SIBling Revelry:
Are Social Impact Bonds the Next Big Thing?

Wednesday, January 16, 2013
12:00–2:00pm

Program and Panel

12:00 p.m. Panel discussion
1:10 Question-and-answer session
Andrea Phillips, Vice President of the Urban Investment Group at Goldman Sachs
Jon Pratt, Executive Director of the Minnesota Council of Nonprofits
Nirav Shah, Director of Social Finance US
Daniel Stid, Partner in The Bridgespan Group’s San Francisco Office
2:00 Adjournment

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Imagine, to quote John Lennon, a world in which nonprofits execute social service programs that are fully and generously funded, and that are producing indisputably measurable outcomes for vulnerable populations. Imagine a world in which foundations and even for-profit firms are willing and able to fund such programs, not as charitable contributions, but as investments for which they will be paid back with interest. Imagine, finally, a world in which government expends precious taxpayer dollars only for programs that have already delivered solid results.

Well, you’ve just imagined the world of Social Impact Bonds, and what a wonderful world it would be, to quote Herman’s Hermits, or if you’re a rock and roll purist, to quote Sam Cook. No wonder then that Social Impact Bonds are all the rage today in the world of social policy; the cause of so much SIBling revelry. They seem to be the instrument by which each sector of society will bring to bear on society’s problems its own peculiar capacities, each appropriately incentivized for peak performance, yet working in tandem.

To help us understand this phenomenon, both its possible upsides and downsides, we’ve assembled a cast of expert panelists from the full range of institutions that must become involved for SIBs to succeed. That is, funders, intermediaries, evaluators and nonprofits. We’ll hear first this morning from Nirav Shah, director at Social Finance, an intermediary organization, which, as he will explain, is a key element in making Social Impact Bonds work. Then we will hear from Andrea Phillips, vice president of the Urban Investment Group at Goldman Sachs, which has just entered the world of SIBs. Next will be Daniel Stid, a partner in Bridgespan Group’s San Francisco office, and director of their Performance Measurement Practice. Finally, we’ll hear from Jon Pratt, executive director of the Minnesota Council of Nonprofits.

NIRAV SHAH: Thank you, Bill, for that introduction, and thank you everyone for joining us today. I’m happy to be back in DC. I spent some time here and it’s always nice to be back in the city, and I left the snow in Boston, which is always nice as well.

First and foremost, I’d like to thank Hudson Institute for hosting this terrific panel today, and thank you all for joining us. I’d also like to acknowledge our panelists here; I’m looking forward to a lively, engaged discussion about Social Impact Bonds. And I’m honored to have the first slot here to give a brief overview of what Social Impact Bonds are, our work in the space and the potential benefits for society.

I plan to spend most of my time talking about the genesis of Social Impact Bonds, how it works, the mechanics of it, and then again, the potential applications. However I’d like to kind of take a moment and step back and talk about the collective goal, of which we are all gathered here today. As I see it, our goal is to constantly innovate, to find new solutions that drive social impact at a scale that can achieve dramatic impact that is measurable, while also being cognizant
that we have scarce resources and we should use those resources very, very effectively. And it’s important, as this sector evolves, that we keep that goal as the focal point, especially as we continue to find new products or new solutions, like Social Impact Bonds, to redefine how the private investment can help us serve a social good.

And with that, I’ll jump into Social Impact Bonds, and I’d like to start by looking at the big picture because there are some market trends that have created an environment for Social Impact Bonds to be created and to be used. Not surprising to everyone in this room, we are constantly inundated with headlines about the never ending fiscal cliff and the impending debt cycle. And we all understand that there is a new fiscal reality where budgets are getting tighter by the day and there are tough budget cuts that need to be made at the federal, state and local levels.

The crux of this budget problem is that we, as a society, spend a lot of money on emergency remediation programs and we don’t funnel funding to upstream prevention programs. And that means that we are spending money at the tail end. Let’s take incarceration, for example, and the state of the corrections system here in the United States. We spend $60 billion dollars annually on corrections. That is up from $10 billion in 1980. There are approximately six million individuals that are in the incarceration system here in the US, which accounts for 25 percent of the global inmate population.

Now it’s not as simple as that we have more criminals in the United States; it’s that the system is actually broken here, where we have Band-Aid solutions that focus on putting individuals in prison and don’t focus on remediation to make sure they don’t end up back in the prison system. Another big market indicator is that we do have proven solutions out there. There has been a big trend for moving towards evidence-based programs and data collection. We know what works, whether it be re-entry systems or permanent supportive housing for the homeless. There is a lot of data that says which programs works but what is missing is the funding to scale these interventions. There are a lot of service providers that are effective, that have proven track records, but again don’t have long-term, reliable funding to scale their programs for underserved populations.

The last market trend that I think really sets the stage for Social Impact Bonds is the emergence of the impact investing space. Over the last five years, there’s a large source of capital that is now funneled into social service programs. We, as a society, and the individual organizations, need to learn how to harness that funding, so not only to drive impact, but to think about sustainability of that source of funding so it is available for generations to come.

So what is a Social Impact Bond? At its very premise, a Social Impact Bond is an innovative public, private, nonprofit partnership that raises investment capital to funnel into prevention programs and bring them to scale. And I’ll take a moment and pause here, because there is a lot of momentum, as Bill mentioned, around Social Impact Bonds, but there is also some confusion, and one of the big ones is understandably, is a Social Impact Bond a bond? And technically, it’s not a bond. Generally bonds have a fixed return payment, whereas with SIBs the returns are contingent upon performance and outcomes. So that is a misnomer and we get a lot of questions about that. It’s more of a hybrid tool that has some debt like qualities and also some equity like qualities.
Now how did Social Impact Bonds come about? And I think the best way to do this is using Popeye; some of you might have heard his story through the New York Times. The first Social Impact Bond was created in Peterborough in the U.K. by our sister organization, Social Finance, and Popeye kind of symbolizes why this type of funding is necessary. Popeye, and this is not the fictional cartoon character I’m talking about, is 59 years old and over his life he has cycled in and out of the prison system to the streets. He started drinking when he was 13, he was homeless when he was 16, and it’s a pretty grim cycle. So he spends his time on the street, drinking and panhandling to survive, gets himself into a little bit of trouble, goes into the prison system. Upon leaving the prison system, he has no resources, nowhere he can go, so where does he end up? Back on the streets.

And this cycle just repeats itself and compounds itself. And this is not sustainable at the individual level or at a society level when you think about our resource utilization. Popeye has a heart condition and it goes unattended until he gets to the emergency room. As everyone knows, the emergency room is not the best way to use our medical dollars, it’s in primary care.

So in 2010 luckily things changed for Popeye. He came out of the prison system and there was an organization called One Service available to him. They set him up with an apartment, created a comprehensive plan to keep him off the streets and out of the prison system. He got primary care, he got clothing, he got access to education, he set up bank accounts and they set up some work training for him. Luckily, since 2010, Popeye is no longer on the streets, and he’s not in the prison system. He is thriving under the One Service program in the U.K. And when you step back and look at One Service, it’s not something new. There are plenty of reentry services in our society, whether in the U.K. or in the United States. What is innovative about this is the way it’s being funded, and that is through Social Impact Bonds.

So let me now discuss some of the mechanics of Social Impact Bonds. At their core, SIBs raise capital from private investors and funnel it to prevention programs to bring them to scale. The service provider, who is executing on the intervention, if they meet certain outcomes which result in government savings, the government then uses a portion of those savings and pays that out to investors. The outcomes are determined by independent evaluators. That is someone who is outside the entity coming in and evaluating the program based on the predefined outcomes. If those outcomes are not achieved, then the investors stand to lose their capital and the government doesn’t owe a dime.

There are four key stakeholders involved in a Social Impact Bond. There is the government, investors, social service providers and then there is the intermediary. And as everyone in this room knows, those four entities don’t necessarily always play in the same sandbox, and the goal of a Social Impact Bond is to align the incentives so that we can come together and bring funding to necessary services for underserved populations.

