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SOCIAL IMPACT BONDS: STATE OF PLAY & LESSONS LEARNT

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This document presents the functioning of SIBs, outlines their implementation in various country and policy contexts, and reports on lessons that can be learnt from the experience so far. It was prepared by Mr Peter Ramsden, Freiss Ltd, under the supervision and coordination of the Secretariat.

It is submitted to the Directing Committee for DISCUSSION and GUIDANCE.

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1. Introduction

1. Social Impact Bonds (SIBs) have spread around the globe in the past five years. At a time of pressure on public budgets following the economic crisis, a financing mechanism for social policies that promises to mitigate the public sector risk, increase effectiveness and pay for services now while requiring public contributions later, is likely to attract attention. Few policy tools have been disseminated so far and so fast. Since the first one, which was launched in 2010, 43 SIBs have been set up in 11 countries representing an investment of over 200 million EUR.

2. The backing for SIBs was illustrated by the launch of Social Impact Investing Task Force 2013 as part of the agenda of the G8 summit under the UK Presidency. The first meeting chaired by Sir Ronald Cohen took place in the White House the same year. In June of 2014, the Pope expressed his support for social impact investment saying: “It is urgent that governments throughout the world commit themselves to developing an international framework capable of promoting a market of high impact investments and thus to combating an economy which excludes and discards”.¹ SIBs were the centrepiece of the final report² of the Social Impact Investing Task Force because they combine three core elements in a single tool: entrepreneurship, innovation and investment.

3. Public welfare expenditures seek to achieve social impact. For a variety of reasons, not all such expenditures succeed. The enduring nature of poverty, recidivism, homelessness, unemployment and other intractable social problems suggests that a greater variety of approaches might be helpful. In this regard, social impact investing seeks to marry social with financial returns (OECD, 2014a). Furthermore, social impact investing- exemplified by SIBs- opens up the world of social impact to private sector investors as well as other funders and offers the prospect for social enterprises and civil society organisations to become a more significant part of the delivery system. In practice, most SIBs have been developed in policy environments where ready cashable savings can be realised through improved performance of a non-statutory service. These are usually areas in which conventional approaches have not worked well. At the same time, they are often in areas that are complementary to existing statutory provision rather than as replacements for provision.

4. A SIB can be defined as “a contract with the public sector or governing authority, whereby it pays for better social outcomes in certain areas and passes on part of the savings achieved to investors”.³ Brookings Institution in a major study of SIBs (Gustaffson-Wright et al., 2015) defines them as: “a mechanism that harnesses private capital for social services and encourages outcome achievement by making repayment contingent upon success”.

5. This paper sets out to explore the current state of play of SIBs. Section 2 presents their geography and thematic scope. Section 3 asks whether SIBs are scaling up social innovations and examines the roles of the different actors and in particular the role of commissioners, investors and service delivery organisations. Section 4 examines the focus SIBs place on outcomes and the use of evaluation, and comments on monitoring systems and where the risk is placed. It also discusses whether the reward mechanism of the contract is able to deepen the focus on results throughout the delivery chain. The final section brings together some main messages.

¹ <http://www.socialimpactinvestment.org>

² Social Impact Investing Taskforce (September 2014), *Impact investing: the invisible heart of markets: harnessing the power of entrepreneurship, innovation and capital for the public good.*
<http://www.socialimpactinvestment.org>

³ <http://www.investopedia.com/terms/s/social-impact-bond.asp#ixzz3h60T8ntj>

6. The paper was written following an experts meeting organised by the OECD in Paris on April 15th 2015.⁴ This meeting included contributions from a number of SIBs such as the Junior Code Academy in Lisbon, London's Street Impact and Rotterdam as well as contributions from evaluators and support organisations. We are grateful to all participants and speakers for these valuable contributions and exchanges from which this document benefited greatly. Other desk research was based on published materials, evaluations and websites of SIBs as well as of support organisations.

