing pilots themselves, traditional government funding mechanisms are somewhat antithetical to the nature of a SIB. Finally, it would be difficult for any key party to a SIB contract (government, industry, social sector) to be the developer and the intermediary, as each partner brings a particular interest to the table. In order to have a successful SIB, each party’s interests must be represented and negotiated into a contractual agreement and a third party who has the trust of all partners must administer the program. This points to a need for third party intermediaries in development of SIBs.

Potential issue of private sector partners (concern of optics)

Government representatives expressed concern that certain types of potential private sector bond “partners” may create difficulty. In the United States, the optics of paying private sector corporate interests (for example, banks or insurance companies) for these bonds was raised as a potential political liability. In Canada, while potential “optics” problems may arise, there is significantly less concern about dealing with investors from the private sector, which, given the relative stability of our financial system has not created the kind of toxic atmosphere that exists in other parts of the World. However, it will be important to carefully consider who would be the best partners for this type of financial instrument; it will be essential that both the corporate and nonprofit partners in initial pilots are beyond reproach. While investors in a SIB would theoretically be at arms length, given the need to sign a contract for performance the credibility of all parties to any SIB deal will be important to ensuring its success.

Issue of fixed vs. marginal costs

The evidence base for health care and other social sector bonds needs to consider individual costs directly attributable to the intervention funded by the SIB as well as fixed costs. The concern raised was that fixed costs cannot be reduced within an acceptable

time period and would require a level of change beyond the scope of initial Bonds, and yet, these costs may figure prominently in the cost reduction equations, particularly on the health care side.

Mature organizations in the health care field have been dealing with these issues for some time and have developed sophisticated models, accepted by government, about the direct costs that might be saved by particular interventions. On the strength of detailed metrics, the cancer community was able to obtain a commitment of over 250 million dollars for specific cancer strategies; diabetes and other health groups have received funding based on similar modeling. These models offer a basis to develop direct costing metrics for the larger sector.

How do you single out individual departments when benefits accrue across budgets?

Government structures dictate that it is very difficult to gain support for a program when benefits are not directly attributable to a departmental budget. There is concern if the budget accrues across a number of departments, it will be difficult to find budgetary support for a SIB. It will be important to begin with pilots that can attribute cost savings to one budget (and accept the positive externalities and ancillary benefits accruing to other departments); once the model is successful it may be possible to deal with Departments of Finance or other central agency on the overall cost savings of a SIB, with key support from most affected Ministries.

Sector issues

Offloading of government programs

As previously mentioned, there is a serious concern by many sector organizations and groups about the potential for SIBs to either download programs (without appropriate financing) to sector groups or to do away with important economic and other support programs for vulnerable populations. Any SIB pilot would need to effectively address this issue, and there are options to do this as described previously.

Possible Diversion of Funds from Grants, Contributions and Donations

Sector organizations have expressed concerns that SIBs could, potentially, draw money from existing sources, rather than provide for additional funds from investors. The intent of the SIB is to provide additional revenue sources, through investors who are looking for a return on their investment. Hypothetically, the return for new “social” investors for SIBs needs to be sufficient to draw them into the market; in practice it is likely that initial pilot investors will be organizations or private sector groups that have an interest in the work of social organizations and would support new funding mechanisms. It is unlikely that funds from these individuals and organizations will come from the same

“pot” as those for grants. The recent “Money for Good”² report which conducted extensive research on impact investors indicates that individuals and groups that are interested or who currently engage in impact investment do not do so at the expense of their charitable investment. It will be important, as the SIB market grows to take this concern into consideration and to continue to track sources of investment and demonstrate how SIBs provide access to capital that was previously unavailable for social sector purposes.

Is there a market beyond Foundations ?

In the United States, since the Foundation sector is so large, program related and mission based investment has translated into funds for experimentation and support for new financing options. In Canada, the Foundation sector is much smaller and has just begun an exploration of PRIs and Mission related investment. There is concern that Foundations funds may not be sufficient to meet all the emerging capital needs in the sector and may in particular not be sufficient for a SIBs. There is additional concern that funds that were being used for grants by all sectors will be displaced by the SIB.

As with all social finance entries, communication will be key to acceptance and success. Pilots that demonstrate how additional funds have been made available, either through endowment investment or the more traditional capital market will be important information for the sector and will likely lead to greater support for these instruments. Grants and donations are a precious resource and need to be preserved, but they are a small resources and increasingly, social sector organizations and looking for new ways to supplement these sources of funding to meet the needs in their communities.

To ensure there is a market in the private sector, or to find ways of encouraging existing organizations with endowments to invest, potential investors and sector organizations will need to see real evidence that pilots are successful for all parties. This gives added weight to the need for effective social impact measures that deal with the list of concerns raised by sector organizations.

What happens once the pilot is over? Who funds participating organizations?

There is concern that once funding for these pilots is over, they will go the way of many social innovations and not be able to continue, while new “innovations” must constantly be produced. As previously mentioned, the “promise” of the SIB is that governments or other funders will embrace successful pilots, (and 5-7 year funding is very attractive to organizations who currently live year to year without operational support) but given the experience of many sector groups with pilot and innovation programs, this remains an

² http://www.hopeconsulting.us/pdf/Money_for_Good_Impact_Investing_Overview.pdf, pg. 10

issue for many. One way to deal with this concern would be to address it as part of the contract negotiation around pilot bonds, describing the “post bond” period and the anticipated next steps for the program or organization.

Could the private sector compete with social organizations and ignore the social impact side (meeting only the cost cutting side of the equation)?

