

Paying for outcomes
Solving complex societal issues
through Social Impact Bonds



Are you prepared for the coming revolution in social policy?

Canadians look to government to provide leadership in solving the most complex issues in our society. These social issues include reducing crime, raising our level of health and well-being, and educating our children and youth.

Vast sums of taxpayers' dollars are invested in these areas every year. Yet, measurable outcomes can be elusive. The government bears most of the financial risk, and there is limited incentive for innovation. Given their complexity, some social problems require collaboration from a number of groups and perspectives – and the opportunities for such collaboration are often limited in the established structures of our public institutions.

A worldwide revolution in how we deal with social issues is occurring. The field of social finance and impact investing is changing the landscape. Similar to the pay-for-success bond in the United States, the Social Impact Bond is one key instrument that offers an innovative way to address many related challenges. Focused on outcomes, the Social Impact Bond enables the government to pay only if an initiative is successful, incentivize innovation, and allows service delivery providers to be commissioned as a group.

The Social Impact Bond can fundamentally shift how some social service programs are structured, impacting both government departments and social sector organizations. How prepared is your organization for the arrival of the Social Impact Bond in Canada?

The Social Impact Bond is really an amazing form of social finance: what it's doing is that it's basically letting government catalyze interventions on the preventions side, instead of being just trapped at the end of the pipeline. It takes risk off the shoulder of government: if no positive benefit is generated, the government is not on the hook to pay any money.

Tim Draimin, Executive Director
Social Innovation Generation

How the Social Impact Bond works

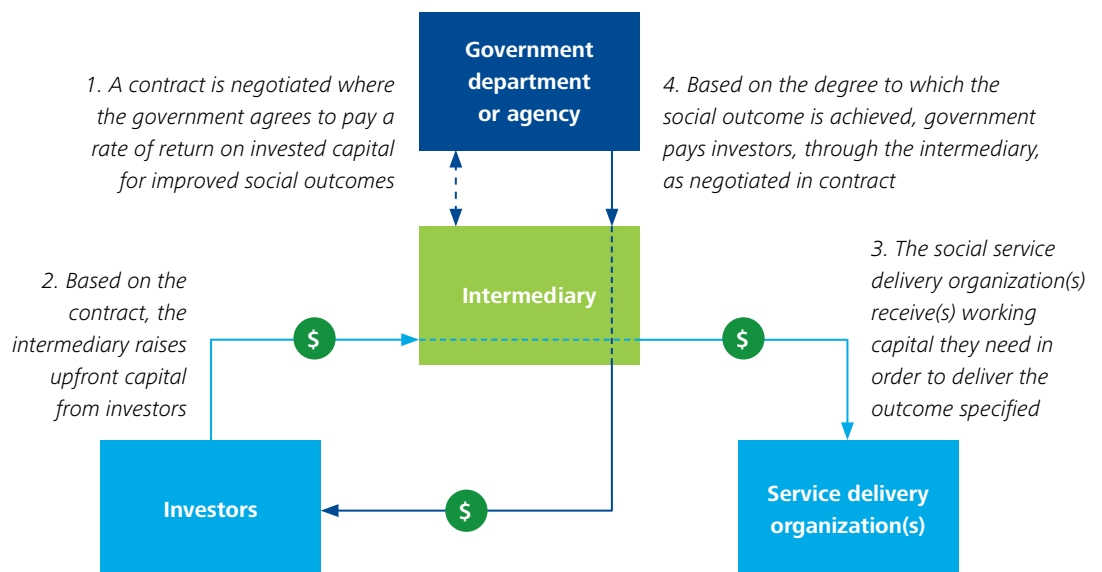
Social Impact Bonds present an alternative investment model in the midst of rising demand for services and unprecedented pressures on public finances. Focused on preventive action, the Social Impact Bond is based on a contract in which the government agrees to pay for improved social outcomes.

Under this arrangement, the intermediary raises money from private investors. These investors can range from wealthy individuals and charitable trusts to more profit motivated investors. Once they have raised the working capital needed, intermediaries then turn to service delivery organizations to implement innovative solutions to social problems. If the solution achieves the agreed-upon social outcomes, the government pays the investors, through the intermediary, a share of the spending that is saved as a result, based on the degree to which the social outcome is achieved. The intermediary may charge a fee to the investors to recover costs from its operations related to the Social Impact Bond.

The financial returns that investors receive depend on the degree to which the outcomes are achieved. As such, the risk of failure is transferred away from the government to the investors, whose financial return is based on the achievement of outcomes.

Although the Social Impact Bond can be applied to a variety of social issues, the model should not be perceived as a one-size-fits-all solution to all social issues. The following conditions are key for success in leveraging Social Impact Bonds:

- **Quantified savings to the government:** The savings associated with the outcome (e.g. reduction in the number of persons re-incarcerated) must be higher than the costs of delivering the outcome (e.g. reduction in recidivism).
- **Clearly defined outcome metrics:** the results-focused approach of Social Impact Bonds requires an objective mechanism for assessing the extent to which social outcomes are achieved.
- **Controls to mitigate external factors:** the outcomes must be attributable to the Social Impact Bond-funded initiative or intervention and not dependent on external factors.
- **Structured rewards that avoid perverse incentives:** the outcome metrics and related rewards should be structured to address the issue in its full defined scope, and not just the easy quick wins.



The promises and challenges of the Social Impact Bond

Social Impact Bonds hold the promise of achieving meaningful social policy gains at reduced financial risk to the taxpayer.

The primary benefits of the Social Impact Bond are:

A focus on results. The design of the Social Impact Bond demands an evidence-based results approach to addressing social issues. Anchored on metrics and evidence, SIB initiatives drive stakeholders to critically analyze and understand the issues, define progress, and focus on results.

Governments pay only if the initiative is successful.

In a time of austerity, governments must be far more selective and strategic in where they allocate limited public dollars. Socially-minded venture capitalists put up the working capital for an initiative to operate, and only receive a payout from the government if the initiative is demonstrably successful.

The transfer of financial risk in Social Impact Bonds

By design, the Social Impact Bonds transfer some or all of the financial risk from the government and taxpayers to private investors. These private investors provide up-front funding, and the government only pays if the intervention is successful.

On the other hand, this implies that, depending on the conditions specified in the Social Impact Bond, the return to investors in a Social Impact Bond could be a total loss. As such, Social Impact Bonds may be most attractive to philanthropists or charitable foundations who would look on a lost investment as a contribution to society that aligns with their cause if the intervention does not ultimately produce the intended results. Indeed, investors in the Peterborough initiative (highlighted on page 6) are charitable foundations. Governments may consider different models of risk-taking to make the investment more attractive to non-philanthropic investors.

The incentives for all participating organizations are aligned for experiential learning. The incentives for each participating organization in a Social Impact Bond initiative are aligned, encouraging all parties to work together and take an innovative approach to quickly determine which interventions are effective and which are not.

Service delivery providers can be commissioned as a group. Many social issues require the effort of a number of service delivery organizations. For instance, the successful rehabilitation of an offender may require employment support, help with addiction issues, and housing advice. Social Impact Bonds solve this problem by allowing service providers to be commissioned as a group to achieve a common social objective.

Participating organizations bring their best expertise to the table. The Social Impact Bond allows each participating organization to bring forward their expertise.

- **Governments as facilitators:** Departments and agencies play a facilitating role by initiating the project setup, supporting the policy framework, and providing the financial incentive for results.
- **Social venture capitalists and financial intermediaries as enablers:** Social finance experts bring their expertise in asking tough, business case questions. Once there are satisfactory answers to these questions, they provide the long-term, socially-minded capital required to fund the initiative.
- **Service delivery organizations as providers:** Canada's social sector has a rich breadth and depth of expertise in delivering services to address social issues. A Social Impact Bond initiative provides these organizations with access to stable working capital to provide interventions that may bring about positive social outcomes.

There are also challenges that must be overcome if Social Impact Bonds are to be successful in Canada.