SIBs are a subset of payment by results contracts

7. The essential ingredient for a SIB is normally some type of payment by results contract (known as payment for success in US and payment for benefits in Australia).⁵ In these contracts, instead of governments paying for inputs at the outset of the contract, they pay for results at the end or at stages during the contract. This shift from outputs to outcomes is important because it changes from paying for an activity to paying for an achievement of policy objectives measured by outcome indicators. A SIB adds a financial circuit to the payment- by- results model that enables the service delivery organisation (typically a social enterprise) to be paid up-front during the contract while the investors are only paid at the end or at milestones. It addresses an inherent problem to payment- by- results contracts whereby only those bidders with deep pockets can afford to wait until results are achieved for their payment. Depending on the structure, these payments can be made annually or over a longer period of time. In SIBs to date, this period has been from 1 to 17 years with the median at 3. Their size in terms of investment raised has ranged from around 0.5 million to 20 million EUR. The number of service users reached has spanned from twenty two to many thousands.

Box 1: The Peterborough One Service SIB

The first SIB was aimed at reducing recidivism at Peterborough Prison over a five year term involving three cohorts of prisoners serving sentences of less than 12 months. This group of prisoners was known to have high offending rates compared to longer term prisoners and existing probation services were not targeted at them. In this sense, this SIB was backing a new service.

The Peterborough One Service SIB was structured as a payment by results contract issued by the Ministry of Justice which would pay up to 13.5% of the original investment, if the rate of reoffending events was reduced by more than 7.5% across all three cohorts compared to average figures across the entire prison estate. To trigger a payment for a single cohort, the reoffending rate would have to decrease by 10%. The contract for delivering services (the One Service) was sublet by the Social Finance intermediary organisation to a number of organisations including St Giles Trust and Ormiston Trust, who were paid up-front on a fee for service basis.

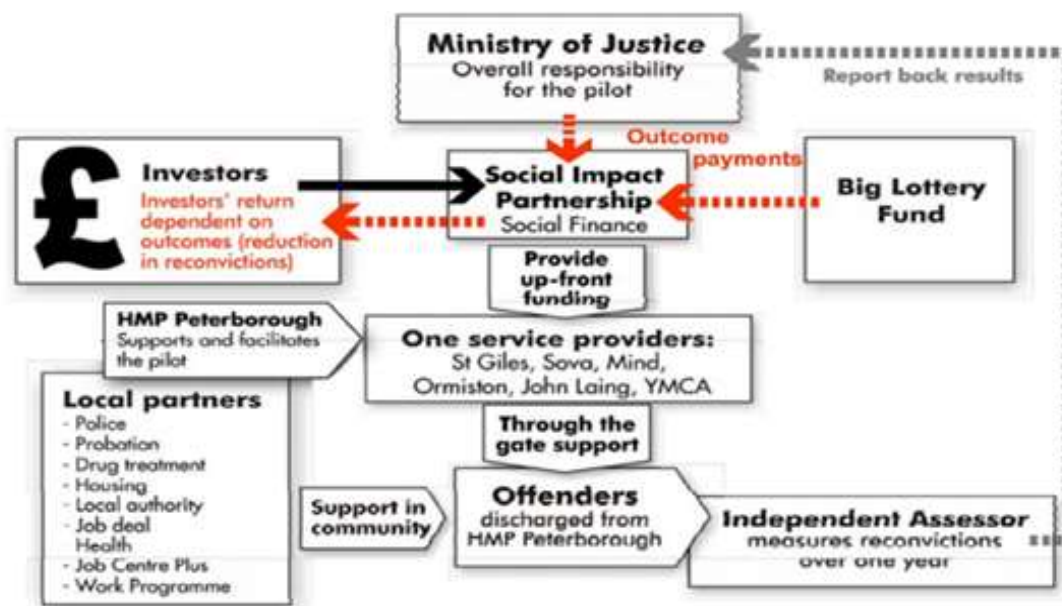
This SIB was intended to run over three cohorts of prisoners but was suspended after the second cohort. The reason was that the government introduced a general policy called "Transforming Rehabilitation" covering all prisons utilising a payment by results contract with an estimated value of £3 billion GBP, which outsourced this function. The payment to investors will depend on results for the second cohort for which figures will be available in 2016.

The Peterborough One Service SIB has been subject to two evaluations by the Rand Corporation Europe (Disley and Rubin, 2014) commissioned by the Department of Justice. Analysis of the results for the first cohort showed that the SIB had achieved an 8.6% reduction of the reoffending rate. This will be enough to trigger a payment, if similar rates are demonstrated for the second cohort. However, this was not enough to trigger a payment based on this cohort alone. The structure is shown in figure 1 below.

⁴ <http://www.oecd.org/cfe/leed/sib-seminar-2015.htm>

⁵ In Australia the corresponding bonds are called Social Benefit Bonds, and in the US as Payment for Success Bonds. In this paper all are referred to as Social Impact Bonds (SIBs) for ease of discussion.

Figure 1: Organisational & contract structure underlying the Peterborough SIB



Source: Disley and Rubin, 2014

What do we mean by a SIB?

8. Two definitions of SIBs were provided above. However, the use of the term ‘bond’ used for SIBs is somewhat of a misnomer. In financial circles “a bond also known as a fixed-income security, is a debt instrument created for the purpose of raising capital. It is essentially a loan agreement between the bond issuer and an investor, in which the bond issuer is obligated to pay a specified amount of money at specified future dates”.⁶

9. Bonds are used by governments at all levels and by corporations to raise money. In contrast, SIBs are not a pure debt investment because the return is contingent on the performance of the service providers in achieving specified social outcomes. Therefore, they are riskier because if these social outcomes are not achieved, the investor can lose its investment. In this sense, they are more like equity investments.

10. The Centre for SIBs⁷, a part of the UK Cabinet Office, examines whether there are the following four criteria in place in order to determine if an investment can be termed a SIB:

- a contract is signed between a commissioner and a legally separate entity (“the delivery agency”)
- a particular social outcome or outcomes which, if achieved by the delivery agency, will activate a payment or payments from the commissioner
- there is at least one investor that is, also, a legally separate entity from the delivery agency and the commissioner

⁶ <http://www.investinganswers.com/financial-dictionary/economics/capital-5749>

⁷ Centre for Social Impact Bonds <http://blogs.cabinetoffice.gov.uk/socialimpactbonds/about-sib/>

- some or all of the financial risk of non-delivery of outcomes sits with the investor

11. Not all SIBs discussed here and elsewhere satisfy this definition on all four counts, for example by having a separate investor, or by defining what appears to be outputs as outcomes. However, these four criteria are helpful in characterising SIBs.

Three are three main structures and two types of SIBs

12. Bridges Community Ventures (Goodall, 2014) argues that there are three main structures being used to structure SIBs:

- Direct in which the contract is signed between the commissioner and the service provider or with a special purpose vehicle set up and controlled by the service provider.
- Intermediated in which the contract is signed between the commissioner and a special purpose vehicle.
- Managed in which the contract is signed between the commissioner and an intermediary or an intermediary managed special purpose vehicle.

13. Not all SIBs fall neatly into these three categories, but overall this typology is a useful way of distinguishing between different management structures.

14. SIBs can also be divided into two broad approaches depending on how the payments relate to outcomes (Gustaffson-Wright et al., 2015): SIB funds and individual SIBs. In the first type, governments set up social impact bond funds to finance several SIBs. Here, the normal practice is to use a rate card that defines the maximum payment for each type of outcome. Service providers bid by offering a discount against these figures. Contracts are awarded based on price and other quality criteria. An example is given below in figure 4 for the UK Department of Work and Pensions (DWP) Innovation Fund, which supports young people not in education, employment or training (NEETs). This approach was also used for the London Street Impact SIB discussed below, in which two contracts were signed with different service providers covering North and South London.⁸ Rate cards require considerable effort by government to calculate the cashable savings and to relate these to the cost of service delivery based on historic contract figures. To assist in this process, the UK has set up a unit cost database.⁹ However, the prices in rate cards are normally set by calculating savings to public budgets if outcomes are achieved rather than by input costs.

15. In the individual transaction impact bond model, which has been used for the other UK examples and for all of the USA and Australian SIBs, the price for the outcome is normally determined by an open call.

⁸ The two service providers St Mungo's Broadway and Thames Reach both cover the central area of Westminster where large numbers of rough sleepers are to be found.

⁹ See unit cost database at http://neweconomymanchester.com/stories/832-unit_cost_database

Table 1: Rate card for the UK Innovation Fund

Outcome	Rate
Improved attitude towards school	£700 GBP
Improved behaviour	£1300 GBP
Improved attendance	£1400 GBP
Entry Level Qualification	£900 GBP
NVQ level 1 or equivalent	£1100 GBP
NVQ level 2 or equivalent	£3300 GBP
NVQ level 3 or equivalent	£5100 GBP
Entry into employment	£3500 GBP
Sustained employment	£2000 GBP
Maximum amount payable per individual over 3 years	£ 11,700 GBP

Source: Department of Work and Pensions website¹⁰

2. The geography, scope and spread of SIBs

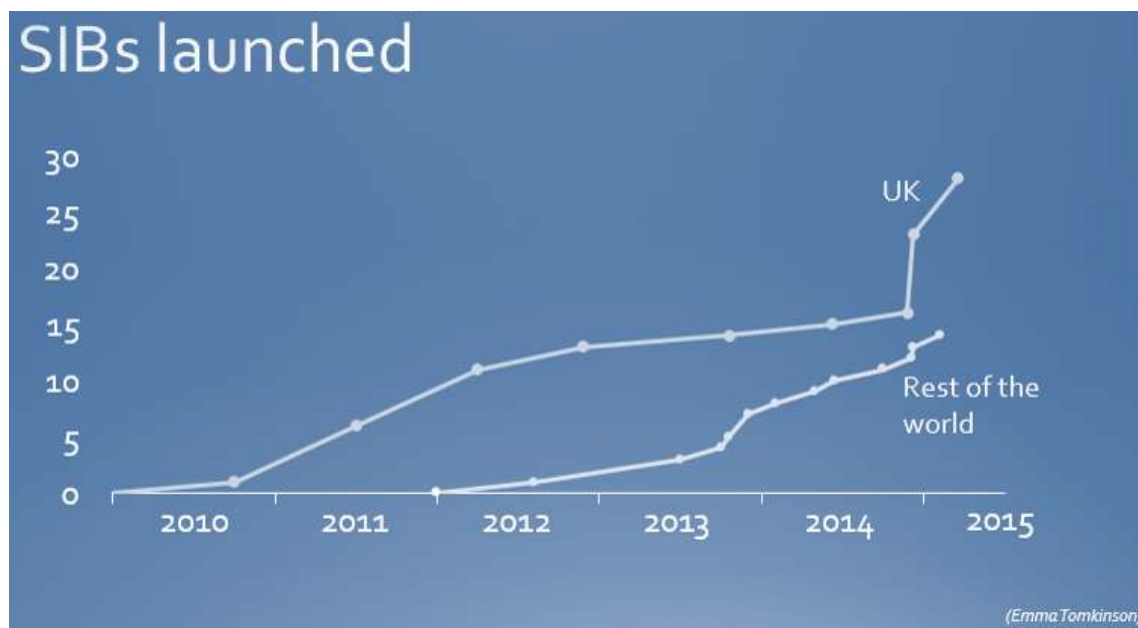
The Geography of SIBs

16. SIBs have spread around the world – particularly among OECD countries. By mid-2015, there were approximately 43 of SIBs launched with at least a further 30 in development (Instiglio database, 2015). SIBs offer a buy-now pay-later promise and may be attractive to governments trying to trim their budgets. They have been taken up most enthusiastically in countries in which significant parts of the welfare state have already been privatised, such as the UK, the US and Australia. In countries that retain a more public sector ethos, including the rest of the EU and Canada, the uptake has been more modest.

17. A growing number of SIBs is being initiated by city administrations and local or regional authorities, but to-date the majority has been conceived and launched by national or state governments.

¹⁰ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/212328/hmg_g8_factsheet.pdf

Figure 2: Trends of SIBs launched in the UK and the rest of the world



Source: Emma Tomkinson SIBs blog¹¹

18. As illustrated by figure 3 above, the UK has set up more than half of the SIBs that exist worldwide. The figure for the UK is so large because it has used a SIB fund model to roll out most of them. In 2012, ten of their SIBs were started as a result of two calls for proposals by the UK DWP Innovation Fund. After the UK, the second country is the US with eight SIBs launched and more in the pipeline. Within the rest of the EU, Germany Portugal, Belgium has one SIB each and the Netherlands has two. Switzerland has launched one SIB as well.

19. The summary of SIBs, which have been launched and financed, is rapidly changing. Three lists are worthy of mention: the Canadian SIBs Tracker website¹², the map of SIBs on the Social Finance website that has now been transferred to the Centre for SIBs¹³, and the database of Instiglio¹⁴, which appears to be the most up-to-date of the three. