



cutting through complexity

Social Impact Bonds

Planting for
future growth

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Introduction

It can be difficult to secure public funds to try out innovative ways of delivering public services. Governments, as custodians of the hundreds of billions raised through taxes, spend money on programmes that have been rigorously tested, evaluated and measured. This is the case when the economy is buoyant and is even more the case when public finances are tight, as they are today. As a result, little public money is spent on testing and trying out new ways to deliver public services and support populations with complex needs; the result is that public services and social programmes can remain unchanged for decades.

In the last few years a new type of investor has entered the public sector market determined to fill the innovation funding gap – social impact investors. These are investors who are not content with sitting on the sidelines, but have identified providers, companies or not-for profits who employ interesting and innovative ways to help particular communities – for example ex-prisoners or looked after children. These investors fund providers and interventions that they believe will do significantly more to help the population than current government programmes do. To create an evidence base, they invest in demonstration projects where they earn their money back once the project delivers outcomes that are better than traditional government support.

Once the case for the new intervention has been proven using investors' innovation capital, the Government can choose to adopt the interventions as status quo policy measures.

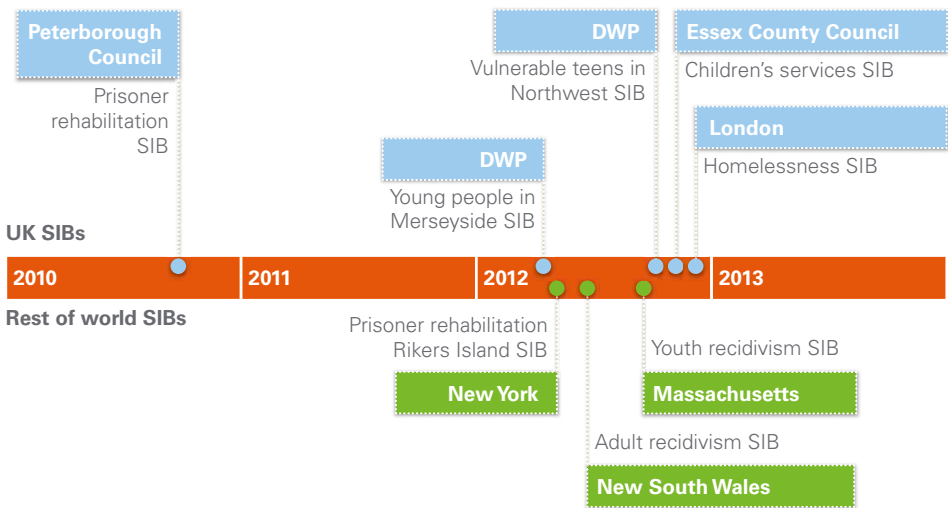
These funding agreements are termed 'Social Impact Bonds' (SIBs) although they are not bonds in the conventional sense. In the last two years a number of investors have become interested in developing Social Impact Bond projects in the UK, US and Australia. In the majority of cases these are socially-minded, often quasi-public sector investors who are willing to make a relatively smaller return for the public good. And it is not surprising that in response local government, the Prison Service and others are lining up to 'host' Social Impact Bond projects.

To date most Social Impact Bond projects have focused on social services. This has been borne out of a frustration that UK public services are reactive – that is they address the problems of children, young people and adults today, but do not spend enough time and effort on preventative action. Many Social Impact Bond investors and issuers believe that concerted preventative action – for instance with young ex-prisoners – could stop individuals from going down a lifetime path causing harm to the community, impact their families and themselves, thereby saving the state significant sums and improving the well-being of a community.

Timeline of recent SIB launches

However, there is no reason why the principle could not be extended to the health arena – for instance a Health Impact Bond – where a concerted programme is put in place to help people with Diabetes to manage actively their condition, or to support people who drink too much or are overweight to change their lifestyles and improve their health prognoses as a result.

This paper sets out some of the elements that should be taken into consideration when deciding whether a Social Impact Bond project is feasible both from the investor and commissioner perspective.







SIB feasibility criteria

For a SIB project to be deemed feasible, there are four sets of success criteria that must be considered both by the government commissioner and the potential investors. The first set is Policy Success. These criteria determine whether the project can be defined in a way that maintains policy integrity, won't create any negative unintended consequences to users of services (e.g. prisoners or looked after children) and allows outcomes to be objectively and cleanly evaluated, thus enabling the use of payment by results.

