



**Responses to Questions Raised at the
Social Impact Bonds: Learning from the U.K. Webinar
May 9, 2011**

Below are brief responses from presenter [Social Finance](#) to questions raised by participants during the webinar. If you have additional questions or thoughts in response to any of the information below, please contact us at info@primakers.net.

THE FOLLOWING QUESTIONS AND RESPONSES ARE FOR DISCUSSION PURPOSES ONLY AND ARE NOT TO BE CONSIDERED AS FINANCIAL OR LEGAL ADVICE.

Relationship/Role of Government

Q: How has the process of government engagement been managed and what has been their receptivity?

A: In the U.S., Social Finance has found the government officials with whom we've talked to be highly receptive to Social Impact Bonds (SIBs). So far, Massachusetts is the furthest along in creating an enabling environment for SIBs. The Commonwealth, through its Executive Office for Administration and Finance, recently released a Request for Information (RFI) soliciting feedback on which social services to target using performance-based contracts or SIBs. Responses to the RFI will inform how the Commonwealth engages in this type of contracting. The press release can be found [here](#).

Q: Why doesn't the government serve as a magnet to entice investors by acting as a credit enhancer to reduce investor risk?

A: The government could consider guaranteeing a portion of investors' repayment to attract more capital. Yet, part of the instrument's value lies in transferring financial risk away from the government toward investors. By enabling the government to pay only for what works, SIBs encourage the expansion of programs that governments have so far been unable to fund directly.

SIBs could be structured to decrease investors' financial risk. For the Peterborough SIB, there is a hurdle until investors receive repayments (at least a 7.5% decrease in reoffending needs to occur before repayment is triggered). To lessen the financial risk, the government could agree to begin repaying investors when lower levels of impact are achieved. Alternatively, foundations could take the role of credit enhancer by agreeing to take a first-loss position, compensating investors if the program is not successful.

Q: Have any alternatives to government involvement been considered?

A: Yes, the payor of outcomes could certainly be an entity other than government. Corporations (e.g., health insurance companies) and foundations are likely candidates for the role of payor.

Q: Regarding stage 2 funding, is the hope that government will redirect funding to programs with a proven track record and documented cost savings?

A: In our view, there are two options for government at the end of a Social Impact Bond contract:

1. Theoretically, government might decide that the program had been so worthwhile that it would now fund the intervention itself. It might supervise this spending directly, ask the SIB

provider to do so on its behalf, or invite the SIB provider, along with others, to tender for this new contract.

2. Government might invite the SIB provider or another intermediary (perhaps following a competitive tender) to issue another SIB on the basis of a new set of outcome targets. This would be an opportunity to incorporate learning from the first SIB.

Q: What role does Social Finance play in Social Impact Bonds?

A: Social Finance serves the role of intermediary and is actively engaged throughout the life of the Social Impact Bond. We originate the deal by identifying SIB applications, sourcing and vetting nonprofit providers, and finding and securing public-sector champions. We obtain a contract with the government and ensure the necessary enabling legislation is in place. Social Finance is also responsible for structuring the financial product, including developing a viable financial model and retaining an evaluation team to design a plan for outcomes measurement. Additionally, we raise capital. After the product is issued, we manage the SIB partnership throughout its life, overseeing the nonprofit providers and evaluation team, troubleshooting any issues that arise, reporting progress, and ensuring compliance.

Investors and Returns

Q: Is there a typical profile of an investor who engages in SIBs?

A: Because the instrument is new and the market nascent, we expect the first investors will represent philanthropic sources of capital (foundations making grants, recoverable grants, and PRIs; other impact-first investors). Investors in the first Social Impact Bond in Peterborough include the Barrow Cadbury Charitable Trust, the Esmée Fairbairn Foundation, and Rockefeller Foundation. Eventually, as the viability of the financing mechanism is demonstrated, we hope to attract institutional and other market-rate investors.

Q: What was the minimum amount from investors? Is there a sample term sheet available?

A: While we understand the interest in seeing the financial terms of the contract, it is part of our contractual requirement to keep it confidential.

