Scotland's Futures Forum

Seminar on Social Impact Bonds

22 November 2010

In an era of financial austerity, governments need to consider innovative new ways of funding the solutions to a variety of social problems. At a seminar attended by over 100 individuals from the public, private and voluntary sectors, representatives from both the Tomorrow Project and Social Finance set out the background to social impact bonds.

The Tomorrow Project is an independent charity, established in 1996, undertaking a programme of research, consultation and communication about people's lives in Britain in the next 20 years.

Social Finance's ambition is to transform the ability of the voluntary sector to respond to society's changing needs by enabling greater access to a variety of investment instruments. SF is a not-for-profit organisation founded in October 2007 in response to the recommendations of the Commission on Unclaimed Assets led by Sir Ronald Cohen.

Why is there a need for alternative investment models in the public sector?

Rapidly rising demand for services and unprecedented pressures on public finances means that we will have to find new ways of delivering public services.

- The Kings Fund estimated that a 2% growth in services to older people will be required in order to 'stand still'
- According to the Improvement Service, a 3 – 4% increase in provision will be needed for services to children due to policy priorities and increased assistance for children with learning support and special needs
- The impact of the recession will also see increased demand for public services such as housing, policing and community safety, social work, education, business support etc.

However, the UK government is talking of cuts to government departments and public services of up to 25% in the coming years.

Social impact bonds – a background

Tomorrow Project co-director Richard Worsley explained that identifying savings that government can make from tackling social problems at their root was at the heart of the development of social impact bonds (SIBs). The SIB is an alternative vehicle for investment in preventative action. Assuming the agreed outcomes are achieved, investors stand to see a return on their initial investment in the form of a share of the savings made by avoiding or ameliorating the social problem being targeted.

He cautioned against seeing SIBs as a panacea, explaining that it was likely that they would only be suitable for particular types of social policy areas and interventions.

Social Finance Associate Director Lisa Barclay then went on to set out the background to the first social impact bond (SIB). Against the backdrop of constrained public finances, investment in early intervention is often easier to cut in favour of funding crisis interventions. Social Finance believes that a shift back to higher levels of early intervention must be driven by a mechanism that creates positive spending cycles.

A SIB is a contract with the public sector in which it agrees to pay for improved social outcomes. On the back of this contract, investment is raised from socially-motivated investors and this investment is used to fund a range of interventions to improve a set of mutually agreed social outcomes. The financial returns that investors receive are dependent on the degree to which those outcomes are achieved.

Risk transfer

SIBs transfer the risk of failure of early intervention away from the public sector and allow investment in intervention without impacting on acute services budgets until outcomes are achieved.

Commissioning and attribution

Currently, finding adequate funding outwith the public sector for early intervention services is problematic. There is often a working capital gap and a lack of accessible funding for the voluntary sector organisations to cover the gap. In addition to this is the problem of attribution. Outcomes are rarely achieved through the efforts of one service. For example, the successful rehabilitation of an offender may depend on employment support, help with addiction issues as well as housing advice. Therefore, it is sometimes difficult to build a contract based on outcomes with individual organisations.

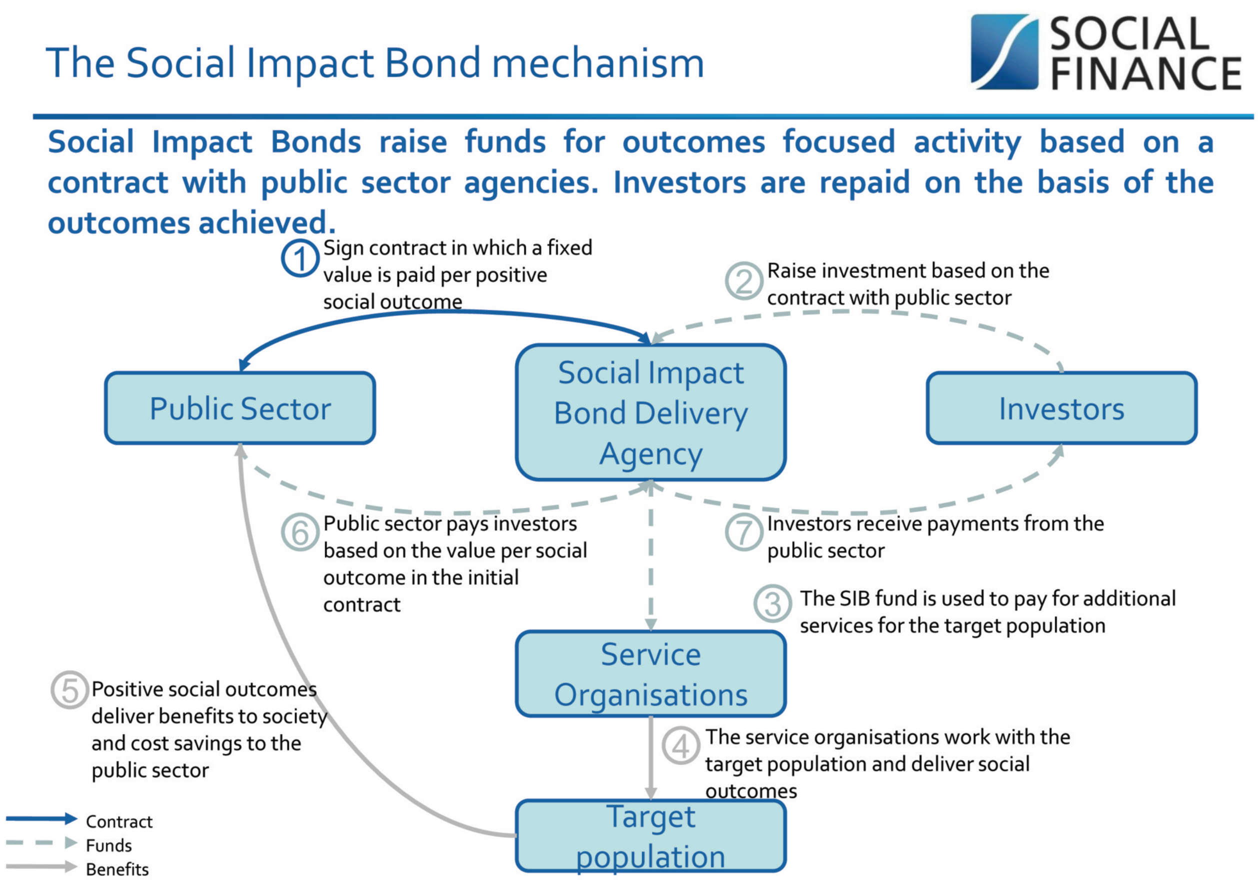
SIBs solve this problem by bringing in separate investors to fund voluntary sector service providers upfront and allow service providers to be commissioned as a group.

