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Policy Principles for Social Impact Bonds A Nonprofit Perspective August 2015

Through a social impact bond (SIB), an “impact investor” provides the program funding for a social program over a period of years (typically 5- 7). If the “service delivery agent”, (the nonprofit) achieves the agreed upon results, then the “payor” (typically a government) pays the investor their capital outlay plus a profit (5- 20%, depending on risk).

A SIB is designed to reduce demand on other government services, thereby “saving” the government money they can pay to the SIB investor. In some cases, the investor risks losing the entire investment if SIB targets results are not met; in others, only the profit is at risk with some or most of the capital guaranteed.

Why we are proposing SIB Principles

The Ontario Nonprofit Network (ONN) has been watching the development of social impact bonds (SIBs) and the interest surrounding them for some time. Here in Canada, we know governments are exploring what they might offer. Saskatchewan has one underway aimed at mothers at risk of losing their children into government care. In Ontario, the Office of Social Enterprise, Ministry of Economic Development, Employment and Infrastructure is in the process of developing a SIB, but the focus is not yet public. The MaRS Centre for Impact Investing is working to put together five social impact bonds, including one to house homeless individuals with mental illnesses. Elsewhere in the world, governments are experimenting with various models and pilots. Social impact bonds are still very much in the experimental stage.

As they progress here in Ontario, we are proposing some key terms and conditions we believe are required for SIB success in the short term. It is important that the voices of service providers are heard at this formative stage. The SIB model is in early development and nonprofits have a unique perspective to bring to the table. We also propose a SIB Evaluation Panel to address the longer-term questions about the role of SIBs. Will SIBs help or hinder governments and their service provider partners provide better outcomes for the people of Ontario? It's an issue that warrants further examination.

The Nonprofit Ambivalence Towards SIBs

The nonprofit sector finds itself in a quandary. On the positive side, a social impact bond can allow the service provider to do more of what they do best and are passionate about. Usually it is a well-proven program that is the subject of a SIB. A SIB allows the

service provider to serve people they could otherwise not serve. Anyone who works in the nonprofit sector knows the commitment the sector has to deliver on their missions and their inventiveness to find the resources to do so. A SIB is a source of cash to do good and needed work- in the short term.

On the challenging side, the SIB sets a precedent that may not work well in the longer term for the service recipients, the service providers, government and ultimately, the public. As currently designed, SIBs are opening up a new market for investment, one that until now has not paid a profit margin. Can we afford to, and should we, pay a profit margin on social services? In addition the costs incurred with a SIB are a future liability- essentially a “buy now pay later plan”. Since government does not pay until program targets are achieved, government liability for program costs are deferred into the future. What are the implications of this approach to service provision?

There is an urgent need to better understand SIB strengths and weaknesses

It is an open question whether SIBs are a suitable model for innovation in social programs. Some of the talk about SIBs is how useful they can be for innovation and new program development. To date, however, SIBs have primarily been used to scale up or replicate existing successful programs. As with all research and development, developing and refining a successful intervention often takes many years and many tries before the successful program participants and program characteristics are identified and proven. From experience to date with SIBs, it is becoming clear that private investors will not be willing to take on the level of risk and expense involved in program innovation because governments will be unlikely to pay them a sufficient return to cover the higher risks. In other words, there appears to be a mismatch between the kinds of programs intended for SIB investing and the kinds of programs on which investors would choose to take the risk.

Can SIBs generate the savings promised? Scaling preventative programs may be good policy, but may not free up resources in the short to medium term. One of the selling points of a SIB is that it saves government money by reducing demand and costs associated with other services. However, the savings to government may not result in actual dollar savings that can be used to pay the investor. Reducing recidivism may not mean governments can close a prison. There may instead be less crowding. Similarly, housing a person who is homeless may not mean the government can close the emergency room or hostel, because of ongoing, or in some cases, growing unmet needs. On the social side scaling a proven program is wonderful, and potentially even life saving for the participants. Over time there will be social and economic benefits for the community, too – but not necessarily directly attributable or easily measured. Scaling preventative programs is so much more than a short-term saving, but without the savings how will it be funded?

SIB programs need to provide a high level of accountability and transparency among the parties and with the public so everyone involved can understand both the social and financial returns and costs. We need to understand the impact beyond the length of the contract. What happens after the end of the SIB? Many programs, such as rent supplements, supportive housing, or addictions and mental health supports, would

leave participants little better off than when they started if they were simply dropped. What responsibility do investors have to the communities involved in the SIB? Will government have to pick up the program to maintain continuity of support to the participants? What are the long-term social returns and the implications for budgets and services?

SIB Design Elements

Sometimes in the enthusiasm for proving a SIB works and in the rush to launch one, key and important design principles are overlooked. It is very natural that everyone involved is anxious to prove that the concept works and get on with it. However, working in the short term on a small scale SIB will not prove a successful foundation for the longer term if the fundamental principles are not present. What is missing in the current SIB design is the perspective and interests of the community service provider. Ontario SIBs need to incorporate these design elements.

