Bulgaria: Reforming the existing and designing of new measures for activating inactive persons and their inclusion in the labour market in Bulgaria
REFORM/IM2020/004

Social Impact Bonds

Output 4 – Innovative policy design of active labour market policies (ALMPs)

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In Brief

Social impact bonds

Social impact bonds are an innovative financing mechanism for social and labour market policies. They belong to the class of social impact investments and bring together commissioners (public bodies) who initiate a social or labour market programme, investors who provide upfront funding for the programme and service providers who deliver their services to the beneficiaries of the programme.

Social impact bonds are an outcome-based financing tool. If the social outcome of the project turns out to be sufficiently high, investors are paid back by the commissioner and receive a return on investment. If the project fails to produce sufficient results, investors lose parts or all of their investment.

Impact bonds for social and labour market policy are a relatively new financing tool and most countries have launched only few or no social impact bonds so far. Five countries (United Kingdom, United States, Netherlands, Australia, France) account for three quarters of all social impact bonds.

1. Introduction

Social impact bonds (SIBs) are an innovative, outcome-based financing mechanism for social policies. They are one type of social impact investments and are a "pay-for-success" instrument as the return on investment of a social impact bond depends on the outcome of the programme that is financed. With the first bond launched in the United Kingdom in 2010, social impact bonds are a young financing tool and many countries have not used this mechanism so far, or are only starting to experiment with it.

This note describes the functioning of social impact bonds and provides examples of how they are implemented in practice. Section 2. summarises key characteristics of social impact bonds and discusses possible strengths and weaknesses of this financing tool. Section 3. provides an example of a social impact bond in France that aims to address mobility obstacles to promote employment among vulnerable groups. Section 4. describes further examples of social impact bonds. Finally, section 5. briefly sketches some considerations for Bulgaria in case the country decided to introduce a first social impact bond.

2. Characteristics of social impact bonds

Social impact bonds are one specific type of outcome-based financing and are an alternative to conventional financing methods for social and labour market policies. They bring together private investors, public bodies and service providers in order to build a partnership and jointly implement social and labour market programmes. Such programmes can be in different policy areas, e.g. aiming to increase employment, reduce recidivism among former prisoners or address homelessness.

Each of the parties involved in the social impact bond takes on a specific role in the provision of the programme (Figure 1). The public body, which acts as the commissioner of the social impact bond, identifies the need for a social action and initiates a specific programme to address this need. In particular, the public body/commissioner specifies the thematic scope of the programme, defines its time horizon and sets the objectives it aims to achieve. In some cases, several public actors jointly commission a social impact bond (e.g. several ministries).

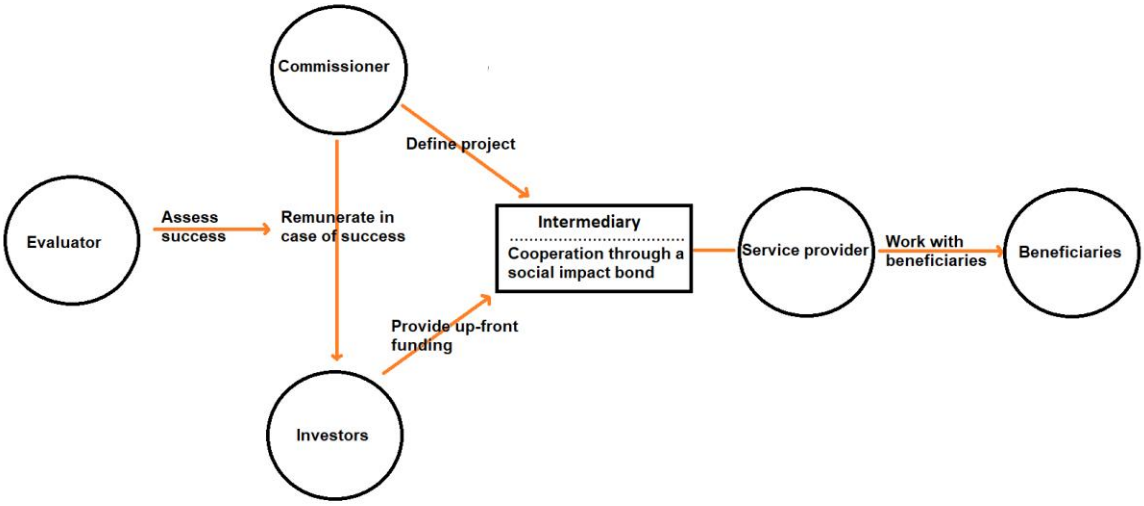
Contrary to other financing mechanisms for social and labour market programmes, social impact bonds do not require the commissioner to directly finance the project. Private investors take on this role and provide the upfront funding that is needed to implement the programme. Such investors are often foundations (e.g. charity foundations), but can also include institutional investors or high net worth retail investors with an interest in the social benefits of the programme (Varga and Hayday, 2019[1]). In return for the risk investors take on, the commissioner commits to paying back investors their investment plus a return-on-investment in case the programme turns out to be successful. If the programme fails to produce sufficient social outcomes, however, investors are not (fully) paid back and can lose parts or all of their investment. The criteria for success, and hence for triggering payments to investors, are clearly defined before the start of the programme and must be objectively verifiable. Typically, independent evaluators assess ex-post whether the criteria for success were met and whether investors are entitled to receive remuneration or not (OECD, 2016[2]). In many cases, evaluators are consulting and evaluating agencies, or educational institutions.