The second set of criteria is around the Provider Market. This set of criteria determines whether there are innovative and/or expert providers who have the capacity and capability to deliver the required interventions. This is important as if there isn't an available group of delivery partners who will be able to deliver the interventions locally to the quality standards or in the way envisioned, the SIB project may face a challenge.

The third set of criteria is around the Financial Case. In order for a SIB to work, investors will only invest their money if they believe the terms and interest being offered are commensurate to the level of risk. When evaluated against a range of other public and private sector investment options, a SIB can look risky. As a result there must be a match between the magnitude of potential outcome payments and the interest required by investors. If the outcome payments, modelled under a range of performance assumptions, cannot cover the risk premium required by investors, then the SIB project cannot go forward.

The fourth set of criteria involves determining the level of Stakeholder Support for a SIB project. For any project to succeed it must have the full support and backing of those who look after the project client base – the mentors, social carers, skills teachers, probation officers, etc. A SIB project only has a chance of success if the staff, commissioners, and clients themselves are comfortable with the project taking place.

Policy success feasibility criteria

Is there a clearly defined SIB target population?

As a SIB's payment mechanism relies on outcomes, it is important to have a clear definition of the target population. This means agreeing a clear target population where the delivery partner cannot cherry-pick participants in the project.

Are there measurable SIB outcomes?

The associated outcome measure for the SIB must be quantitative and link directly to the SIB target population. It is necessary for the outcome to be quantitative as it will need to be measured against a counterfactual (e.g. what the likely number would have been had the SIB interventions not occurred). In this way the success of the SIB outcomes can be evaluated, and in the instance of a successful outcome, payment can be made.

The type and impact of interventions on the target population may not deliver outcomes for several years. Depending on the choice of intervention and target population, it may be possible to design both a medium term outcome measure (e.g. 1-2 years post intervention) and longer term outcome measure (e.g. 3-4 years) which would then lead to two separate payment points.

Are there innovative interventions that are not used today?

Much of the idea behind SIBs is to provide a platform on which new approaches to supporting vulnerable groups can be trialled and tested. Therefore, for a SIB to work, it is necessary to identify interventions that could make a demonstrable and meaningful impact on the target outcomes.



If, for instance, the target population and outcomes are defined, but a distinct set of interventions cannot be identified, then a SIB project is unlikely to be funded. Investors will only invest their money if they believe that an intervention set is likely to produce results beyond what is achieved under the status quo. Often investors will require an evidence base that demonstrates the effectiveness of the proposed intervention.

Can a counterfactual be measured?

In order to determine the effectiveness of the SIB project, the measurement of a counterfactual position will be essential. The counterfactual establishes the baseline of what happens in the absence of the SIB project. The outcomes of the SIB project target population can then be measured against this baseline.

This baseline can be established in different ways – either by projecting the baseline drawing on past outcomes, or by establishing a control group. As the SIB project is dealing with vulnerable young people and a small population, it may make more sense to establish the baseline through projection. Only by creating a robust baseline with a methodology that is accepted by the provider base and investors will a payment by results model work.

If the four Policy Success criteria can each be met, and most importantly are perfectly aligned then, from a policy perspective, the SIB project will be feasible. To give an idea of what this would look like, we have set out some examples on the following page.

Policy success feasibility criteria cont...

	Target population	Measurable outcomes	Interventions	Counterfactual
	(Criterion 1)	(Criterion 2)	(Criterion 3)	(Criterion 4)
Example 1	Current population of looked after children.	X% increase Looked After Children off-flow back into their family.	Wrap-around work with family and child to rebuild relationships and address any family issues.	Baseline established by projecting off-flow rates using recent historical data.
Example 2	Current population of prisoners to be released in next quarter.	X% decline in prisoners who re-enter criminal justice system within two years.	Wrap-around work with emphasis on education, language and employability skills and provision of long-term mentor.	Baseline established by projecting re-incarceration rates using recent historical data.

Provider market success criteria

Are there providers/delivery partners who would be able to deliver the programme?