1. The well-being and continuity of service to *the participants* in a SIB need to be negotiated into the SIB project up front. The challenge for service recipients is one of continuity of service. Since SIBs are time-limited “proof of concept” projects, a commitment or obligation to continue to provide needed service to the participants at the end of the SIB needs to be built into the project. For examples, people who are homeless cannot be set up to fail and put back on the street because their rent supplement and support services are no longer funded, just as mothers and their young children can’t be discharged from their residence and the support services they need to make changes in their lives because time has run out on the SIB contract.

2. Government needs to improve its capacity to shift and adopt proven programs. Government needs to be ready to do more than just pay out if a SIB is successful. Funding a SIB to provide “proof of concept” begs the question of what will happen at program end. Government often has a difficult time changing what it funds to keep up with changing times, new evidence and better ways of doing things. SIBs will often be effective programs that have been developed in community, but have not been adopted into government funding portfolios. What will change during the SIB that will allow the program to be supported on an ongoing basis if successful? Just expecting or hoping government will pick up successful programs is not enough, as many frustrated foundations and service providers know only too well.

3. Transparency is an essential element implementing SIBS. All RFPs, contracts, progress reports and evaluations must be publically available. Best practice in the United States has SIB contracts and other documents as public documents¹ providing a valuable accountability resource and a learning opportunity for others negotiating SIB agreements.

¹ <http://siblab.hks.harvard.edu/government-documents>

4. Proactive accountability and evaluation - Government needs to demonstrate to the public why the added cost of having private capital pay for public services is justified. The planned reductions in tax revenues, especially corporate and consumption ones to government(s), along with cuts to program spending appear to make private investment in social policy and programming the default option at least in the short term. Longer term, however, governments' financial capacity to deliver community services needs to be addressed. As an alternative to SIBs, governments can undertake outcome funding directly with their service partners. It is unclear whether there is both value and a need for outside investors and whether the up front and carrying costs are justified in a SIB.

5. Service providers need to be principals in the SIB, determining service outcomes and contract terms along with the payee, impact investors and intermediary. In several SIBs, the outcomes of the SIB have been determined before or without the involvement of the providers. Service providers have on-the-ground experience and can assist in finding indicators and benchmarks that are realistic, achievable and good practice. In other business contexts, no one would dream of excluding the experts and the ones charged with getting the job done from defining the terms of the contract and outcome metrics.

6. Shared Returns. In other business contexts, when there is an investor and an operator, they share the revenue if the venture goes well. It is a bonus for the community that surplus revenues to the nonprofit will be ploughed back into their mission, but it does not mean they should not be paid that share for their work. SIBs, as a business model, needs to drop the vestiges of the charity model embedded in its current design where the investor's capital makes a return and the provider gets the privilege of doing more good and remains forever dependent on others for funds to do its work. Nonprofits need to be able to receive revenues for their work that can be redeployed into their mission when they are involved in for-profit financing models.

7. Service providers need to ensure the SIB program budgets cover their full costs. This includes SIB contract negotiation, project administration and management, data collection and outcome evaluation, as well as costs associated with scaling up and winding down the program. Organizations that have invested research and development funds over the years also need a return on that investment and intellectual property rights need to be addressed. Most, if not all programs, undertaken by a SIB will have been developed by philanthropic and/or government investments. SIB contract negotiations can be costly and time-consuming, and nonprofits are at a structural disadvantage in the same way they are in negotiating Transfer Payment Agreements with government. Support needs to be provided for nonprofit provider participation and legal advice. Taking a loss on a SIB is not a sustainable or appropriate business model for the nonprofit sector.

8. Service providers need to ensure they provide value added and do no harm with the project design. The service system needs to be improved and strengthened by a SIB, not distorted. SIB contract evaluators should evaluate the SIB's capacity to

address systemic and structural issues to ensure they do not become a series of expensive band aids. Participants cannot be dropped from service at project end, or discharged prematurely. There needs to be safeguards against cherry picking clients to meet timelines and targets, and protection against queue-jumping - displacing others with preferential access of SIB participants to existing community services.

9. An Expert Panel to monitor and track SIB development and learning. Individual SIBS will have their own external evaluators, but the development of SIBS as new social policy needs system wide evaluation and monitoring. ONN will bring together an expert panel to monitor and advise on SIB development and issues. ONN would be pleased to work with government, intermediaries and investors in Ontario to design a process to evaluate SIBS as a funding model.

In sum

SIBs as currently designed are not sustainable for the nonprofit sector unless they include the delivery organization in contract negotiation, program and evaluation design, ensure full cost recovery and include revenue sharing for the nonprofit.

In addition, participants in programs need to be treated with respect and good faith. They cannot be harmed by their participation in a SIB program or left without needed supports. Government needs to do more than pay a premium for testing a program model. They need to commit to incorporating successful programs and the participants into their service systems at the end of the SIB. If these design features are present in social impact bonds, this financing method may have a place in the spectrum of program financing.

We look forward to working with government and others to incorporate these important design features into the SIBs model and as SIBs move forward to evaluate its efficacy as a funding model.