

Social impact Bond

Social impact Bond (SiB) / Pay for Success Bond

What is a Social Impact Bond?

SiBs are restructuring the relationships between government, non-profit service providers, and existing and potential social investors (the “impact investment” universe; social finances, etc.), such as foundations, that are beginning to invest in “social enterprises” in addition to their role as donors.

With the ability to issue SiBs, a non-profit organization is able to raise capital from private investors based on a contract with government. Through this contract, a non-profit organization commits to obtaining social results that will generate future savings to the government.

If these results are reached, the generated savings will be used to reimburse the capital invested by investors plus a rate of interest that is contingent on the social outcome. If these results are not achieved, government pays nothing to the investors, representing a **transfer of risk from the public to the private sector**. In the end, the non-profits’ social goals become performance-oriented to assure returns for the investor. Social responsibilities assumed by government are subordinated to generating profitable returns for investors.

In terms of financial investments, SiBs are not bonds in the traditional sense. These “bonds” are closer to an equity investment in which risk is associated with the failure of non-profit organizations to produce concrete and quantifiable results.

Necessary conditions in the creation of SiBs:

- Evidence of **significant public expenses** linked with a **strong probability of reduction of these costs** associated with social interventions.
- Possibility to gather data and to develop the analysis necessary to **clearly evaluate the potential results**.
- Strong **co-operation** between the various stakeholders.

Where were these programs initiated and implemented?

United Kingdom

- Instrument designed by **Social Finance Ltd.** (an organization based in London that is developing the social investment market) within a working group on social investment.
- Implemented in September **2010** by the **Ministry of Justice** to reduce **repeat offending of inmates** upon their exit from prison (recidivism).
- The **6-year** program targets the **rehabilitation of 3,000 inmates** from the Peterborough prison through repeated interventions both within prison and in the community.
- This type of bond is based upon a mechanism focussing on **performance outcomes**.
- Advantages: the **reduction of government expenses** and **positive fiscal outcomes**.

Amount of bonds	Decrease in repeat offence rates (recidivism)	Financial return to investors
£5 million (~Can\$8 million)	7.5% to 15%	2.5% to 13.3%

This financial innovation was designed to attract private investment into the non-profit sector to improve social outcomes and generate public savings. As a result of this approach to reduce the rate of repeat offences, the number of prison inmates would decline as well as the cost of judicial procedures. The multiplier effects to government would also include the fiscal advantages associated with the potential integration of inmates into the labour market.

The return on investment in the case of “social impact bonds” is directly related to a quantifiable social benefit. The program launched in Peterborough in September 2010 offers its investors a **graduated return between 2.5% and a maximum of 13.3%**, once the minimal rate of **7.5% reduction in repeat offences** is reached. The financial return increases in tandem with the decrease in the repeat offence rate. The annual return to investors is capped at 13.3% (representing a 15% decline in repeat offences). Even in this situation, the cost to public authorities is only about one-third of the planned savings. On the other hand, if the reduction of the repeat offence rate is less than 7.5%, the government pays no interest and investors lose their investment.

United States

This is more of a “Pay for Success Bond”

- Social Finance USA (recently established in Boston) expects to introduce social impact bonds on the American market in 2012.
- Advanced discussions are taking place in Massachusetts. The city of New York and other local authorities are considering wider application of SiBs to problems of **criminal justice** and **housing**.
- At the beginning of 2011, Obama announced the injection of **\$100 million** for **seven pilot programs** through social impact bonds.
- Today, the Obama government is providing funding to **states and municipalities** that wish to test this new instrument. The **Department of Labour** will provide **\$20 million** and the **Justice Department** is poised to fund a second-chance program. Although less than the \$100 million announced, this amount is significant and will inspire states and the cities across the USA to consider this approach.

Simulation of the impact of SiBs on housing in the United States¹:

- Assuming a hypothetical case in which government currently spends \$100 million for its homeless population (health, jails, shelters, etc.), and non-profit organizations working with these populations could reduce this public expenditure to \$25 million, there would be \$75 million in savings for government.
- Let us now suppose that to carry out this work and get positive results (decrease in the number of homeless, for example) these non-profit organizations require \$40 million in funding.
- By issuing SiBs, the non-profit organizations raise this amount from private

¹ Social Finance, Inc., 2012.

<http://www.socialfinanceus.org/sites/socialfinanceus.org/files/small.SocialFinanceWPSingleFINAL.pdf>

investors. If the expected results are achieved, government will repay the capital (\$40 million) and interest with the savings it will make in the future (\$75 million – \$40 million = \$35 million net public saving).

Cost of a given homeless population (health, jails, shelters, etc.)	\$100 million
Cost after the interventions “Permanent supportive housing”	\$25 million
Funding through SiBs that covers the cost of the intervention program as well as the implementation of the SIB system (management and evaluation).	\$40 million
Public saving	\$35 million

Australia

In Australia, the New South Wales government plans to launch a SIB program (Social Benefit Bonds) at the end of 2012 to reduce repeat offences and improve the rehabilitation of youth in foster families. It is currently running a trial with three organizations in out of home care and recidivism (announced recently).

Israel

Social Finance Israel is in the process of being created. One of its first initiatives will be to issue social impact bonds.