The concern about competition and private sector organizations “recognizing a good deal” is inherent in most social finance models. As the SIB blog puts it:

As the model rolls out, though, and the more or less parasitic private sector organisations start to bring their economies of scale to bear, and start to out-compete the smaller charitable organisations which have done the hard early graft, things may well change. Driven by the need to meet targets at all costs, offenders may become less important to service providers than offenses.

While it's impossible to foresee exactly what may happen, it's possible that in order to meet the 'non-reoffending' rates needed to meet targets and take in the cash, ex-offenders may be kept on such a tight leash (perhaps by agreement with a new style probation service) that ex-offenders may not get the chance to re-offend, but only at the cost of a total lack of re-integration into society, and perhaps even an explosion of offending the day after the target is met. Perhaps we will even see, as we did with Welfare to Work, payments made to offenders, perhaps to make themselves scarce beyond the geographic area of measurement until such time as the target is met. (Beyond Big Society: Social Impact Bonds and the post-Conservative state, Nov 2010).

Again, in addressing perverse consequences, all possible negative outcomes will need to be addressed. There are significant potential perverse consequences in any social program and are sometimes ignored by organizations seeking funding in an increasingly competitive world. The promise of SIBs is that the contract requires that social impacts be negotiated and measured, thereby providing a contractual obligation between the parties to value the outcomes that have social impact and are relevant, rather than leaving them to chance. Research in all fields creates the opportunity for bias and “system gaming” ; it is impossible to create a system that is foolproof. It will be important to have an agreed upon set of ethical and measurement standards and an independent, well-respected review panel for aspects of social impact research to mirror those that have been set up in other fields. Even in the pilot stage of SIBs, it will be important to set up agreed upon reasonable standards that will work to ensure the integrity and principles of the program are upheld.

Will there be a drive to cherry pick the easiest and perhaps least innovative options

Initially in any market, success for pilots is essential to build support. There is concern that given the models commitment to results, that the emphasis will be on “sure bets” verses real innovative programs that may not all be successful, thereby limiting the possibilities of this model as a means to innovation in the sector.

This issue needs careful consideration. However, in the beginning, sure bets that create real social value are essential to help prove the model. In the current economic environment “sure bets” are having as much difficulty with funding as are more obscure opportunities. It would seem that funding them would be of benefit to the communities they serve.

Investor issues

Forgoing financial compensation, or setting a low limit on financial return in favour of social value does not prove the market for the bond or incent commercial investors to participate.

Some proponents of the Bond have suggested that, in the pilot stage and to gain government support, Foundations and other investors be asked to forgo large returns in favour of “financing” the model. Concerns have been expressed at this approach, saying that in order to prove the SIB as a viable entry to capital markets, it is essential to demonstrate the upside potential for investors who are taking on considerable risk.

How does government reserve funds to pay for the Bond; do they restrict funds; how is payment guaranteed?

It is unclear, in particular because the contracts of the current UK model are confidential, how a government might reserve funds over a 5-7 year period to pay for the Bond. Many investors (and potential government partners) have asked how this could be done. Clearly, it has been done, but the risks inherent in a change of government, Minister or senior official are clear to potential investors and this issue would need to be clarified at the outset of any SIB arrangement.

Where to now?

While SIBs are new, they did not emerge whole cloth as an idea without history. Several different models, encompassing different aspects of the SIB, have been working in communities for many years. Given this, there are existing views about all aspects of the Bond, some of them riding the waves of concerns about financial innovations that have not been successful and have left both the sector and potential investors wary of new financing instruments.

There is, also, experience to draw on. The questions and issues raised point to the need for development of some standard litmus tests in developing SIBs that will require pilot proponents to deal with the possible perverse consequences that stakeholders have raised. While no system can be foolproof, transparency in dealing with issues and a clear set of standards would help and would provide some answers to those with legitimate questions and concerns about SIBs.

It will also be important to have more pilots, in different jurisdictions. It is almost impossible for governments, investors and social sector participants to evaluate the potential of any new social finance model in the absence of direct and concrete examples to build from. While the UK pilot has provided some instructive information, a Canadian example would prove much more fruitful in examining both the promise and the pitfalls of such an instrument in Canada. Universally, organizations have indicated the need for resources to support them in their development efforts. SIG is beginning to develop these tools and in response to feedback from interested stakeholders will create collaboration spaces for developers and other interested parties and some initial tools for evaluating pilots. Perhaps most importantly, SIG is working to collect and share information and tools from sources around the globe as the pilots and first phases of work on SIBs continue.

It is clear that, while Social Impact Bonds are not going to fill all needs for capital in the social sector, they provide an important opportunity in the continuum of social finance. SIBs will provide the greatest opportunity in sectors where prevention innovations can provide significant social benefit as well as relieve a growing financial burden for government.

SIBs require considerable support and there is a great deal of work needed in order to realize their opportunity. While some tools exist, they are in their infancy. To ensure that Canadians can explore this opportunity, infrastructure and resources are required. While it is essential to build on whatever resources are available, from the UK and elsewhere, circumstances, regulatory environments, government programs and markets are not identical and a program that adapts whatever exists and builds additional support for a Canadian marketplace will be critical. And, where no tools or information is available, we need to work with collaboration partners to ensure we make wise use of scarce resources. The U.S. and Canadian contexts are not identical, but there are sufficient similarities to make exploring collaboration options in development of tools, standards and infrastructure a reasonable first step.

We welcome the opportunity to share what we have learned and developed and to learn from and collaborate with our colleagues across Canada and around the world.