Service providers implement the programme and deliver their services to eligible beneficiaries. The funds service providers receive are restricted and must be used for the specific programme, i.e. they cannot be used to cross-finance other programmes. Some social impact bonds fund programmes are implemented by more than one service provider.

In addition, there may be an intermediary whose role is to coordinate the social impact bond between the commissioner, the investor and the service provider. Intermediaries can take on a large range of responsibilities, depending on the structure of the programme and the legal complexity of the bond. They can be in charge of designing social impact bond details, ensuring the legal feasibility (e.g. setting up special purpose vehicles[1]) and act as financial intermediaries, e.g. receiving payments from investors and delivering profits from the commissioner to investors in case of success. Intermediaries can also be in charge of selecting service providers. Intermediaries can be not for profit organisations, but, depending on their role, in some cases also financial institutions.

[1] Special purpose vehicles are legal constructs that can sometimes be useful to set up social impact bonds. Special purpose vehicles permit to separate the financial risks involved in the social impact bond from a firm’s other activities.

Figure 1. Functioning of social impact bonds



Note: Generic functioning of social impact bonds.
Source: Authors' compilation.

Regardless of what their name suggests, social impact bonds are no true bonds. 'Bonds' refer to loans from investors to borrowers. They are typically structured as fixed-income debt instruments, i.e. they pay a regular interest until the bond matures and the investment is paid back. Bond payments are secure unless the borrower defaults. Conversely, the return on social impact bonds is contingent on the outcomes of a social or labour market programme. Investors will only receive their investment and a return on investment if the programme produces the targets set in advance. The main risk for investors is that the programme does not perform sufficiently well, and not only the (very limited) risk that the commissioner defaults. Therefore, social impact bonds are riskier than suggested by the term 'bond'. In addition, contrary to many types of bonds, social impact bonds are not tradable on the secondary market.

While social impact bonds are a young policy and financing tool, they were strongly publicised and their dissemination has been rapid in some countries. Social impact bonds offer a number of advantages that make them attractive for policy makers, contributing to the rising number of social impact bonds that were implemented after 2010 (see e.g. (OECD, 2016[2]); (Carter et al., 2018[3]))

- Social impact bonds permit to transfer financial risks involved in social programmes from public bodies (who only pay in case of success) to private investors (who earn a positive return in case of success).
- Social impact bonds can reduce pressure on public finances as the public sector has to pay for successful projects only. Furthermore, projects can be implemented today, while payments for successful project will take place in the future, once outcomes of the programme are evaluated.
- The involvement of private investors has the potential to increase the efficient use of public spending on social programmes. Investors face strong incentives to finance only programmes with a significant chance of success, thus channelling investments to the most promising programmes.
- Social impact bonds could permit to finance programmes which might not have been implemented with conventional financing methods by mobilising additional funds, thereby possibly enabling innovative solutions to social problem that public policies have not been able to solve yet.

- Programmes financed through social impact bonds are thoroughly evaluated to determine whether investors are paid back. A systematic assessment of the outcomes of the project can help gather knowledge on which type of programmes perform well, and which do not.