I can walk through an example of how this would work. So an intermediary, such as Social Finance, kind of sits in the middle of these three different stakeholders and our job is to identify issues that we think work well with Social Impact Bond financing. And that is, there’s a social good that is measurable and there are savings and value created to the government. We identify those solutions, bring the stakeholders to the table and then we issue a Social Impact Bond, raise
the investment capital, that capital is then funneled to a service provider, it can be one or it can be a group of service providers who go out and execute on that intervention. It’s the intermediary’s job to provide some oversight on that program, to make sure that the dollars are being used effectively and that the outcomes are on target, per the predefined negotiated outcomes.

The independent evaluator comes in, based on what the predefined outcome measures are, and makes the evaluation if outcomes have been achieved. If they have been achieved, the government then uses a portion of the savings to pay the intermediary, which then, in turn, pays out the investors their principle plus a modest rate of return. And again, that rate of return is calibrated based on the savings that the government is realizing, or the value created.

Social Impact Bonds have gained a lot of momentum because if they are done correctly they can produce a win-win-win situation for all stakeholders involved. The government is transferring performance risk away from the taxpayers and onto investors. They are gaining accountability of taxpayer funds because they’re only using dollars if the outcomes are achieved. And lastly, they’re breaking down the cycle of spending funds on emergency remediation, and funneling taxpayer dollars upstream towards prevention, which is a cheaper way and achieves better social goals than emergency remediation.

Now if you look at the service providers, what are they looking for? They’re looking for long term, reliable, predictable capital, which they don’t necessarily get in the current marketplace. A lot of nonprofits live on one year cycles, where you finish a year and then you have to go out and fundraise. With Social Impact Bonds you have funding for anywhere from five to ten years, depending on the term of the program. And what that does is allow nonprofits to focus more of their energy towards the population they’re serving, and not having to be constantly polishing their fundraising pitch to foundations.

Then there are the investors. They get a double bottom line. They get not only a social return, but they get some financial return with a modest rate of return. I think another important aspect of Social Impact Bonds is that from the investor lens they get measurable impacts. There are other impact investments out there, where you put your dollars in an investment where you might not get a measurable impact, which investors get through Social Impact Bonds.

However it’s important to note that Social Impact Bonds are not a panacea. It’s not a one size fits all problems. It’s not going to solve every single one of our social issues. There are specific criteria that allow SIBs to work. One is that there has to be evidence based around an intervention; Social Impact Bonds are here to scale what works, not funnel money into early innovations. Two, the economics have to be there, meaning that the value created from the system has to be larger than the cost of the intervention itself. Third, there has to be measurable outcomes. And four, and most importantly, we want to ensure that the Social Impact Bond does no harm. We want to protect against perverse incentives and unintended consequences. So those elements have to be in place for them to work.

What are we working on? There is, again, a lot of momentum around Social Impact Bonds, and there is a healthy set of issue areas where we think Social Finance can really advance social
good, and also draw in capital from impact investors. And the federal government has actually done a lot to play a catalytic role in spurring the Social Impact Bond market.

In the summer, the Department of Labor put out a grant for $20 million dollars for up to one to three projects for Pay-for-Success, which is kind of an umbrella term used for Social Impact Bond financing. Social Finance was lucky enough to be selected to be the intermediary for New York State around a workforce program that tries to employ the hardest to employ population.

So that is one of the projects that we are working on, but we see the application area as much broader than this one project. We are working on homelessness, criminal justice, and I’ve specifically been working on a lot of healthcare applications, where the goal is to better the health of the population but also reduce the cost, which is clearly a policy objective at all levels of government.

So with that said, I’m going to pass it on to Andrea, who has done some tremendous work at Goldman Sachs that has really allowed this market to flourish in the U.S.

ANDREA PHILLIPS: Thank you so much, Nirav. And thank you to Hudson Institute for having us all here today. It is really exciting and as Nirav says, Goldman Sachs has sort of, I’m not sure if we’ve dipped our toe in the water or dove in headfirst, but it is certainly an area that we are pleased to have done our initial investment in the Riker’s Island intervention, which is what I’m going to talk about today. And we are really interested in seeing the potential of this type of financial instrument.

I also want to particularly thank Nirav for the not-a-bond description, because I feel like I spend a lot of time describing what I now call “social impact not-a-bonds,” which as you can imagine, has not caught on. [LAUGHTER] In fact, when we were getting ready to announce the Riker’s investment, I worked very hard with our communications team when they were working with New York City Hall’s press office around doing the press release, and I got them all to write in “social impact loan.” As you can imagine, in the final edit, it all went back to bond. And I asked my communications people if they were going to go back and tell them that it has to be social impact loan because that is really more what it’s like. And they were like, “Yeah, no, we’re not doing that. Social Impact Bond will play better in the press.” So we’re stuck with a term that doesn’t really work.

I think there are two additional challenges with using the term “bond.” One is that when people think about bonds, they think about something that is tradable and that there is a market for. However there really isn’t a market for these, so they are illiquid investments and that is an important thing to think about.

I also think a very important thing is that when a municipality of New York City were to issue this as a bond, you would have the full faith and credit of New York City behind it, sort of their guarantee of repayment. And in fact, as Nirav pointed out, the repayment of these is based on performance, and so there is a lot more risk. So when we think about return, municipal bonds are not a good benchmark, right, because it’s a very different amount of risk. For that reason, I think that “not-a-bond” is a better description, but I have a feeling I have lost that battle for good.
I’ve been spending a lot of my time these days talking about our Rikers investment, which got a lot more attention than I think we originally anticipated. What I like to make clear to folks initially is that I do not work for the Goldman Sachs Foundation. We have a wonderful team of people that work for the Goldman Sachs Foundation and fund a lot of wonderful work, but I work for Goldman Sachs Bank. And that is an important distinction, because this loan was made by Goldman Sachs Bank and not as a program-related investment from our foundation or as a recoverable grant. It really was made by the bank.

The next question I usually get asked is, why would Goldman Sachs have done this, which is not necessarily a bad question. I work in a division called the Urban Investment Group at Goldman Sachs. We are a team of about 25 people who invest the firm’s capital in what we would call double bottom line investments. So we are making investments that provide both a financial and a social return. This is a business that has existed at Goldman Sachs for about 12 years now and we have invested about $2.5 billion dollars of the firm’s capital.

A lot of those investments are targeted to low and moderate income communities, oftentimes centered around real estate; so affordable housing, mixed income housing, neighborhood serving retail projects, community health centers, charter schools, and we’re very proud of the impact that we’ve had. And so when we had been in discussions with folks in New York City and others around about what would a social impact not-a-bond look like, we have been trying to help folks think about, from an investor perspective, what would be the important pieces of that.

Then at a certain point, the team from New York City came to talk to us about a real opportunity. We were interested in it for two reasons, and this tends to be sort of how we think about our investment opportunities, is really to not only think about what are the economics, but also to think about what the impact is. And you don’t have to get very far into the conversation about young people on Rikers Island to not be struck by the potential for impact. For kids who end up on Rikers Island, there is a 50 percent chance that within a year they will be back on Rikers Island. And that is a pretty sobering statistic. I think we all very quickly felt that if we could be involved in something that would even move the needle on that a little bit, that that was pretty powerful.

The second reason the opportunity was of interest to us, was really about these kinds of conversations. In our work we think about communities holistically, so some of it is about the built environment, and some of it is about quality jobs and how can we make investments that will help create those quality jobs. But what we also know is there are challenges in those communities that social services can help mitigate. But, as Nirav very aptly described, there is less money there for those services.

My friend Linda Gibbs, who is the deputy mayor for Health and Human Services, is the driving force behind the Rikers project. She will talk about the fact that her commissioners have gone through year after year of budget cuts. And what that means is when you’re the head of the Department of Corrections, if kids get sent to you, you have to feed, clothe, guard and shelter them. You can’t cut those costs, so what gets cut are the programs.
In addition to being convinced by the potential impact on the young people, we also were really convinced that this type of financial instrument has promise. And I choose my words carefully to say “has promise” because I don’t think we are quite there yet. I don’t think the Rikers investment deal was a perfect deal, but it also was the first one and that’s okay. We were able to mitigate the risks and get comfortable with the risks. We felt that by having a financial institution like Goldman Sachs be the investor and do it through that structure, we would help move along the potential for leveraging more private capital behind us. And I’m happy to say that some of my colleagues at some other banks are now a little bit more interested, and I think that is a really great thing.

