5.1 SOCIAL/DEVELOPMENT IMPACT BOND

Brief Description

A Social or Development Impact Bond (SIB or DIB) is a pay-for-results funding model involving multiple parties. It is designed to enable non-profit interventions (typically encouraged by public actors) to attract private investment in order to pre-finance the activities needed to generate a defined set of impact outcomes (outcome targets). Private investors provide the up-front capital. The impact bond reimburses the investors for their capital with a pre-defined return in case the outcomes targets are achieved. The transaction may be structured with a Special Purpose Vehicle (SPV) which acts as a contract partner for all actors involved. In this case the SPV takes on the private capital from the investors and contracts one or more service providers who are charged with actually generating the outcomes. The service providers are usually NGOs. There is typically an independent organisation involved for verification of the impact outcomes.

An impact bond is not a bond in the traditional sense of the word, since the repayment and the return are dependent on the achievement of desired outcomes. In case the outcomes target is not met, the investors typically receive neither a return nor the (full) repayment of the principal.

Purpose/Fit	De-risk the testing and roll-out of innovative service delivery models by non-profit organisations, attracting private investment for the pre-financing of non-profit programmes
Can replace	Grants, public contracts
Risk/Return Profile	Dependent on the risk to achieve the pre-defined outcome target
Enterprise Lifecyle	No enterprise, but an (established) non-profit organisation with existing track record for achieving impact outcomes
Maturity	Linked to the length of the intervention, but usually around 3 years

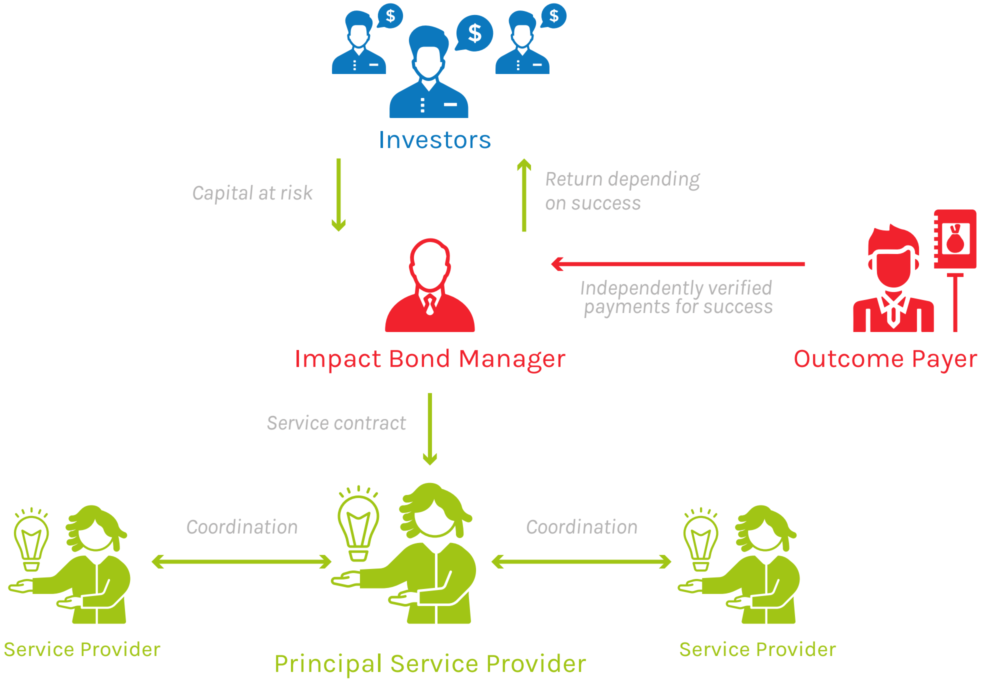

Figure 5.2 - "Understanding Social Impact Bonds", source: OECD.

Defining Criteria

- **Outcomes-based:** Repayment and return for the investor are tied to the achievement of outcomes (as opposed to activities or outputs).
- **Shift of risk to investors:** Investors, but not the service providers, carry the risk of non-achievement of outcome targets.
- **Specific scope:** Often focused on prevention measures and public cost savings.
- **Impact verification:** Independent verification of the outcomes.