Challenges that must be addressed include the following:

Detailed understanding of quantifiable savings. For government to benefit from issuing a Social Impact Bond, the price it promises to pay investors if outcomes are achieved must be substantially less than the cost that government would bear if they were not. To set the price of the Social Impact Bond, governments must have a detailed understanding of quantifiable savings associated with the outcome.

Clearly defined metrics, and a shift to outcomes-based service delivery. Evidence-based outcomes are often difficult to define. For a Social Impact Bond initiative to work, all stakeholders must agree upon a clearly defined goal and target population (e.g. "reduce the rate of re-offending among short-term offenders by 7.5% over 6 years as compared to a matched cohort"). The focus on outcomes presents a shift from traditional funding models for many not-for-profit service delivery organizations. It will be important for all parties to agree to an objective mechanism for determining whether the initiative has met the stated goal, which should involve contracting with a neutral third party to evaluate and certify the results of the Social Impact Bond initiative. Further, long time frames are required to measure the outcomes - not just outputs - of a social program. A number of years may be required before the outcomes and the financial returns can be determined. With the focus on outcomes, service delivery organizations also incur reputational risk relating to the success of the interventions. The costs of measurement, long time frames to achieve outcomes, and the shift in culture may be barriers to overcome.

Direct attribution of outcomes. The ability to draw a direct relationship between the intervention and the outcome is key to the design, but can also be challenging given the macro and micro economic as well as societal and cultural impacts on specific issues. Assessment approaches involving control groups and independent evaluations can help determine the extent to which service delivery organizations have achieved the outcomes sought.

Legal and administrative barriers. Social Impact Bonds are still a nascent concept in Canada. Ambiguities in the application of the law could serve as obstacles for potential investors, intermediaries, and service delivery organizations. Upfront cost related to legal advice and due diligence may be a barrier for service delivery organizations due to limited resources and capacity. Although these costs will likely be reduced as the Social Impact Bond concept matures, governments and intermediaries should consider how they can support smaller service delivery organizations. Sufficient time should also be built in to navigate and resolve legal and administrative issues.

The importance of metrics and evaluation

Well defined, relevant, and measurable metrics are key to the success of the Social Impact Bond. Successful metrics include the following considerations:

- **Agreed upon metrics at the outset:** The metrics should be defined and agreed upon at the outset by the government, the intermediary, and service delivery providers. Investors should have a clear understanding of the metrics and the risk implications.
- **Specifically-defined parameters:** The metric should define the specific target population or other parameter to define the scope of the social outcome intended for the Social Impact Bonds.
- **Independence of the evaluator:** The measurement of the impact metrics should be conducted by an independent party to minimize bias. Stakeholders should have a clear understanding of the measurement methodology at the outset.

In 2009, a new impact reporting system called the Global Impact Investing Rating System (GIIRS) was developed. GIIRS is among the first organizations to provide company and fund impact ratings. Deloitte is a founding partner of the GIIRS rating process, which uses the common language and definitions provided by the Impact Reporting and Investment Standards (IRIS) to determine ratings. The anticipated growth in the breadth and depth of social impact metrics in the next few years will help to unleash impact investing as a recognized asset class and facilitate investor comparisons between different Social Impact Bond initiatives.

The world's first Social Impact Bond at HMP Peterborough

The UK Ministry of Justice launched the world's first Social Impact Bond at HMP Peterborough in September 2010. Located near Cambridge, this correctional facility houses short-term male offenders. A consortium of charitable foundations that invested £5 million carefully selected a coalition of four social sector organizations to provide interventions both in prison and after release. If the interventions are successful in reducing the rate of recidivism by 7.5% as compared to a matched cohort from the national police database over a period of six years, the bond will be paid out by the government at annual rates of return ranging from 7.5% to 13% based on the degree of reduction in recidivism. This initial undertaking in Social Impact Bonds has attracted so much attention that HMP Peterborough has had to limit the number of fact-finding visits it receives from interested social venture capitalists and government agencies worldwide.

Source: research conducted by Deloitte

Managing public understanding and perception.