What I now want to do is actually walk you through the details of the deal, because I think that is what helps folks really understand what it means to execute one of these, not in a theoretical sense, but in the actual sense. In this case, you had two investors, Goldman Sachs and the Bloomberg Family Foundation. Our intermediary in this case is a group called MDRC. Goldman Sachs made a $9.6 million dollar loan to MDRC; we are funding that loan on a quarterly basis over four years. They are using the proceeds of that loan to fund a group called the Osborne Association, which is providing the direct services on Rikers Island. They are providing something called Cognitive Behavioral Therapy to youth who are between the ages of 16 and 18 years old, who come onto Rikers. Average stay on Rikers Island is about 90 days, but kids stay there anywhere from four days to a year.

There is a very hefty body of literature on Cognitive Behavioral Therapy, but really what it is, is teaching kids skills around conflict resolution, anger management and things like that. So they use a structured curriculum, it’s incorporated into the school day and is mandatory for all the kids who enter into Rikers at this point.

MDRC, in addition to having a loan agreement with Goldman Sachs and a grant agreement with Bloomberg Family Foundation, is under contract with New York City. New York City will pay them based on the evaluation that’s conducted by the Vera Institute of Justice, which will look at decreases in recidivism amongst the population that has received the Cognitive Behavioral Therapy curriculum. The final payment is made after five years, even though the initiative is only four years. It is a five year payment because that is when the city will have realized sufficient cost savings to be able to repay.

At the same time that Goldman Sachs is funding the loan, Bloomberg Family Foundation is funding a guarantee fund that sits with MDRC. At no time does Goldman Sachs not have any money at risk; the foundation doesn’t fund ahead of us, and so, at year three, we will have funded $7.2 million dollars and they will have funded $6.6 million. So there is always some Goldman Sachs money at risk.

To the extent that the initiative is successful, and we believe that it will be, Goldman Sachs will be repaid with a modest return. When we think about the return, it is similar to our other types of community development lending. What I will say is, those types of community development lending have a bit of a longer track record, but we were willing to make it work. And what will happen with the $7.2 million dollars is, those funds will stay at MDRC and then be used to seed other types of social impact programming. So that is how we see sustainability in this.
Another big question I always get is, isn’t this easy to do because you have a billionaire mayor who can fund a $7.2 million dollar guarantee fund? And yes, it made it a little bit easier. What I will say is that there are things about the structure of this transaction that made a pretty significant guarantee fund necessary for the deal to work, given the risk. First and foremost, this is the first one of these that has ever been done in the U.S. market, and ever done with a financial institution. And just that sort of total execution risk is very hard to mitigate without some kind of backstop on the losses.

There are other things about the transaction that also make it more risky, in that the repayments to MDRC that then lead to the repayment of the loan are structured in such a way that if recidivism is decreased by 8.4 percent, there is no payment by the city. If it’s decreased by 8.5 percent, there is a payment of $4.8 million. It continues in a bit of a step function. Most investments have smoother returns, unless it’s more like private equity. In those cases, however, you typically have an unlimited upside. So it’s very hard to have a binary repayment structure and a capped upside. And the way we were able to mitigate some of that was through the guarantee fund.

What I will also say about the guarantee is that there is a long history of guarantees to spur things that will have a positive social impact. First and foremost, if a small business wants a loan from any commercial bank, that bank can go to the SBA and access a 75 percent guarantee on that loan. Again, the government thinks it’s important to get capital to small businesses, I would agree with them on that point. It’s important for creating jobs, and in order to spur that, because the government knows loans to small businesses are typically riskier, they provide a 75 percent backstop.

Similarly, when you look in the fields of affordable housing, you see similar places where either philanthropy or government will come in with subordinate debt. And I think those kinds of structures are things we’re going to continue to see with the Social Impact Bonds. We really had to think about what the risks were here, and I think even whether you’re at a bank, a foundation, or with the government, when thinking about these types of structures it is important to think about the risk.

The first area we really focused on was impact risk. Where we're likely to achieve the impacts that we needed to achieve, both from a social perspective but also from a financial return perspective, and as I alluded to before, there’s a large body of research on Cognitive Behavioral Therapy. We reviewed that research and were able to get comfortable with the fact that the design of the initiative at Rikers fell into the description that was laid out in the research and would achieve comparable reductions in recidivism.

The next area we really focused on was implementation risk, because you could have an intervention that’s incredibly successful, if well-implemented. However if it’s not well-implemented, you are not going to get your results. And what really made us more comfortable was the quality of our partners. MDRC, although not a sort of social finance intermediary, I think this was the first time they had ever really taken on debt, has a long history in the research space of developing and implementing large scale social service programs. So we were very confident
in their ability to provide the quality assurance and performance management to make sure that it was implemented well over time.

Osborne Association has a long track record also of working on Rikers Island with this population, and we were comfortable that they had what it took to really go out there and deliver the highest quality possible of services. To mitigate that risk a little bit, within the contract between MDRC and Osborne, if they are not performing, there is the opportunity to bring in an alternative provider.

The third area of risk is around appropriation. And I think this has to do with the fact that these are long term contracts, and you’re going to typically have a change in administration. In fact, in New York City we are facing that; we’ll have a new mayor next year. That poses some challenges because you need to be confident that the money is going to be there five years from now when you need to be repaid. Different localities have dealt with this in different ways. Massachusetts, for example, has put the money into a trust and set it aside. New York City structured their contract in such a way that if the incoming administration cancelled the contract, they would have to repay the expenses, providing them a real disincentive to cancel the contract. So I think it’s a risk, but it’s also one that can be structured around.

The fourth area of risk is execution risk. Social Impact Bonds rely on a complex web of partnerships that are codified by a web of contracts that need to all hang together five years from now. And I think that is a real risk. We did our best to mitigate that by working very closely with a wonderful legal team to help make sure that those contracts were appropriately aligned, and we feel very comfortable that they are.

So in closing, a couple words about whether this is scalable or replicable. What I would say is I am cautiously optimistic. I don’t think three years from now we are going to have a $500 million dollar bond market that’s tradable in Social Impact Bonds, but I do think five years from now there will be a sort of healthy marketplace where financial institutions like Goldman Sachs are providing the capital for these types of initiatives. And it will be a growing market and a scaling market. Right now, $10 million is probably a good size for one of these deals. I hope five years from now they’re $100 million dollars.

In terms of getting from here to there, I think what those of us who are working in this space really need to do is work hard on standardizing terms and agreements, so that we can build towards something that’s more efficient. That said, we also want to try new things.

I also think there’s going to have to be a little bit of a shift in terms of thinking, because I don’t think at the end of the day these can really work if it is a total risk transfer from government to the private sector. There is going to have to be more of a risk sharing. That also implies an upside sharing. I think the intermediary should share a little bit of the risk, but also share some of the upside; the same thing for the service provider and the government. That helps to align incentives and helps to make these deals much more doable. And I think what most of the nonprofits would find, if they can get comfortable with the risk, the return of unrestricted money into your organization is a really good thing.
The other elephant in the room is, what is the appropriate role of evaluation and how should that be thought about moving forward, because I think the current approach of using either an experimental or quasi-experimental design is not really scalable. Folks are going to have to be creative in how they think about measuring the outcomes that get paid on and that always using a more traditional evaluation may not work.

So thank you all very much. I’m going to pass it along to Daniel, who can tell you more about that.

DANIEL STID: Thank you, it is great to be here. Kristen and Bill, I appreciate the invitation. I’m with the Bridgespan Group. We are a nonprofit organization that is focused on trying to achieve breakthrough solutions for disadvantaged families and communities across the US, and we also have a small global practice.

The perspective I’m sharing with you today is based on work we’ve done with a number of leading nonprofits that have developed and or are implementing evidence-based practices. I want to come back and talk a little bit about what that means, with philanthropists that have been looking to identify these providers and programs and fund them, and then also, state and local government agencies primarily, that are seeking to do business with them to affectively outsource their human service delivery to them. So that is the perspective.