For investors, social impact bonds can offer interesting financial opportunities. An increasing number of investors is looking for social causes, at least for parts of their portfolios. Furthermore, returns on social impact bonds can be high. For example, in the case of the first social impact bond that was implemented (see section 4.), the payment structure was designed in way that the annual internal rate of return[2] could reach up to 13% (Nicholls and Tomkinson, 2013[4]). Nevertheless, in some cases, the interests of investors are broader than the sole return of the social impact bond. For example, in the case of a set of social impact bonds commissioned by the UK Department for Work and Pensions and implemented in Scotland to improve employment prospects among youth, investors were “involved” investors (Varga and Hayday, 2019[1]). Besides providing up-front funding for the programmes, the investors also spent their own time and other resources on the programmes. The range of investors included local businesses and individuals as well as a local church.

Despite advantages for public commissioners and private investors, the use of social impact bonds to fund social programmes also implies risks and weaknesses, which have triggered criticism (see for example Pratt (2013[5])) and warnings regarding the limitations of social impact bonds (Keohane, Mulheirn and Shorthouse, 2013[6]). Commonly discussed limitations include:

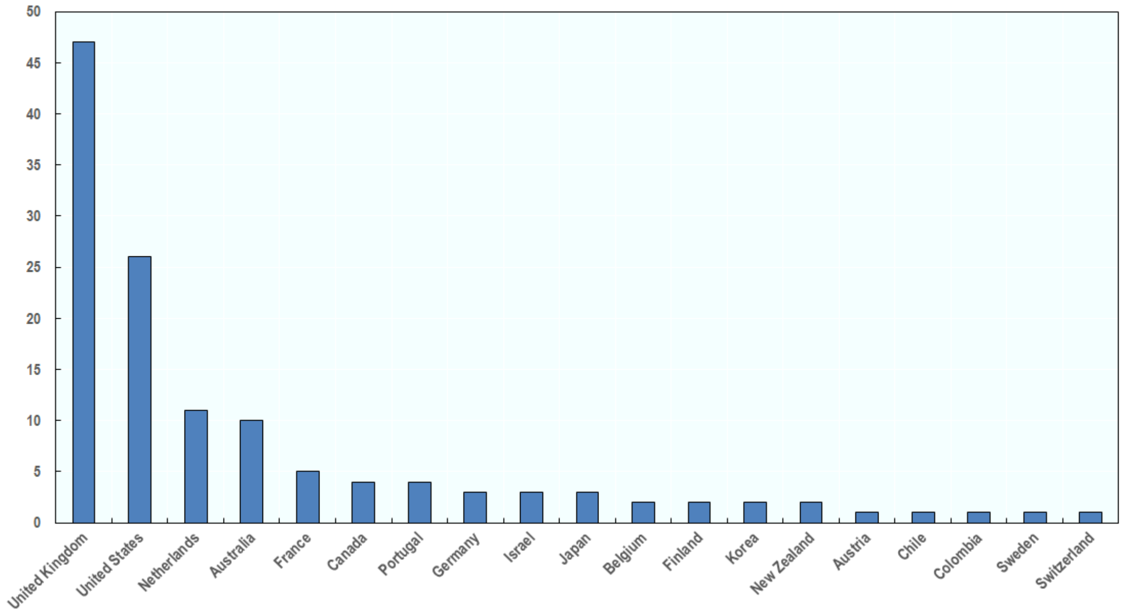
- Private investors risk making financial losses unless the programme they invested in turns out to be successful. This creates incentives for them to strive for more influence on service providers.
- It is not possible to use social impact bonds for programmes for which objectively verifiable measures of success cannot be defined. This excludes the use of social impact bonds for a large number of projects. Furthermore, objectively verifiable measures may not always adequately reflect the success of a project.
- The use of social impact bonds generates significant costs (e.g. need for an independent evaluator, financial intermediary) weighing on the overall profitability of the programme.

As of March 2021, at least 138 social impact bonds have been launched worldwide, in at least 26 countries (Figure 2). Most social impact bonds for which information is available were launched in the United Kingdom and the United States, with the two countries accounting for more than half of all social impact bonds. Further examples of countries with a relatively high number of social impact bonds are the Netherlands, Australia and France, whereas other OECD and EU countries have only launched a small number or no social impact bonds so far. In Bulgaria, social impact bonds have not been used yet to finance social programmes.