One of the purposes of a SIB is to raise significant money which can be used to front-fund specialist, innovative or existing providers to deliver in different ways. The delivery partners could range from voluntary and community sector organisations (VCSOs), corporate or private sector providers.

Another important consideration is whether the providers have the balance sheets to cover the up-front cost and investment required in a payment by results system. If this were the case, external funding and investment would be required. This was the model used in the DWP's Work Programme.

It will be important to determine there is a healthy and competitive local potential supplier base for the range of interventions planned. In some cases this could mean testing whether specialist delivery

organisations would be interested in opening up a facility, or providing experts in new areas. In short, unless there is a provider base that will bring the energy and enthusiasm that is required, it will be difficult for the SIB project, even if perfectly specified, to flourish.

Is there a workable structure for the delivery model?

Once it has been established that there is a suitable set of potential providers to deliver the different elements of the interventions, the next stage will be to determine that there is a workable multi-provider delivery model.



Provider market success criteria cont...

To succeed, not only must the delivery model ensure cooperation between the different providers of services, but even more crucially, the model must complement and work with existing staff.

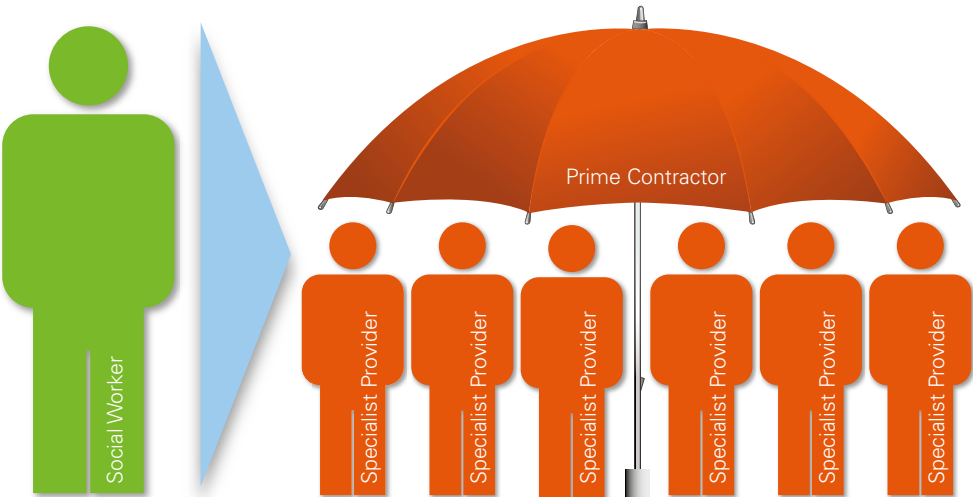
To illustrate, we have outlined two examples of delivery models below; however, there are a range of alternatives.

Umbrella Delivery Model: This model is used in the DWP's Work Programme. Under this model one provider acts as the 'prime' and all of the other providers act as specialist providers under their umbrella. All clients are referred to the prime contractor, and the prime contractor involves the specialist providers only if their specialism is required.

In this way a tailored package of care can be provided. This model works well from the commissioner's point of view, as there is one point of contact and accountability. To illustrate, in the case of a looked after children SIB, a child's social worker would work with the prime contractor to design a care package and provide support care and access specialist services.

The main drawback of this model is that in a payment by results environment, the prime contractor can have a disincentive to involve specialist providers, as they then have to pass on part of the outcome payment.

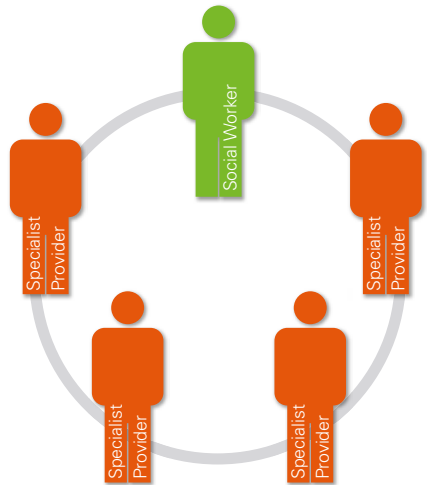
Illustrative umbrella delivery model



Wrap Around Model: Under this model a set of providers work together to support the target population. The set of providers would then work cohesively towards the outcome as the outcome payment would be paid across all. The drawback of this model is that the 'set' of specialist support is fixed.

If both criteria can be met – there is a suitable array of providers who can deliver the interventions and specialisms to the standards required, and a suitable delivery model can be designed, then we can determine that from a provider delivery perspective, the SIB project is feasible.

Illustrative wrap around delivery model



Financial success criteria

Is there a financial case from a commissioner's perspective?

The primary purpose of a SIB is to finance innovative trials and different approaches which could dramatically improve individuals' outcomes and, as a result, society. However, if those outcomes are positive but the net cost is greater than the status quo, they will not be feasible. Therefore it will be important to determine that the achievement of a positive outcome will positively impact the commissioner's cost base. To do this, it is necessary to determine the potential impact on the commissioner's cost base is positive, significant, measurable and proportionate to the effort of setting up and running a SIB project in the first place. In other words, the projected cashable savings that could be achieved through the SIB project (which will depend to a certain extent on the distribution of fixed and variable costs) must be greater than the cost of setting up, procuring, running and the outcome payment for the SIB pilot.

Is there a financial case from an investor's perspective?

The same logic applies to investors. For a SIB project to succeed there must be a robust investment case. This means that the investment terms, both length of the investment and interest rate, are commensurate to the underlying risk.

As there have been less than a handful of SIBs launched, it is difficult for investors to assess risk. For this reason most SIB investors have been non-for profits and quasi-public sector, rather than private sources of money. For example the Big Lottery Fund was one of the largest contributors to the Peterborough Prison SIB.

Is there a workable commercial model from a provider perspective?

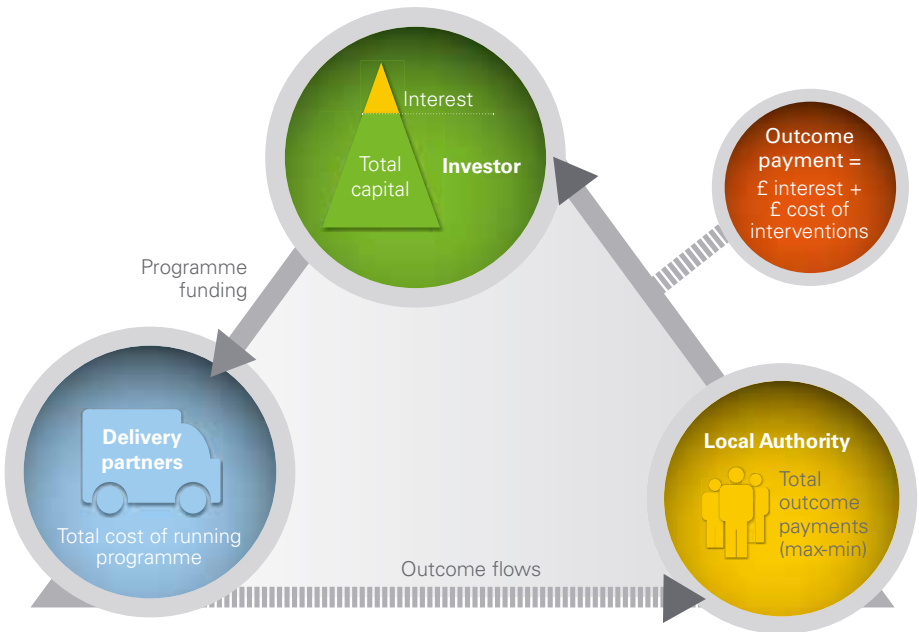
It will also be important to determine that there is a workable commercial model from the viewpoint of providers. This can be a challenge and can require negotiations with the potential provider market. Commissioners will need to agree a payment tariff for outcomes. The tariff structure will be determined by the type of outcomes, the cost of delivering the interventions, the predicted outcome success rate and the estimated cashable savings realisable by the commissioner once a successful outcome is achieved. All of these different elements will be drawn together to design a payment by results framework that is workable for providers.

Is there a workable financial model?

Underpinning the SIB, there must be a workable financial model that draws together the financial case for the commissioner and investors with the provider commercial model. The 'currency' of outcome will determine the financial model. The cost savings to the commissioner must be commensurate to the sum of the costs to the providers of delivering the SIB interventions plus the interest payment. As the outcome payment

is made per outcome, the numbers should be run on a range of outcome volume scenarios. Once the outcome payment can be estimated then, the total investment total can be calculated. If an outcome payment can be found that is acceptable to providers, and an investment total and associated interest rate that is acceptable to investors, and a cost savings projection that is acceptable to the commissioner, then the financial model can be deemed feasible.

Illustration of financial model



Stakeholder success criteria

Do staff support the SIB project?

SIB projects are unlikely to proceed unless the staff support the SIB project itself and are supportive of the interventions that are to be trialled. Staff may also have a good sense of what new interventions are likely to succeed, given their close knowledge of the target populations and their families. It is important to work with them to develop the intervention set as well as the delivery structure. If the staff are uncomfortable or uncertain about the SIB project, it will be difficult for the project to succeed.

Do LAC support the SIB interventions and project?

It may be appropriate to also gauge support for the proposed SIB intervention set by the target population themselves. The insights of this group could be invaluable to the project design. It can also be important to understand the likely reaction of political stakeholders.

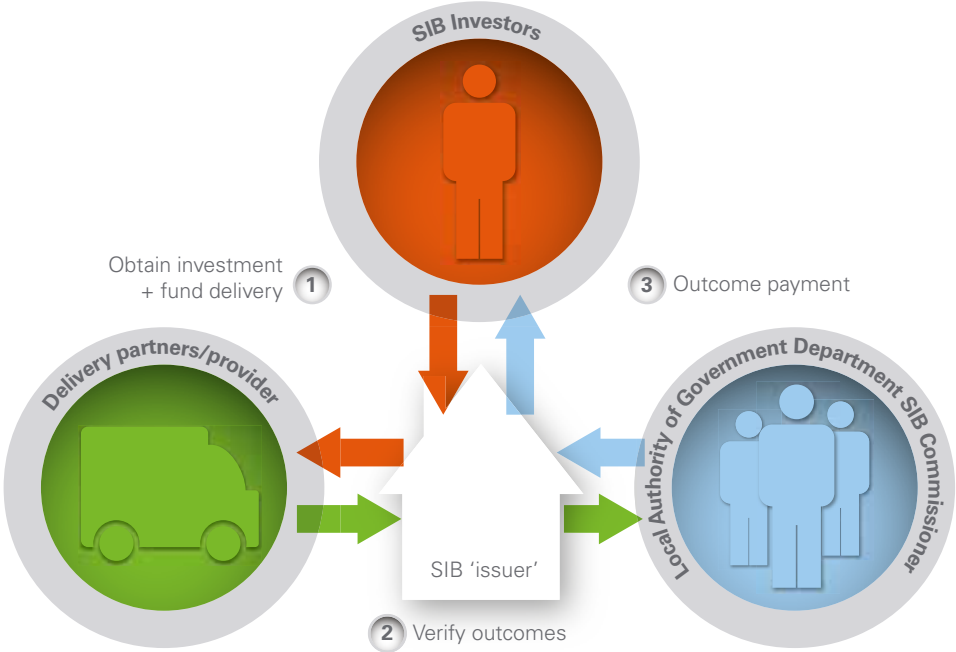
Do the SIB project and the interventions meet objective standards of ethics and quality?

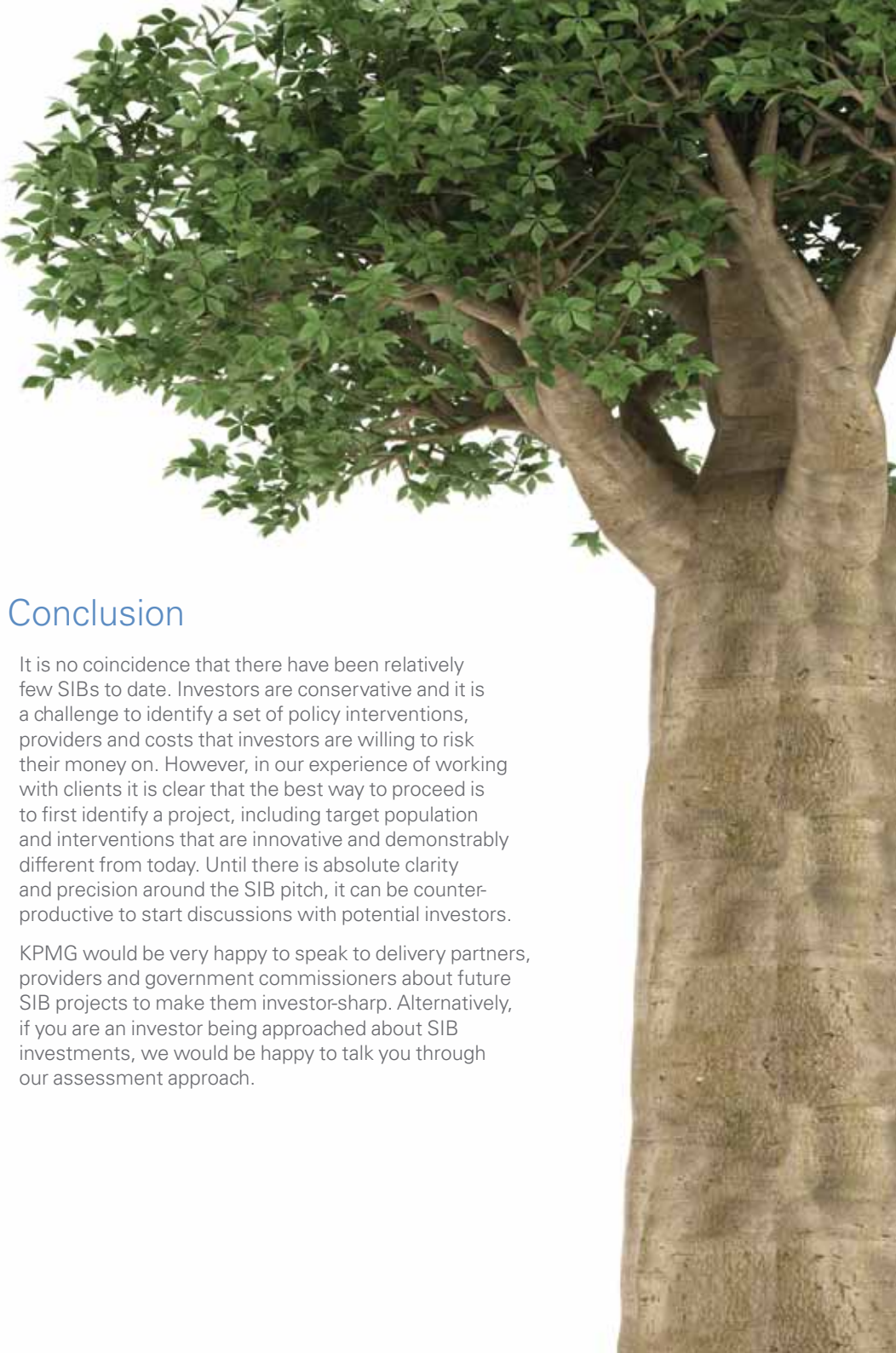
Perhaps the most important consideration is whether the interventions and project itself are ethical and will provide quality interventions to what are often vulnerable groups. It is also important to stand back and assess how the SIB project would be viewed through the eyes of the public.

For a SIB to be feasible, each of the four sets of criteria must be met. We have found that this is often an iterative process. For instance, the interventions may need to be revisited in light of the financial model, or vice versa.

Through the process of assessing each of the feasibility criteria, the shape of the optimal **SIB investment structure** will emerge. Often it is preferable if a third party SIB 'Issuer' plays a role in the structure, as depicted below. The SIB 'Issuer' acts as an 'honest broker' between the parties and is often a required by investors.

Strawman for SIB structure





Conclusion

It is no coincidence that there have been relatively few SIBs to date. Investors are conservative and it is a challenge to identify a set of policy interventions, providers and costs that investors are willing to risk their money on. However, in our experience of working with clients it is clear that the best way to proceed is to first identify a project, including target population and interventions that are innovative and demonstrably different from today. Until there is absolute clarity and precision around the SIB pitch, it can be counter-productive to start discussions with potential investors.

KPMG would be very happy to speak to delivery partners, providers and government commissioners about future SIB projects to make them investor-sharp. Alternatively, if you are an investor being approached about SIB investments, we would be happy to talk you through our assessment approach.

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