Arguments used to promote SiBs

- **Long-term funding** prospects for non-profit organizations **without incurring financial risk**, thanks to available working capital for the entire duration of the program. These organizations typically face recurring funding challenges.
- The funds remain in the organizations long enough for the program to obtain results. The time period and expected results are established at the outset.
- Because this applies to clearly targeted populations that are strongly supported and accompanied by social organizations with clearly understood interventions and measurable impacts, SiBs offer a high guarantee of returns to investors .
- **Transfer of risk** from the public to the private sector and **cost savings** to the government.
- Improvement of **social results** and emphasis upon the improvement of **operational efficiency**.

Criticism of Social impact Bonds

- One more step towards **results-oriented evaluations** and the **quantification** of the progress made by society where social interventions are privatized and subordinated to measurable and profitable performance outcomes.
- Increasing pressure on non-profit organizations that already bear large responsibilities and commitments.
- In an increasingly financialized economy, the proliferation of such initiatives contributes to resolving social problems through processes of **financialization and privatization**.

- SiBs will mostly be applied to activities deemed less risky and with a high probability of achieving positive results. **What will happen to those non-profit organizations that cannot deliver these results** in an environment of disengagement by government? They will neither be attractive to investors nor will they be assured of ongoing public support.
- Larger established non-profit organizations will benefit from this initiative to the peril of smaller organizations.

Are these bonds?

Bonds can be an excellent method to raise capital to invest in social initiatives serving the common good. **Community bonds** are a good example -- important examples exist in Toronto and in the United States where the bonds issued by community development financial institutions (CDFIs) are guaranteed by the US Treasury, etc.

In contrast with conventional bonds, there is **no guaranteed return on investment** in SiBs. The return to investors depends upon the social performance of organization. Investors will therefore make very careful choices and select profitable social initiatives, leaving numerous others aside (representing the **privatization of social services and perversion of public-private partnerships**).

Public goods have been threatened with privatization for a number of years. As far as SiBs and the Peterborough pilot project are concerned, the responsibility for rehabilitating prisoners is transferred to the financial market. In Texas, an American state where the death penalty is still in force, training programs exist within prisons (publicly funded) with extremely positive results. People leave with an ability to successfully reintegrate into society and the costs to the State of Texas are reduced. There is no incentive or need to attract private investment.

Evaluation of results

It is very difficult to evaluate the precise impact of a social intervention within a fixed time frame. **SiBs are only concerned with easily quantifiable results.** What would happen to those positive innovations that require more complex evaluation criteria? Geoff Mulgan (one of the early advocates of SiBs at the Young Foundation in the UK) is now critical and admits that very few non-profit organizations have programs that allow for the type of evaluation imposed by SiBs that are only valid if they can be compared to a control group.²

Numerous social innovations with the potential to be most profitable for society would not obtain funding through this program because their multidimensional and non-quantifiable results would be too difficult to evaluate. These initiatives would be set aside at best or disappear, at worst.

Time horizon

Even with a clearly positive impact, it is very possible that at the end of the predetermined time period, a non-profit organization may not yet have reached the required social results. How will this be evaluated? Will a negative scorecard have detrimental effects on such an organization if it is not given the time to meet its

² Geoff Mulgan, et al. Social Impact Investment : The Opportunity and Challenge of Social Impact Bonds. Young Foundation, 2011. http://www.youngfoundation.org/files/images/11-04-11_Social_Impact_Investment_Paper_2.pdf

objectives? The impact of educational initiatives or of rehabilitation or reinsertion into society, to name only a few important examples, often appears only in the long-term and cannot be tied to a time horizon set by financial markets. Moreover, investors will not get their return on investment and selected sectors that have issued SiBs may find themselves under-funded yet again.

A resolutely one-dimensional approach

Unless there are complex multi-sector impact evaluation grids which are less easily quantifiable and rely on estimates and therefore make it difficult to attain the precision sought by SiBs, SiBs will reinforce a one-dimensional approach and vertical management (in silos) of socioeconomic problems.

A circular approach that applies solutions that caused the initial problems in many cases

If government or communities (through collective enterprises) respond to certain needs in society, it is because these needs cannot be addressed in an isolated manner based on simple performance criteria to assure a market return on investment. These needs are complex, multidimensional and difficult to measure, especially in financial terms.

The need to evaluate the results of social initiatives that will attract private investment could quickly legitimate the creation of a credit-rating agency. It is due to the necessity of evaluating the soundness of bonds that Moody's, Standard & Poors and others exist. Today, these rating systems are associated with conflict of interest, speculation and crises (subprimes, credit default swaps, speculation on the Greek debt, etc.) and punish before any corrective strategies can be applied. We can only imagine the devastating consequences that such a rating system would have if applied to social problems. Using this analogy, one could stretch the imagination to include speculation on the failure of a rehabilitation enterprise and why not on recidivism itself!

Why social impact bonds should not be considered by the social economy

One of the founding principles of the social economy is that its members, users or consumers are also stakeholders in the management of the production of goods and services. SiBs are based on a different premise entirely. Investors seek financial return and have no commitment or engagement with the organizations issuing the SiBs. The social purpose of the organization becomes a source of profit, even if for society, it is presented as an innovative and efficient strategy to reduce social problems and therefore, the fiscal burden on government.

Another step in the wrong direction

In short, this system offers the financial sector an additional means to generate wealth and increase its influence on what should or should not be funded. Partnerships between the public and the private sectors must not be resisted, quite the contrary, but SiBs involve a subordination of the public interest to private interests with consequences for society.

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