Social impact bonds – a background

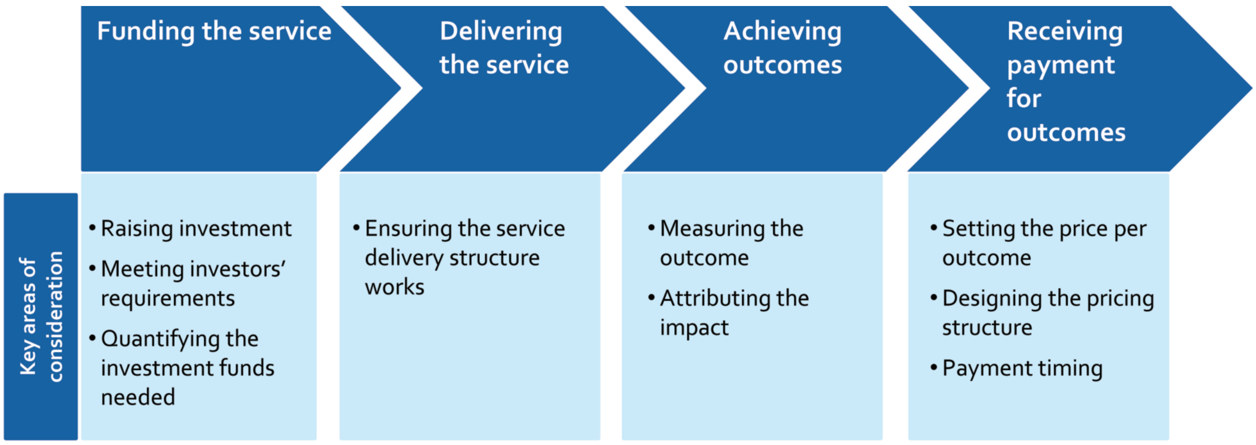
Longer term funding streams

SIB investments also have the potential to provide a more rational, long term income stream for the voluntary sector because:

- The focus is linked to social outcomes rather than outputs
- Organisations compete on the basis of value delivered rather than cost of service provision
- The income stream is longer term providing the organisation with more certainty and stability
- There is a greater incentive to innovate as programmes that can deliver better outcomes have a long term funding stream



The Steps in the Financing Structure



Peterborough prison SIB

The first SIB was launched in September 2010 with the UK Ministry of Justice. It is based at Peterborough prison and is focussed on reducing reoffending rates amongst approximately 3,000 short term male offenders over the next six years.

The services will be provided by voluntary sector organisations that have a proven track record of working with offenders and the individuals will receive a range of interventions both within prison and after release. For example, the St Giles Trust will support offenders within prison and after release. The Ormiston Trust will support offenders' families whilst they are in prison and on release back into the community and the YMCA will give offenders a base within the community.

The success of the SIB will be measured against conviction levels amongst the target population compared to a matched cohort taken from the Police National Computer. If conviction rates are reduced by more than 10%, the scheme will pay out per conviction avoided.

£5m has been raised by around 10 different investors. These investors are primarily socially-motivated charitable trusts and foundations. The maximum financial return investors can achieve is the equivalent to 13% per annum return on their initial investment. If the services are not successful, the original investment is not returned.

Lisa set out other potential future applications for SIBs such as adolescents at risk of entering care due to behavioural problems and family breakdown and diabetes sufferers.