The involvement of private investors in solving complex social problems will be novel to the general public. The Social Impact Bond may raise perceptions that private capitalists are financially benefiting from the misfortunes of others. Further, governments may be seen as devolving their responsibility for social programs to the private and social sectors. Citizens may also be uncomfortable with the concept of using taxpayers dollars to contribute to the profits of private investors. It will be important to communicate and engage with the public about the social outcome focus of the Social Impact Bond, how financial returns are tied directly to positive social outcomes, and the intent to encourage each sector to bring their best to the table.



Deloitte's experts can help your organization in building the capacity to participate in Social Impact Bond initiatives. Our experts can advise your organization through strategy design, due diligence, workforce development, financial modelling, analysis of tax implications, readiness checks, implementation support, and independent evaluator.

Checklists for success

Government departments and agencies can create a revolutionary impact in social issues by positioning themselves to effectively leverage the Social Impact Bond. Social sector organizations with the potential to assume the intermediary role also have a remarkable opportunity to enable social impact in Canada by taking a leadership role in the Social Impact Bonds. Use the following checklists to guide your organization's participation in this revolution in addressing social issues.

Government departments and agencies

- Has a social issue suitable for Social Impact Bonds been selected?**
 - A defined target group and goals are key to the success of the Social Impact Bond. Is there a potential to define and scope the population related to the social issue?
 - The government needs to realize a cost savings to be able to provide a return for investors. Would prevention in the area present a cost-saving opportunity?
 - How can the Social Impact Bond complement existing programs and services?
- Are there measurable social impact metrics for the social issue?**
 - How can your organization take an outcomes approach to measuring performance and results?
 - Is there an objective party that is able to measure the outcomes of initiatives related to the issue?
- What is your strategy for pricing and implementing Social Impact Bond initiatives?**
 - Has your organization addressed any potential legal or administrative barriers?
 - How can your organization equip your staff with the skills to design and implement Social Impact Bonds?
 - Do you have a detailed, evidence based understanding of the quantified savings to government associated with the outcome(s) the SIB seeks to achieve?
 - What accounting treatment is appropriate to recognize Social Impact Bonds on the public balance sheet?
- Are your stakeholders ready to take on a Social Impact Bond?**
 - Has a feasibility and readiness study been conducted to assess how ready the related service delivery organizations, intermediary, and other stakeholders are for a Social Impact Bond on the social issue, and to identify the potential investors?

Potential intermediary organizations

- How does the Social Impact Bond intermediary role align with your organization's mandate?**
 - According to your mandate, does the enabling of innovative solutions to social issues align with the work of your organization?
 - Are there particular areas where your organization would be most suited to participate in?
 - Does your organization have the familiarity and capability to select the service delivery organization(s) for the Social Impact Bond?
- How connected is your organization with potential investors?**
 - How connected is your organization to potential investors? What are the costs and efforts required to identify and bridge the connections to future investors of the Social Impact Bond?
 - Can these relationships be valuable for your overall organization?
- What is your workforce strategy for facilitating the Social Impact Bond?**
 - How can your organization equip your staff with the required skill sets in areas of negotiations, legal, analysis, contracting, social finance, risk evaluation and management?
 - Can your organization develop a capability to raise private capital for the Social Impact Bond?
- Is your organization ready to successfully implement the Social Impact Bond?**
 - How supportive is your Board of Directors? Do staff have a credible plan to execute on the Social Impact Bond initiative?
 - What change management strategy is required to optimize the chances of successful implementation?

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To learn more about how Deloitte's public and social sector professionals can help, please contact:

Gianni Ciuffo

416-775-7443
gciuffo@deloitte.ca

Jitinder Kohli

571-858-0821
jkohli@deloitte.com

Shruti Shah

571-814-6753
shrshah@deloitte.com

Carmen Wade

416-643-8382
carwade@deloitte.ca

Howard Yeung

613-786-8613
hoyeung@deloitte.ca

Ivy So

613-786-7582
ivyso@deloitte.ca

www.deloitte.ca

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