[2] The internal rate of return is an estimate of an investment’s rate of return. Investments amounted to GBP 5 million, the maximum repayments by the commissioner were capped at GBP 8 million.

Figure 2. Five Anglo-Saxon and European countries account for more than three quarters of all social impact bonds

Number of social impact bonds launched in OECD and EU countries since 2010



Note: This figure includes social impact bonds for which information is available. It cannot be guaranteed that this figure is complete. Depending on the definition of social impact bonds, other social impact bonds may exist.
Source: (Social Finance, 2021[7])

The 138 social impact bonds for which data are available in the "social finance" database permitted to raise a total of more than USD 440 million, and more than 1 700 000 individuals benefitted from the programmes financed through them (Social Finance, 2021[7]). The average size of social impact bond programmes varied across countries. In the United Kingdom and the Netherlands, the average amount raised by social impact bond programme amounted to approximately USD 1.3 million and USD 1.2 million , respectively, against USD 4.4 million in Australia and USD 8.4 million in the United States.

The most common use of social impact bonds, in terms of the number of social impact bonds, was in employment (32%), housing (17%), health (16%) and family welfare (14%) (Social Finance, 2021[7]). The average amount raised per social impact bond was lower for employment programmes (USD 1.7 M) than for family welfare (USD 3.4 M) and health programmes (USD 4.1 M).

3. Using social impact bonds to increase access to employment in France

Among the five social impact bonds that have been launched in France to date, four aim or aimed to improve employment outcomes. One of them, referred to as "parcours numérique", or "digital journey", was specifically targeted at increasing employment outcomes among vulnerable groups by increasing their physical mobility (Minisère de la Transition Écologique et Solidaire, 2019[8]). In particular, the social impact bond funded a programme aiming to actively assist vulnerable groups (many of which live in suburbs far away from the economic centres of towns and cities) in becoming more mobile and thus more autonomous in order to improve their job chances.

The programme was targeted to people with a weak attachment to the labour market who might face mobility obstacles, including young people entering the labour market, people on temporary contracts and unemployed people. The programme was implemented in several regions across the country.

For this social impact bond, there were three commissioners who jointly initiated the programme: the Ministry of Economy; the General Directorate for Employment and Professional Training; and the Ministry for Ecological and Inclusive Transition.

The up-front financing for the programme was provided by several investors: BNP Parisbas (a banking group), Caisses des Dépôts et Consignations (a public sector financial institution), Aviva Impact Investing France (an investment fund dedicated to social impact programmes) and Ecofi Investissements (an asset management firm). In total, they invested EUR 680 000 in the programme. BNP Parisbas also acted as intermediary, coordinating the programme and structuring its financial and legal aspects (BNP Parisbas, 2019[9]).

The service provider for this programme was the association Wimoov, which is an organisation that originated as a car sharing and car pooling association during a large-scale public transportation strike in France in 1995 and defines as its main objective to promote inclusive mobility (Wimoov, 2021[10]). In the context of its social impact bond programme, Wimoov provided a number of services to vulnerable people:

- Carry out mobility tests permitting to identify possible mobility obstacles and raise awareness among vulnerable groups about the importance of sufficient mobility.
- Define participants' mobility profiles and identify ways to overcome mobility obstacles they are facing.
- Assist people with mobility obstacles pedagogically (e.g. personal mobility coaching), financially (e.g. access to micro-credit for better mobility) or by providing adequate material for better mobility (e.g. renting bikes at low cost).

The programme was launched on 1 January 2018 and ran for one year. After the end of the project, the results of the service provided by Wimoov were evaluated by an independent body, KiMSO, which is a consulting and evaluation agency specialised on social impact evaluations. The three commissioners committed to jointly paying up to 750 000 EUR to the investors, depending on KiMSO's assessment. The criteria for success were defined as follows (Minisère de la Transition Écologique et Solidaire, 2019[8]):

- No less than 10 000 people benefited from a "mobility test" in 2018.
- No less than 80% of mobility tests were followed by tailored assistance (pedagogical assistance, financial assistance, provision of adequate material for better mobility or by building up partnerships)
- At least 17% of mobility tests were not carried out by Wimoov, by directly by the PES (or another prescribing structure)

The final outcomes of the evaluation, and thus the outcomes for investors, have not been made public so far.