In the case of the at risk adolescents, it is known that adolescents entering care have a strong probability of staying in care on a long term basis and that the outcomes for looked after children are considerably worse than for children in the population as a whole. Potential outcomes might include a reduction in preventative family breakdowns and number of young people entering care, a reduction in the length of time spent in care and improved outcomes for young people at risk of going into care.

In the case of diabetes sufferers, outcomes might include reduced emergency admissions and amputations. (Currently diabetes is the most common cause of non-traumatic limb amputations. In the UK, 5,000 people per year have a limb amputated as a result of diabetes.)

Conditions for a successful SIB

Social issues with the following attributes are most likely to be potential applications for SIBs:

- Clearly defined target group and outcome metrics – stakeholders need to trust that there is an objective mechanism for assessing and agreeing on the extent to which outcomes are achieved
- Controls to mitigate external factors – outcomes must be attributable to the success of the agreed interventions and not be dependent on external factors
- Reward schedule that avoids perverse incentives – the schedule should encourage service providers to work with everyone in the target population and not just the potential 'quick wins'
- Value rather than cost-based reward payments – this encourages the development of more cost-effective outcome delivery models
- Engagement with a public sector commissioner that is comfortable paying out a share of cost savings if pre-agreed social outcomes are achieved

Types of investors

Unsurprisingly perhaps, the organisations investing in the Peterborough SIB are primarily charitable trusts and foundations. However, it is hoped that once the SIB model is shown to work, more mainstream investors – maybe even retail customers – will be attracted to investing in future SIBs, broadening the pool of available capital.

However, Lisa was keen to point out that traditional funding streams will still be critical to the funding of many services. SIBs have the potential to work best in situations where the cost of intervention is smaller than public sectors savings and where those savings accrue over a relatively short period of time (arguably no longer than 5-6 years). The cost savings must be cashable and there must be good outcome metrics on which to base a contract and preventative interventions already known to improve the outcome.

Process for SIB development

SOCIAL FINANCE

Research and Development

- Identifying and defining an appropriate outcome;
- Testing and analysing potential intervention models;
- Assessing financial feasibility;
- Confirming stakeholder engagement.

Contracting and Capital Raising

- Developing a robust contract between public sector agencies and the Social Impact Bond investors;
- Building relations with service providers and developing an operational plan;
- Raising investment.

Delivering outcomes

- Establishing the Social Impact Bond Delivery Agency;
- Monitoring the effectiveness of interventions throughout the bond period;
- Working with local stakeholders to ensure ongoing impact.

Potential for Scotland

With various pressing social issues and dwindling budgets, Scotland could benefit from social impact bonds. Unlike other parts of the UK, there has been less upheaval in its public sector infrastructure and with devolved government, decision-making is potentially less time-consuming.

Plenary discussion

Participants raised a number of issues as well as seeking clarification on the procedure for setting up the Peterborough SIB.

Set-up and running costs of SIB

The genuine set-up and running costs of the first SIB were queried and it was established that the £5m investment did not include lawyers' fees or the input from Social Finance, which is a not-for-profit organisation part-funded by the Big Lottery Fund. However, Lisa Barclay maintained that the costs of future SIBs should decrease as a standardised process emerges.

Defining the 'investment'

Another participant asked where the investment sat on the balance sheet of the investor. Was it regarded as a charitable donation, deferred benefit or investment? It will be the decision of each charitable trust or investor organisation as to where the investment sits on their balance sheet. If it comes from their endowment funds it is more likely to be classified as an investment.

Banks and developing a common currency

One participant felt that there was a need to develop a common currency between the public sector and the banks, if the banks were to become regular investors in SIBs.

There was a widespread feeling that we should put pressure on those banks that are currently part or wholly owned by the state to consider investments like this.

Defining 'social goods'

It was felt that we needed to work on defining what we value as 'social goods' in Scotland so that a 'social currency' emerges in the way that in recent years carbon has become the accepted measure of environmental impact.

Creating a wider pool of potential investors

One participant suggested that matched funding based on investment from local authorities/national government might be a way of attracting more mainstream investors. Lisa Barclay agreed that there was no reason a local authority could not become an investor, provided there were no conflicts of interest.

It was also noted that, given the stringency of regulation regarding investments by charitable trusts, mainstream investors should take confidence from the fact that the first SIB has been largely bankrolled by socially-motivated charitable trusts and foundations.

Given that many private sector organisations have well-developed corporate social responsibility programmes that they pursue for mainly reputational gain, one participant suggested that they might take minimal persuading to consider investing in a SIB that had the potential for a financial gain.

Legal challenge

Lisa Barclay was asked whether Social Finance had considered the possibility of potential legal challenges from control groups. She responded saying that it was not an issue with the Peterborough SIB because the outcomes were being compared with a National Police Computer database. However, it is an issue to be considered when designing future SIBs in other areas.

Additional advantages of SIBs

There are huge potential benefits of scale for voluntary sector organisations which is often a problem when moving beyond a pilot stage.

The Peterborough SIB is enabling the capture of data in new ways due to its collaborative nature and it should be possible to use this data to further improve outcomes in future.

Lisa Mackenzie