Involved parties

- Outcome payer is the entity which places the 'pre-order' on the outcomes to be generated. This is usually a local government entity (Social Impact Bond/SIB) or an international development funder (Development Impact Bond/DIB); philanthropic foundations can also engage as outcome payers (though have typically engaged as the investor up to now).
- Investors provide private capital which is used to pre-finance the activities of the non-profits (service providers) and gets repaid with returns in the case of success.
- Service providers are generally NGOs who enter into a contractual agreement with the impact bond and agree to deliver certain outcomes against pre-financing.
- Fund manager (or transaction manager) as a central intermediary engages in the process of brokering and managing the impact bond transaction; in case an SPV is used, the fund manager is the one to manage it.
- Impact verifier is the independent organisation in charge of evaluating the level of target achievement of outcomes.
- There can be a performance manager and/or advisor involved in supporting the service provider to achieve the impact outcomes and in providing a source of information and scrutiny to investors and the outcome payers.

Interesting Variants and Options

- In case of no need for pre-financing: a direct performance-based contract with ongoing results-based payments for outcomes achieved between the outcome payer and the service provider can replace the impact bond structure, thereby removing the SPV and reducing the complexity of the transaction (no need for raising private investment).
- In case of limited need for pre-financing: a direct performance-based contract with an up-front payment (i.e. 30% of total funding) and ongoing results-based payments for outcomes achieved between the outcome payer and the service provider can replace the impact bond structure, thereby removing the SPV and reducing the complexity of the transaction (no need for raising private investment).
- The risk for the investor can be partly reduced by a guarantee or first-loss capital provided by another public or philanthropic funder.
- Staggered outcome targets can be defined so that repayment and return for investors is not "all or nothing".
- Bonus payments for the service provider can be agreed upon to increase the performance orientation (and return participation) of the service provider.

Example of Impact Bond structures

- Social Impact Bond: The pioneering example for a Social Impact Bond (SIB) is the Peterborough bond in the United Kingdom (HMP Peterborough). In this example, a set of service providers were funded to decrease the reoffending rates among ex-convicts being released from Peterborough prison. The bond did meet its targets and the investors were repaid. The bond was not continued.
- Development Impact Bond: An example for a Development Impact Bond (DIB) in the education sector is the 'Quality Education India Development Impact Bond'. In this case the objectives relate to educational enrolment and achievement (learning outcomes) among girls in selected regions. The impact bond currently operating is an expansion of an initial pilot DIB called 'Educate Girls'.

Examples of relevant terms (as formulated in a contract):	
Priority	Definition: Student enrolment defined by the number of out-of-school girls (between age 7 and 14) enrolled in school by the end of the third year. Outcome target: 79% of all eligible out-of-school girls.
Learning outcome improvement	Definition: Learning outcome improvement: standard deviation[36] as a difference from the comparison group performance. Maximum Payment: (USD 71) Outcome target: (0.4)
Investor Return	Repayment of investment plus (15%) p.a. in case of full target achievement (outcomes). Repayment of investment plus (10%) p.a. in case of target achievement (outcomes) of minimum 90%.

Main Advantages[37]

- Impact bonds can encourage innovation and tackle difficult social problems (including prevention).
- The public sector (funder) only has to pay for results (i.e. effective services); the third-party investor bears all the risk of services potentially being ineffective.
- The impact bond approach embeds the ongoing evaluation of programme impacts into programme operations, accelerating the rate of learning about which approaches work, and which do not.
- Enables collaboration between multiple stakeholders.

36 Standard points of variation around the mean

37 Source: "Building the tools for public services to secure better outcomes: Collaboration, Prevention, Innovation", Carter, E., Fitzgerald, C., Dixon, R., Hameed, T., Airoldi, M., The Government Outcomes Lab (2018);"Putting the front line first: smarter government", Cabinet Office (2009): "Towards a New Social Economy: Blended value creation through Social Impact Bonds", Social Finance (2010)

Main Challenges[38]

- Impact Bonds are often complex and time-sensitive instruments that require adaptability from the stakeholders engaged in them.
- Impact Bonds have been proven to be costly instruments so far.
- Ensuring continuity of social service delivery for vulnerable groups and citizens is indispensable.
- Stimulating social innovation can be a significant benefit but is not guaranteed.
- More evidence and rigorous evaluations (including a "theory of change" for using Impact Bonds) are needed.

Case studies and additional resources about Social/Development Impact Bond can be found here.

38 Source: "Understanding Social Impact Bonds", OECD (2016)