4. Further examples of social impact bonds

Further examples of social impact bonds include programmes aiming to reduce prisoner recidivism, improving health outcomes and family-related policies.

- The first social impact bond worldwide was the Peterborough Pilot social impact bond in the United Kingdom, which was launched in 2010. The programme provided specific support to prisoners with short-term sentences, aiming to reduce recidivism rates. The commissioner committed to paying an annual return between 2.5% and 13% if the recidivism rate among the treatment group turned out to be sufficiently lower than the reoffending rate in a control group (convicts with a similar profile who did not receive the service) (Nicholls and Tomkinson, 2013[4]). The University of Leicester and the private firm Qinetiq acted as evaluators of the programme. They estimated recidivism rates among former prisoners in the treatment group as well as former prisoners in the control group over 12 months after they were released from prison. The minimum difference in the reoffending rate for the programme to be successful was set at 7.5%. Ex-post evaluations of the programme concluded that it had been a success, reducing reoffending rates by 9%, leading to a repayment of investors with an annual return of over 3% (Social Finance, 2021[7]).
- In Delaware, a social impact bond was implemented to finance a programme aiming to promote blood donations among young people (Delaware Community Foundation, 2018[11]). Only few people below 35 donate blood in Delaware, accounting for about 15% of all donors. The programme, which was launched in 2018 and runs for three years, intends to increase blood donations of younger people thanks to the provision of mobile services. Depending on the indicators of success of the programme, including the increase in blood units received from young people, investors will be paid back and receive a return on investment.
- In 2017, Australia launched a social impact bond to fund a programme to reunite families in which children that were separated from their families and lived e.g. in foster care (Social Finance, 2021[7]). The programme, which was set to run for seven years, intended to lead to the opening of three centres aiming to prevent family-related risks, including intra-family violence and child neglect through the provision of family and community services. The programme focused primarily on First Australians (indigenous Australians). However, the programme was terminated earlier than planned (in June 2020) as too few families signed up for it (Social Ventures Australia, 2020[12]).

5. Considerations for Bulgaria for the potential introduction of social impact bonds

Social impact bonds are a young policy tool and are still in the fledgling stage in many countries. When social impact bonds are newly introduced in a country, they first need to overcome obstacles related to their implementation and then prove their operational efficiency before they can be rolled out on a wider basis.

One major obstacle during the early stages of impact bonds relates to legal restrictions that can make the implementation of social impact bonds difficult, or even impossible. The non-profit organisation Instiglio put together a legal roadmap for the implementation of social impact bonds in seven countries (Colombia, Mexico, South Africa, Mauritius, India, Chile, Brazil), which highlights some of the legal challenges that exist(ed) in these countries (Instiglio, 2014[13]). Different types of challenges can emerge and a number of interrogations have to be clarified before launching a social impact bond. If Bulgaria decided to plan a social impact bonds, some of the main questions would include the following:

- In general, does public procurement regulation permit the use of social impact bonds?
- Can the report of an independent evaluator be legally binding for a government to trigger payments in the case of success?

- How are capital gains taxed in case of success? In case of foreign investors, can double taxation be avoided?
- Given the fiscal framework, who is allowed to become a fiscal investor?

In Chile, for example, public procurement is highly regulated and the experts contributing to the roadmap on social impact bonds estimated that, at the time, “the central authority may not conclude such agreements ” because government payments would fully depend on social outcomes (Instiglio, 2014[13]).

In Argentina, the first impact bond was launched in 2019, following more than one year of negotiations between stakeholders. One of the main obstacles was that the tax system did not permit non-governmental organisations (NGOs) to act as social investors, and it was necessary to clarify the income tax law to permit social investment bonds (Aurisicchio, 2019[14]).

A country wishing to use social impact bonds as a means of financing social policy programmes has to go through a number of steps before the tool can be used:

- Exploring the legal feasibility of social impact bonds
- Assessing whether investors could be found to fund social impact bonds
- Evaluating the (potentially high) costs of social impact bonds, in particular administrative costs (e.g. setting up the social impact bond, paying an independent evaluator)
- Setting up a first small social impact bond to test the financing tool (identifying a relevant social policy need, defining a social programme to address this need, identifying investors, service providers, intermediaries and other parties involved and implementing the programme)
- Thoroughly evaluating the programme and drawing conclusions regarding the advantages and challenges of using social impact bonds

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