I will say, everything that I’m about to tell, we are still in the process of sorting out, so these are kind of emergent and provisional views. We would welcome questions or reactions if you’re seeing things differently. I’m going to organize what I have to say to you in five observations, just to structure my remarks. The first observation is that the system we use for funding and delivering human services in this country is broken at a fundamental level, and it’s going to change. And underneath that, there are two or three aspects of the situation that I’d like to call to your attention. One is, our society, at all levels of government and philanthropy, is funding and underwriting a lot of programs and providers that are well intentioned and well meaning, but aren’t making a significant impact on vulnerable populations. As we start to think about the reduced funding that we’ll have available, certainly in the public sector, as our commitments to pensioners, social security recipients and Medicare recipients increases with the demographic shifts we’re undergoing, there is just going to be less and less money to spend.

Another aspect of the situation is we are now starting to see emerge a subset of programs or providers that actually are delivering truly differentiated results cost effectively, whether it’s high quality home visitation for first time mothers in difficult circumstances or therapeutic interventions for kids caught up in the child welfare system, we’re starting to have line of sight into what is actually working, what makes a difference and what really does warrant deeper investments.

So I think this brings us to the crossroads that we are now at, which is, if we go down one way we will basically give all these programs and providers a haircut as government retrenches. Everyone takes a bit of a hit. And I think the tragedy of that is that the emerging subset of programs and providers that truly are giving taxpayers more bang for the buck are going to take a
haircut alongside everyone else. That differentiated capacity that allows them to implement these programs with fidelity and with impact is going to be eroded.

That is one pathway that we could see occurring. Another pathway would be that more and more we make a series of intentional choices, we revisit some programs that were well-intentioned when they were started, some providers that are great organizations, but that aren’t actually making a substantive difference for the families and communities they’re serving, and repurpose that money to support those that are. That is really the choice we are increasingly coming to grips with. And I think the question is, will we recognize it and will we actually make it?

So this leads me to my second observation, which is that I think Social Impact Bonds are a mechanism that could help us make a better choice at that path. They aren’t going to make it in and of themselves, and there are a lot of other things that need to fall into place, but I think SIBs can be one of the things that pulls us further down the path of focusing our increasingly scarce resources on better solutions. And I say that for a couple of reasons.

First, it is already bringing more people, more organizations, more ideas and more capital to bear on these problems and in search of better solutions than there have been traditionally. I’ve written before about what I refer to as the “social services industrial complex,” which is this combination of government programs and providers that has been in existence over time, again well-meaning, well-intentioned, but is not really making the fundamental differences in society that we need to make with these resources. And suddenly we have got a fresh set of people joining up with us, and I think that’s a good thing.

The second and more practical way that Social Impact Bonds can make a difference is by making it easier for government to engage in pay-for-success approaches. Now, as many of you know, pay-for-success is not new. I was teaching undergraduates 20, 25 years ago when the notion of reinventing government was just coming into vogue. The Clinton Administration and Vice President Gore were picking up on this notion of shifting government spending from inputs and outputs to outcomes and results, which is a great thing.

Now one of the challenges is that in doing pay-for-success is that the costs that need to be incurred to support young men at Rikers Island needs to be done in year one or two, and the outcomes that you’re seeking might not appear until year three or four or five. And in some of the more complex interventions, the outcome might not occur until even later. So there is a time lag effect. Historically government always kind of fudged a little bit and ended up paying for some inputs and outputs just to keep the organizations whole.

Now through this financing mechanism, where a third party pays for the upfront work and then is reimbursed if and when the outcome materializes, that kind of solves the fundamental time lag problem that limited the extent to which performance-based contracting could really take hold. So those are the things I think Social Impact Bonds can bring right away to the table.

Which brings me to my third observation, which is that government is really the weakest link in this chain. And there are aspects of SIBs that really aggravate government’s capacity to make pay-for-success work. There has been a lot of attention, and there’s obviously some painstaking
and thoughtful work that has gone on in terms of aggregating the capital and structuring the deals, but the question is, can government pull this off? And this perspective is really informed less by the example from the UK, which is still in development, but rather from just looking at the challenges that government has faced in undertaking more traditional forms of performance-based contracting here in the US.

A performance-based contract is much harder to design and manage than a more traditional input-output activity based contract. And government procurement and contracting shops, maybe not in New York City or the State of Massachusetts, but as you kind of go out across the fruited republic; these are really challenged portions of government. There are very good people working in these shops, but the issue is that their leaders, and ultimately we the voters, put so many constraints on them about how we want government to be engaging in contracting, that they are literally hogtied. And by nature they aren’t necessarily bean counters, but by the time all of the rules and regulations around how we want government to engage in contracts are applied, they quickly become bean counters.

There have been some really interesting studies; Larry Martin at the University of Central Florida has done a lot of thinking about performance-based contracting and I would recommend his work to you. He’s done surveys and research on government procurement and the promise of performance-based contracting that was never fully realized. There were a few places, New York City and a few states, so it’s more idiosyncratic, where you’ve had exceptional, dynamic and creative leadership within government.

And if performance-based contracting is the procurement equivalent of a swan dive, what we’re talking about here, with some of the complexity, is more like a double backflip with a twist. We are asking people to suddenly up their game at a level that, I think, is going to be really challenging.

On a related, but different note, is what I’d call the principle agent problem. That is when government is turning its work over to third parties; turning over helping young men stay out of prison, looking after the chronically homeless, and looking after kids in the child welfare system. That is serious work where at one level there is a lot of money involved, a lot of room for financial problems, irregularities, and scandals. There is a lot of room for programmatic failure. And when that happens, kids are hurt, people are killed, and it’s bad. So that leads to an incredible risk averseness on the part of the contracting agency, that makes them very anxious principles, as they delegate to their agents. They tend to want to micromanage what those agents are doing and to make sure those agents are checking boxes and doing the stuff that they said they would do for this money.

So all of the incentives are to keep the focus on inputs and outputs. Social Impact Bonds really run the risk of aggravating that, as you’ve seen in some of the diagrams. Now you have intermediaries and third parties coming between the contracting agency, government and the providers that are actually consuming the resources and using them for the purposes that they were intended. And I think this has the propensity to make government contracting officials more anxious.
It’s further compounded by the fact that in a lot of these complex interventions, where you have the money assembled that can actually make it economically viable, you typically have multiple agencies involved at a state or local level, and even at the federal level. So now there are multiple principles, each with kind of the same, but slightly different sets of priorities that are concerned about this outcome.

When Al Gore was doing his Inconvenient Truth movie, when he first started giving the lecture, he was too pessimistic and someone told him that he was exhausting the audience’s hope budget. Now I realize with my skepticism that I may be exhausting the hope budget, so let me get to my fourth observation, which is that there are two or three really good experiments under way now. Let’s let them play out, let’s learn from them, and let’s support other experiments, because I think this is a very nascent field. If you think about the situation in New York City, between Linda Gibbs and her team, who I think have always been at the vanguard of using pay-for-success effectively, Bloomberg Philanthropies, Goldman Sachs, and MDRC, if you were to assemble a cast of characters who you wanted to try this, that would be a really good group. Massachusetts, the Patrick Administration, ROCA, Third Sector Capital, Social Finance, again, blue chip organizations. So you have got some very thoughtful and engaged people in different sectors working on this, and that’s a good thing. We need to see how it plays out.

Antony Bugg-Levine, at the Nonprofit Finance Fund, has remarked that there has been a lot more commenting and assessing of Social Impact Bonds than there have actually been deals done, and that ratio is probably unhealthy. And I would agree with that and actually say that the real ratio, though, is how many deals are done versus how many deals bring about these good things that we’ve been talking about. That’s the ultimate ratio that is really going to matter here and is something that will play out with time.

There are some things that I think can be done and that are already being done in some instances that will help increase the odds of success. One is to alleviate government’s principle agent problem by reducing, if not eliminating, the extent to which intermediary organizations are coming between government and the actual work. If you look at New York, where Linda Gibbs and her team are working, MDRC is a very trusted programmatic organization that they could rely on to do this work well. In Massachusetts, you have the state working directly with ROCA.