Q: What type of return is acceptable to investors for the risk that they take?

A: For the Peterborough SIB, if the program does not achieve a minimum 7.5% reduction in reoffending events, the government will make no payments to investors. Any return for investors above that would depend on the size of the reduction in reoffending achieved, up to a cap of about 13% return per year.

Q: How does the return get generated? Is it based on the government paying a premium if the results are favorable?

A: The government pays investors based on the improvement of the social outcome. The price paid per improved outcome is based on an estimation of the cost savings that would be delivered. The payments from government both repay investors' capital and provide a return.

Q: How are the savings being shared (i.e., what percentage of avoided costs goes to investors)?

A: The portion of the estimated cost savings shared with investors will be different for each bond and will depend on the outcome value agreed with the government. For the Peterborough SIB, we cannot predict savings at this time, as that will be dependent on the impact the program has on reoffending. But the potential benefits to government, society, and the economy are considerable.

The UK National Audit Office has recently estimated that in 2007-08 re-offending by all recent ex-prisoners cost the UK economy between £9.5 billion and £13 billion. As much as three quarters of this cost can be attributed to former short-sentenced prisoners, some £7 billion to £10 billion a year.

Q: How would you develop deals for SIB v1.0 involving large foundations as payors of outcomes and offering PRIs for investors?

A: A foundation-funded SIB could have two primary advantages. First, legislation would not be required to secure contingent payments to investors, so the development time could be shorter. Second, foundations could agree to pay for outcomes that don't generate savings, such as improved educational attainment or enhanced job skills, which could significantly broaden the kinds of interventions SIBs could fund. Social Finance would welcome the opportunity to explore this approach with interested foundations.

Evaluation

Q: It seems that one of the biggest challenges will be proving a causal relationship in an uncontrolled environment. Aside from a control group, how has this been managed?

A: The only SIB to-date uses a comparison group of short-sentence prisoners in the U.K. Other methods are being explored for future SIBs where this methodology is not feasible or appropriate.

Q: For Peterborough, how are the nonprofits financed? If it is performance/outcome based, would they not continue to be strapped for working capital?

A: SIBs provide upfront operating funds to nonprofits to cover the costs of delivering the contracted services. In Peterborough, the intention is to develop long-term partnerships as long as the nonprofits are delivering impact for the target population.

Q: Do you think it will take four years before we have reliable outcomes info from Peterborough? How long does it take to start measuring the impact of this model?

A: It will take about 4 years until the first outcomes payment is made for the Peterborough SIB. An independent assessor will evaluate whether outcomes have been achieved for each cohort of 1,000 prisoners. It is estimated that it will take two years for a full cohort to be released. Then there is a time period of a year to measure whether ex-prisoners re-offend or not and a subsequent year for database updates and analysis.

Social Finance is tracking intermediate outcomes to effectively manage the interventions. An evaluation of the model and its efficacy is currently being conducted by an external consultant. The first report on the Peterborough SIB will be published at the end of May.

Other

Q: Board members will ask about the pros and cons of different models for engaging the social sector. Is there any data comparing the SIB approach with alternatives?

A: We do not have an analysis of how SIBs compare to alternative social-sector investments, but can briefly lay out where we think SIBs will work best. SIBs are an innovative way of providing capital to the social sector, but they are not a panacea and work best only for certain applications. In the US, we are currently targeting SIB funding to evidence-based early interventions delivered by nonprofits with strong track records. SIBs are an excellent option for investors looking to help effective nonprofits scale the reach of their programs, with an opportunity to earn an aligned social and financial return.

Q: *How are new SIBs being developed?*

A: We are in discussion with various parties – government agencies and nonprofit providers - on possible SIB application areas. An overview of the process and key steps in setting up a SIB can be found [here](#).

Q: *How can I receive updates when new SIBs are publicly announced?*

A: In the US, Social Finance will soon be launching Facebook and Twitter pages to keep interested parties up-to-date on the latest news regarding Social Impact Bonds. For now, we are posting SIB-related news articles on [our website](#).

To receive updates from the UK, please register [here](#). You can also follow us on [Twitter](#).