If you look at the more elaborate conceptualizations of the Social Impact Bond idea, as they were first articulated, you have these all-powerful intermediaries that were arranging the capital and the providers and were the sole point of contact with the government. For the vast majority of states and localities, that is not going to fly. We’ve already seen in these existing examples a streamlining of the connection between government and the service providers that I think will simplify it.

One thing that you may see emerge would be to almost remove the intermediary all together and have a subset of providers that are relatively well capitalized, have a very proven intervention, have philanthropic backstopping, and have existing relationships with states and localities. You can see a situation where they can go right to the officials and say that they’re prepared to take on some execution risk, here we can line up our financing from our contributors, but we want some more degrees of freedom. And we want the upside, if and when we deliver successfully.
I’ve talked with a couple of providers where this is something that they are really considering. This has the benefit of having the upside from success really concentrated in the organization that is delivering at a differential level. You need to have larger scale, well-tested organizations with a lot of capacity to do this. There’s a few out there that could do that.

I also think that we need to be more realistic about what we can expect from evaluation and performance measurements. I collate Bridgespan’s performance measurement practice, and the one thing I’ve learned in the time I’ve been doing this is that evaluation always takes longer, costs more, and is much less conclusive than you might think. And that is when there is not a lot at stake.

The federal government has commissioned several large scale assessments of long standing programs, and these evaluations, as they almost always do, come back with mixed results. There is a lot of back and forth about sign off and clearance on these evaluations when not much is riding on it because odds are that these programs are going to continue to be funded at the level they are. Now, imagine there is an all or nothing payment hinging on the results for this evaluation. I worry this could set back efforts to assess what’s working by politicizing them and bringing in a financial charge that is not going to allow for the real assessment of what’s working and what isn’t.

In instances where there may be less randomized and scientific but practical and feasible measures that are already present in the system through other forms of data collection, where and how can we just capture the information as part of our systems, so that it’s non-disputable, non-debatable, and we don’t have to pay to collect it? Those are the sorts of things that I think will lend themselves to more success.

One other idea, and I wrote a blog about this that nonprofits and governments loved but philanthropists not so much, but I think philanthropy needs to invest in the capacity of government to make these things work. The example I would draw on is what Eli Broad has done for urban school administration. He wanted to reform education in this country, starting about 10 years ago, and he realized that to do that he really needed a cadre of leaders that had the chops, the wherewithal and the reform credentials. So he basically financed it and funded it through the Broad Residency in Urban Education.

And if you look across the country at any urban school district that is really making an impact for low income and minority kids, the odds would be highly likely that there’s a set of Broad people in there that Broad has paid to train, recruit and brought into government. I think we need to do the same thing with pay-for-success, and I think we need one or more philanthropists to really commit to that.

Last observation and then I’ll wrap up, and this is truly provisional thinking, I think we need a much better political theory, if you will, for pay-for-success. Because right now there is a rhetorical trope that advocates, and even progressives on the left are using it too easily, which is government should only pay for what works. We should only invest in what’s working.
Well I guarantee you, there is a lot of stuff the government is doing that isn’t working, and there are a lot of things that as a society we’ve acknowledged that we need a collective solution to and we need government to help us enact one. And I worry a little bit that the framing and the advocacy for Social Impact Bonds, there’s something that’s corrosive in there, and there are larger sets of commitments that could be opened up and unbundled inadvertently if we aren’t careful. So I just think we need to think though that more. I don’t really know what the answer is; I just think that we need a better one than we have now. So, with that, I’ll leave it to you.

JON PRATT: Thank you also to the Hudson Institute for putting on this program. It’s easy to see why this is so attractive and why it has getting so much interest. It’s more resources and better results and don’t we all want that? We can build on the business theory of bringing in some invisible hand and tying the flow of funds to where there is a return on investment and greater results. It’s partly a view of human nature, of an organizational motivation. So, if you want system change, change the rewards.

If people perform best when they receive a specific award, in this view, organizations are more likely to deliver when they have something at stake. Teachers and schools, for example, we have seen this, will teach more effectively when they have some sort of a system of carrots and sticks. This is seen as an opportunity by nonprofits, who certainly would like more resources. Part of the problem we have delivering results is that we don’t have enough resources. Nonprofits love to see themselves as the high performers and that they’re up for a challenge.

And finally, nonprofits are natural scroungers. They are always looking for new sources of funding. One of my favorite cartoons has a picture of Moses on Mount Sinai, and he’s standing there with perhaps the world’s most challenging mission statement, he looks up at the sky and he says, ‘What about funding?’ And I think that is sort of our existential challenge, nonprofits are not about money but they need it to operate.

This is an attractive idea—more resources, better results, and applied to society’s toughest problems where we’re often dissatisfied with the current results we’re getting. We wish everything from homelessness, to education, to kids going back to Rikers Prison worked more effectively. So I concede that there are different parts of the current system that aren’t operating as well as we wish they did. We need to set aside our dreams of human perfectibility. We fight with the army we have, we deal with the society we have and we believe in the continual improvement. And clearly a lot of creative energies have been put into this idea, even before the first prisoner is sent back to Peterborough Prison, there is an intense internal logic to the whole set of ideas around performance bonds.

There is a place where this would work very well and I’ll call that place Social Impact Bond world, where it’s a very tightly constrained world, self-contained, suited for pilot projects and requiring probably a lot of subsidy. There’s a place for each of us in Social Impact Bond world. Government officials are saving funds and getting better results in an intensely rational process. Human systems operate with a high degree of certainty, in predictable, controllable ways. Capital is patient and public spirited, and legislative bodies are hyper rational and stick to their commitments.
However to come back to our day to day world and some of the problems that we face, there are two questions that we need to address. Number one, would Social Impact Bonds bring more money to the table, and second, would they actually deliver better results?

So first, would they bring more money to the table? And I understand this is in the pilot phase, so we are experiencing the novelty effect. It’s brought a lot of us into this room, and it’s beginning to attract foundation dollars, consultant hours, and the attention of public officials and political leaders, who also like the idea of more resources and better results.

I understand the underlying argument that it’s cheaper to keep the kids out of Rikers than to have them go back and forth all the time, and we can create new economic activity if they are productive members of society. Cost savings and generating economic activity are not new ideas. And in fact, in the current system of allocating resources to address social problems, this is the everyday work of legislative bodies.

Last week I heard testimony saying that for every dollar we spend on chemical dependency treatment, this saves seven dollars, either in incarceration, medical costs or other ways. This is heard in legislative hearings all the time. If you look at all the parts of the budget, from chemical dependency, to early education, after school programs, English as a second language, and sanitary sewer systems, often the argument is, ‘Let’s compare, should we do the expenditure and what are the consequences if we don’t?’

Legislative bodies have this responsibility every year to consider the effects of either spending money or not spending money on future obligations. Do these expenditures in fact work? Can they be quantified? Do they generate savings? In many cases, and this is also part of the legislative and administrative process, is that they do work, they can measured, they generate some savings and they’ve already been considered and factored into the appropriations process.

So what part of our society’s resources should be spent on our common problems and issues, and what part should we leave to the citizens to have to themselves? Perhaps we can all agree that government should be as small as possible, but as large as necessary. Then the question is, so what is necessary? What is it we need to do? In this legislative process, it is very common to hear the debate between prevention dollars and remediation dollars afterwards. And there is no shortage of advocates who appear before county and state government to make the case for their particular program. However often when push comes to shove, the question is well, is this a gotta do or is this kind of a nice to do? And this is the hard work legislative bodies have in allocating funds.

So it is an ongoing struggle and the legislative process is not as rational as perhaps we’d like; it is a human process. All 50 states have some kind of social services to help people reentering from prison and incarceration. They’ve made this judgment and it’s already factored into their legislative allocations. We believe this is in our public interest, it probably saves money at some point and we’ve decided we’ll allocate this amount of dollars.

To argue with that, well I have a new idea for a program that actually is savings on top of everything you’ve already done, so we’ll capture those extra dollars, and then you commit to pay
me those extra dollars, it can work in the pilot phase. Over time legislative bodies tend to forget. Think of all the hearings about afterschool programs, what happens to kids in middle school after school? What problems can they get into? It could be in our interest to take care of them. People testified, the legislators listen to this and they allocate funds. Ten years later there is a budget crisis and you go, ‘Well, I hate to do it, but that program is not as important as some other things that we absolutely must do.’ It’s a problem that we face and I don’t see it necessarily being automatically solved by Social Impact Bonds.

California passed a lottery to improve its education system. The money was dedicated to the schools in California about 25 years ago. Since then California’s schools have been on a constant decline in funding and resources, and probably in quality. The earmarking of funds, and sort of the carving up of budgets and saying, ‘Well I have a dedicated fund for this particular purpose’ certainly is the argument there, and people try to do it all the time. I worry about creating all these small micro dedicated streams of funding that then have evaded some of the legislative process, which is somewhat more public.

There is a second major issue here, which is what actually occurs with the better results? What occurs when we create this rational system that will create these sets of incentives, and what is the actual innovation? I think everything that’s been described, all the services, would be provided in the same way as other social services are already provided. So there is nothing about the way Popeye was served or what Osborne is doing at Rikers that is different than what other service providers or counselors are doing. The innovation is not actually the delivery model.

What was different in this case is the instrument and introducing a new set of intermediaries. The transaction itself adds some costs. It’s bringing together the financing with the rewards system and giving government decision makers a language to use. Partly maybe the argument is, the public is discouraged and they feel like they’re not getting their bang for the buck, and this will give public officials a stronger case that while we’re bringing business know how to the case.

I would say that, again, in pilot projects are sort of taking advantage of the novelty effect. And it probably required subsidy on the front end. It’s interesting; the Rockefeller Foundation is the major investor in the Peterborough Prison example in England. Foundation funding was required in the New York case, and I would say, in other discussions around the country, the foundation community is very involved and seen as an essential partner, which then still raises the question, well is this new money being brought in or is it existing money?

The vision of these rational systems that are judging and then making institutions more effective, partly because of the increased attention on them, is often described as scientific management, where we can be much more careful about the activities. But then when you meet human systems, you can lose some of that predictability and certainty. Often the pressure is on the frontline workers and on the organizations themselves to make your numbers do what you promised.

This was the case with No Child Left Behind, which said that there had to be consequences if they’re not educating those students. We have got to either reward teachers who are doing a great job or punish schools, reform them or break them apart if they do a bad job. I attended the
Governor’s Civil Society Summit in Florida and heard Governor Jeb Bush speak, and he was talking about how they remade their social service system. He said that much of what government does is broken. However if it’s not broken then we need to break it so that we can fix it faster.

Well, in some ways, No Child Left Behind achieved that goal. Fifty states have had cheating scandals regarding testing around No Child Left Behind; forty four Georgia school districts. In El Paso, Texas the superintendent was sent to prison because they were expelling children who would do poorly on the tests. Seedco in New York City got some publicity they never would have wanted for reporting 1,250 people who got jobs that didn’t actually get jobs through Seedco’s work.

A lot of this is about tracking and reporting numbers. The police department in New York City found that they could reduce crime by just losing the property reports. So if you want lower numbers, we can give you lower numbers. If you think of Ferris Bueller’s Day Off, remember the scene where principal Rooney has called his mother, and he’s saying, ‘Well, Ferris has been absent four days from school.’ He’s looking at the computer and suddenly the number goes from four, to three, to two, to one absence.

We create incentives to change these numbers and it turns out there is a name for it. Campbell’s Law says: The more any quantitative social indicator is used for social decision-making, the more subject it will be to corruption pressures and the more apt it will be to distort and corrupt the social processes it is intended to monitor. So we have an effect on the system, unintended, certainly, but it does have an effect on the results that are reported. Certainly those are abusive cases, no one wants that, that’s an unintended consequence, but it’s an example of the kind of pressure that is put on systems. And that pressure can help change the relationship between the service provider and the person receiving the service.

It’s interesting, one of the major proponents in Minnesota of these pay-for-performance systems is Twin Cities Rise. And what they’ve done is they are on a pay-for-performance system. They only get paid if the people in their program receive job training and job placement. So each participant signs a contract agreeing to stay in the program, attend all the sessions and to follow the instructions of their job coach. If they don’t, they agree to repay the cost of the program. So the idea is that consequences have to be on both sides. If the organization doesn’t get paid, the individual needs to understand how important this is. So the natural next step is that they’re told if they drop out, we will sue you to get the money back and we’ll trash your credit rating. One of their participants, who also was a client of legal services, received the lawsuit. They had dropped out because they found a job on their own which they really liked, but that meant that the organization itself didn’t get credit for the service. So the organization is under this incredible pressure, and then they have to put pressure on their participants as well.

I think the danger is that we’re changing the set of relationships with these service providers, where often, we rely on long term, trusting relationships. A great display of this has been in the state of Florida, which had gone through a huge transformation, marketizing their whole social services system. Joe Soss has written a great book, Disciplining the Poor, that looks at this, and
it really has decreased the reliability and the cohesion of this set of services. We do have an imperfect set of services that absolutely can be improved, but I’m afraid that Social Impact Bonds are being oversold as a cure all. And as of today, we haven’t actually completed a single one of these in the entire world. So we are in the early stages.

It’s a caution that this idea is surrounded by well-meaning, well-intentioned intermediaries, consultants, PR firms and financiers. It could be described so far as 95 percent inspiration and 5 percent perspiration. So I would say that we need a moratorium on promotion to allow the experiments to progress. Each of us has a duty not to mislead the public, not to oversell our results and to be open to alternatives. It is hard to think of a concept that has been promoted more than Social Impact Bonds that has been based on no results yet. So other than that, I think it’s a noble experiment and I can’t wait to see how it turns out.

Finally, let me say that it’s just too easy for us to talk about the future with no consequences or accountability for the speakers here. So I would like to challenge each of my fellow panelists to take one half of the speaker’s fee for today and put it into a performance bond, only to be paid out if our remarks still make sense 10 years from now in the year 2023, to be judged by the always impartial, independent and incomparable, William Schambra. Thank you.

WILLIAM SCHAMBRA: We do not actually provide speaker’s fees, I should quickly add, for those of you who now have visions of getting rich off this scheme of speaking at the Bradley panels, it won’t happen unfortunately. [LAUGHTER]

As ever, I want to stir the pot for a second, and we’ve got an half an hour for Q&A. Going to a point that Andrea made, and this is a question that keeps coming back to me, judging from the chart we have a proven therapy that works for reducing recidivism. What is to prevent the government from saying, ‘Hey, we’ve got a proven system that works and measurable outcomes for this approach.’ As Jon points out, what the legislatures always hear is that a dollar spent with this program will save us seven dollars over the next 10 years. To which my question is, if we are saving ourselves so much money, how come we’re so broke? But that’s another problem. However, why is this system better than the government just saying that this program works so we should do it at Rikers?

ANDREA PHILLIPS: I think that is a very valid question. Linda Gibbs is the best person to answer it, but I’m going to try and give the answer I’ve heard her give. If government had the money, they would. The role of the investor in this is basically monetizing something that is going to happen in the future, so that we can do something today. And keep in mind, what we are talking about is a pretty simple financial structure. At its core, it’s a five year loan where interest is accrued, full payment including interest at maturity, with a variable rate based on impact. At its core, that’s what it is.

I think you’re making an important point, which is, there are two pieces of this, one government deciding how they want to fund things, which is do we want performance-based contracts? Then the question becomes, who then finances it if you want to do that? In a prior life, I actually managed large scale performance-based contracts. As a nonprofit organization, we self-financed those. We didn’t go to the capital markets. In this case, the city didn’t have the money up front or
wasn’t willing to put resources towards this up front, and they needed external financing to provide the cost of operations.

WILLIAM SCHAMBA: So I guess my follow up question would then be, granted everyone signs contracts and is therefore legally obligated, however we are depending on the city to pay further down the line. So the city is saying that the don’t have the money right now but they’ll have it in the future, so let’s just go ahead and sign this contract. That’s what government does a lot of, right? And with variable results. So how does one deal with that consequence?

NIRAV SHAH: Yes, and I think the difference is here, as Jon aptly mentioned, that legislatures, it’s their job to allocate resources and put money into funding that produces savings. The problem becomes that a lot of times they put money into programs that theoretically will produce savings, but never go back and see if those savings were produced. And a lot of times funding is based on historical precedent and not necessarily outcomes that programs can produce.

So often you have funding for programs that don’t have impact and you don’t realize those savings in the long run. I think the innovation here is that this forces the government and all of us to put some analysis behind, was this program successful? Did it achieve the results it was intended to do? And if it does, there are government savings attached to it that can be the source of repayment.

ANDREA PHILLIPS: What I would also say here, and to be a little bit provocative, I don’t even think there has to necessarily be concrete savings. Again, this is the way we think about our role, is we’re a source of capital, right? I didn’t go to Linda Gibbs and say, ‘Linda, I’m deeply concerned about kids on Rikers Island.’ That’s her job. The people of New York City have elected Mayor Michael Bloomberg; he has chosen a team of people that help him set his local priorities, that is what they do. They come to us and we can provide financing, whether it’s for affordable housing or the services on Rikers Island, but we’re responding to what they identify as priorities.

Government could identify a priority and decide it wants to pay on outcomes and there aren’t resulting cost savings. It could just be something that either the legislature or the executive branch decides is something they value, and therefore, they want to fund it. But they may decide that they want to fund it on a performance basis, which by definition, creates a disconnect between when those services are delivered and when there is a payment on them.

That problem of a time disconnect can be solved in a number of ways. The organization can self-finance it and then get paid on the backend. The government could provide an advance against future performance payments, you can look to philanthropy to provide a grant or you can look to the private capital markets to provide financing. However these are sort of different decisions along the way, and you can have pay-for-success and pay-for-performance without having a private sector financing structure.

DANIEL STID: I just want to connect a couple of dots here, and I want to go back to something that Andrea said, which I thought was very interesting. I think one of the virtues here was the due diligence that you were doing, looking at this as a commercial transaction. Now I’m presuming
that as you were doing that, you were applying the same scrutiny that maybe other colleagues are applying when they are looking at possible businesses to invest in. And where I’m going with this is, that in the New York case you had an evidence-based program and an organization like MDRC overseeing it, which would give you confidence that this would be carried out.

ANDREA PHILLIPS: Absolutely.

DANIEL STID: I would hazard that if you were looking at financing the deal in the Peterborough Prison, you would not have had as much confidence because, my understanding is, there is a range of different providers and it is not one evidence-based program that everyone is implementing systematically.

And so, Jon, one area where we might discuss more is, in our experience, you can have a whole bunch of people doing basically the same thing, doing Head Start, supporting transitioning foster youth, trying to run a charter school serving low income and minority youth. Same organizations undertaking the same things, but the system and the discipline with which they do that, and the caliber of the people in the organization, really drive the results.

So even though everyone is kind of doing the same thing, you actually have widely different levels of performance. In so far as you’re implementing with greater fidelity against an evidence-based practice, you’re going to be achieving the results with greater fidelity. I would dispute the claim that everyone is kind of doing it at the same level. I don’t know if you have any --

ANDREA PHILLIPS: No, I would agree with you. I mean, there hasn’t been a lot of public information about what is happening in Peterborough. One of my initial concerns in looking at that is, it is not an evidence-based intervention. The analogy I use is, if you had a piece of property and you wanted a loan to build a building, you’d have to say more to the bank than ‘I’m going to build a building and I’m going to build the best building I can. Trust me.’ They are going to want to know, is it rental apartments? Are they condos for sale? Is it going to be commercial office space? So I think that you’re exactly right, that we have to look at this in the same way that you would look at the quality of a developer in a real estate transaction, you look at the partners.

NIRAV SHAH: I think it’s important to remember, when talking about Peterborough, it is definitely a slightly different model, where it’s not a national program. Think of housing first, or homelessness, where it’s being executed throughout the state here. Peterborough is another example where Social Impact Bonds could drive a little bit more value, albeit putting more risk on the investor side. The program is taking different evidence-based practices and stringing them together to create a continuum of support that is necessary for people leaving the prison system to get back on their feet.

So having a continuum of services and support can get better outcomes than we have been getting through one-off, siloed programs, albeit there is a greater risk for the investor, because there is no history to prove that. But at the same time, the U.K. market for impact investing is slightly different, and maybe not completely analogous to the market here in the United States,
and so, there might be differences there. But, you can see the product being able to add a lot of value over time, through that stringing together of services.

JON PRATT: I just took a look at MDRC’s 990 and they have $91 million in assets, including $36 million in publicly traded securities. Why didn’t they just finance this themselves? I mean, they have the expertise and companies often invest in their own operations where they know they’ll make a return.

ANDREA PHILLIPS: I would never presume to speak for Gordon Berlin, but my guess would be they didn’t want to take on the risk and that’s okay.

WILLIAM SCHAMBRA: Let’s go to our audience.

Q: My name is Denise Byrne, and I’m one of the founders of Friends of New Orleans. So I have two questions. One is for Nirav. Who, in all the examples that are happening right now around the globe, who initiates getting this going? Is it the mayor? Is it the provider? And do you have to have an actual, very successful, innovative model in that locale where you want to get this going?

And for Jon, one of the questions you said, does this bring more money to the table? Shouldn’t that question be, does this bring different money to the table? And just to give you a quick example in New Orleans, one of the big problems after Katrina was getting healthcare services to all the neighborhoods. Tulane came up with a model of neighborhood clinics, which has been very successful, but the city still struggles on, how can we get more of those services out there? So I’d love to hear how some of these other examples of SIBs got going.

NIRAV SHAH: Thank you for the question. I don’t think there is a standardized answer to which entity brings up the idea. We see lots of circumstances where governments are coming to us and saying we think we have an idea that will work with this financing, but we don’t have the budget resources to attack it ourselves, can we use investor dollars through this construct?

We also have service providers that are coming to us and saying, ‘Look, we’ve been doing this for 20 years. We’ve been doing it effectively and we have the data to prove it. Our challenge has been we never get funding beyond a one year cycle.’

We, as an intermediary, are actively looking through the evidence, talking to experts in the field, to get a sense of what are programs that might work well with this program and then building the business case for that, and then going out and engaging the service provider community and the government community, to see if this is of interest. So there are a lot of different channels of which ideas are being floated around.

JON PRATT: For the question about different money, I guess part of my worry is the flash in the pan effect, where suddenly there is an infusion, but does it become reliable over the long run? And looking at the post-Katrina experience, philanthropy jumped in big time for two to three years. Now many of the organizations have been cutting back and are actually in some ways in a very tough position right now in New Orleans.
WILLIAM SCHAMBRA: The other thing, and this goes to Daniel’s point, which I thought was quite interesting, the notion of needing a new political theory, and also Jon’s notion of the unintended consequences. As you point out, Daniel, the mantra is, pay only for success, right? Is this device inadvertently going to divert money that is sort of traditional charitable dollars, possibly given in what nonprofits regard as sensible ways, i.e. long term general operating support grants? Are the foundation program officers now going to say, ‘Hey, this is terrific! Let’s encourage this trend. We know we can sell it to our board members; they’re always beating us up about only having successful grants.’ So are you going to be diverting money from traditional philanthropic pursuits into this area and calling it new money?

JON PRATT: I think that’s a serious challenge. It is sort of a different money problem where, could there actually be winners and losers? So those that can best argue that their results will be measurable will do the best. And there’s another issue, which is the conductor for the last stop on the train, where your organization provides a service that keeps kids out of Rikers, but their family is also receiving services from six different organizations or city entities. All of which are important, but if you’re the one who gets the credit for the one thing, so the last stop on the train, you collect the fare.

A lot of the nonprofit and social services world is a multi-hub, decentralized network where no single organization has exclusive jurisdiction over a single client. So by definition, there are a multitude of factors at work and trying to measure and get down to that single factor that made the difference and then reward that single factor is almost an impossibility.

NIRAV SHAH: Cannibalization of foundation funding is something that we talk about a lot. Clearly we don’t want to be shifting resources from philanthropies that are already spending money on homelessness. That is not the ideal but I think we have to balance that with the understanding that we’re very, very early talking about Social Impact Bonds. There are two out there in the world, and as Jon mentioned, they haven’t gone through yet.

And there is an understanding that, in order to build this market, we will need help and philanthropy can really play a role in this. I think the goal is, over the long term, and that’s a five or 10 year horizon, is to get new capital in the space. And that is getting investments from Goldman Sachs and from other commercial institutional investors that are willing to put their money into social programs. But that is an evolution.

ANDREA PHILLIPS: I would also add that in those conversations that are going on, we are all pretty clear that this is not the solution for everything. And I think that goes on the plus side of the scale that that is being said. I think you’re absolutely right that if you take this to the extreme, we’re in trouble because there are certain things that government should fund and philanthropy should fund that will never save money and may not change anything, but it’s the right thing to do and we should keep doing them.

Q: Hi, my name is Chris Bullivant, I was a director of a think tank called the Center for Social Justice in London and we did a fair bit of work with Social Finance, and now we’re here in DC with Food for the Hungry, an international development NGO. I just wanted to applaud the work that Goldman Sachs has been doing with Social Finance.
Our understanding at the Center for Social Justice was that government was spending a lot of money on the need to fix the extreme issues. The prison population had doubled over a period of 10 years, which meant there was a lack of innovation in what was occurring in the prison system. Nonprofits were able to do innovative and effective work and the Social Impact Bond model allows that sort of innovation. As Andrea said, it allows that time lag in results to be able to come through. So the fact that someone like Goldman Sachs is willing to invest in this sort of model is fantastic news, I think. So, thank you so much.

And then the question would be, even though this is still in the early days, is there any possibility of this sort of model working for international development and NGOs where there isn’t a government to provide the backup necessarily?

NIRAV SHAH: We’ve been talking with our sister organization in the U.K. about the potential of international applications for Social Impact Bonds, where the risk of repayment from developing countries is much higher. However there might be a way to think about how donor countries can play a role as a payer where they are already giving goods and providing money to developing countries. One question that needs to be worked around yet is cannibalization of funds. But we are in discussions thinking about international applications.

ANDREA PHILLIPS: In terms of Goldman Sachs, when the Rikers investment was announced this summer we had folks reaching out to us from our offices across the world with interest on the part of governments, the philanthropic sector and individual clients asking how they could use this strategy. I think Nirav hit it on the head that one of the challenges that would need to be structured around is relying on that source of repayment.

JON PRATT: Maybe this could deal with the time lag problem you mentioned, Daniel, that when you think about Haitian redevelopment after the earthquake, there were international pledges. Would investors be willing to wait for the payment by the international community paying on its pledges and risk the money now, thinking that they will come through with their pledges?

WILLIAM SCHAMBRA: And you think that would be not terribly likely?

JON PRATT: It could be a challenge. It depends on the investors. I would ask the investor --

ANDREA PHILLIPS: What I would say is, I’d have to look at the deal. It all depends.

WILLIAM SCHAMBRA: Daniel, you haven’t picked up the bait on my political theory question, the notion that there is a quite a different political theory about this. Is that what explains the fact that we have 95 percent discussion and 5 percent execution so far? In other words, it is something of a puzzle, how it can have generated so much interest out of proportion to the actual number of projects on the ground.

DANIEL STID: I guess I would pick up on Jon’s point that there is a realm in which all these pieces can fit together, and meanwhile, we’re struggling to fund and get results with what we’re doing. So it is almost like, if we can pull out and look at things in this self-contained world, there
is an appeal there. But again, I don’t think anyone’s doing this with any sort of malign intent. I think it goes into the debate about what are the obligations that we owe each other in this society and what do we ask government to do.

You can make headway in advocating for this particular type of instrument by saying that government should only pay for success, which most of us, as citizens and taxpayers, if we’re presented with that proposition would probably say that it makes sense. But then if you think about it at a deeper level, you realize that there are a lot of things that. As bad as our child welfare system is, it is a lot better having government orchestrating this with some degree of equity than what we had 100 years ago.

Another real issue is the sheer variation in what government does and what government has outsourced across a range of human services. We are talking about Social Impact Bonds where the outsourcing has already occurred, and we have a third party providing it. And you could say, well, we’ve got laboratories of democracy, let a hundred flowers bloom here, I’m just wondering around basic questions of equity, and especially for young people who aren’t in a position to make choices, if we want a more systematic answer. So I don’t know what the answer is, I just feel like there’s more work that needs to be done here than we’ve done today.

Q: Hi, thank you all very much. I’m Adam Kaplan; I’m from the Aga Khan Foundation’s Impact Investing Initiative. I have a question about structuring, and I guess it’s partly theoretical and then partly technical.

Andrea, you mentioned a need for standardized terms and agreements, and I think that’s really important both in terms of providing an onramp for new sources of capital, as well as allowing for the replication of successful models. But I think that the reason there’s a lot of appeal in the social impact don’t-call-it-a-bond model, approach, if you will, is that it allows for the tailoring of solutions for a specific social problem and a specific state or municipality, and it allows the actors who know that area the best, to tailor solutions. So I’m wondering, how do you kind of balance those two?

And then the technical piece is about structuring the actual deal. You talked about the Rikers Island deal, and because there is only one capital provider, it becomes a little bit easier to, you talked about how simple it is, right --

ANDREA PHILLIPS: Did I really say that? [LAUGHTER]

ADAM KAPLAN: Pardon me, but as you move from $10 million to a $100 million dollar deals, you start to bring in more of the partners that Nirav’s slide showed, whether they are large DFIs or national governments, PRIs from foundations. And as you have different return expectations from these different providers, it becomes a little bit more difficult to structure the actual investment, right? You can’t just write in different terms in a loan. So I’m wondering how do you actually make space on the term sheet for different types of investors once this does start to scale?
ANDREA PHILLIPS: So let me talk a little bit about standardizing terms. What I don’t mean is standardizing necessarily what the intervention is for a particular location. What I mean is some of the other more financial structures. When we had to draft a loan agreement for this loan, we were sort of starting from scratch. The hope would be that it can be a model for next time, so you decrease your legal costs. The idea is to just not look at everything *de novo*.

Now, the truth is, currently folks are thinking about these differently. We thought about it as debt, I know other folks are thinking about it as equity. As much as I think we need to sort of let a thousand flowers bloom, I do think if this is going to scale and get to a $100 million dollar deal, we do need to come to some agreement about basic terms and structures and how to think about returns, because from an investor perspective, the binary all or nothing repayment is not scalable. It will be very hard to make those work. So that is more what I mean, is the need for some standardized thinking about that and the financial terms.

In terms of your very good question about how to scale it, we are in fact looking at another investment opportunity right now, where we’re going to sell participations to a couple of other banks. Again, because these are so new, and you end up with so many players at the table, even if it’s the simple model that we did, to add four investors is going to stall the process. I can tell you from a Goldman Sachs perspective, we have our standard language for commercial loan agreements. If Chase was sitting there, they have their standard language. We then have to agree and you’d never get through the process. So our feeling moving forward in the near term is that the most effective way to do that is to have a lead investor and then sell participations, and that’s a way to do that a little bit more efficiently, but then also bring in new capital providers, because I think this is a case where we’re hoping to bring other folks in.

Moving down the road, sort of in a world five years from now, where there is really a track record, you could see a place where somebody might originate a $100 million dollars and then sell off. Or you would create a syndicate from the start that would go in on it. We’re just not there yet.

WILLIAM SCHAMBRA: I promised Andrea that we would be finishing promptly at 2:00, so if folks have final comments, final observations, responses to issues that have come up in this discussion? Jon, anything?

JON PRATT: Well, when I buy my first Social Impact Bond, I hope Andrea and Nirav are doing it.

DANIEL STID: I will second those comments.

ANDREA PHILLIPS: And we hope to do one in Minnesota.

WILLIAM SCHAMBRA: That would be a good place to do it, although Jon is going to be a tough audience.

ANDREA PHILLIPS: Though not in the winter.
NIRAV SHAH: I would just say that having these discussions is really important. We are at the early stages and having different viewpoints will help us innovate and create better products. Hopefully over time we’ll meet the goals of society that we need, while bringing new capital in.

WILLIAM SCHAMBRÁ: Excellent. Very good. All right, let’s thank our panel for a terrific conversation. [APPLAUSE]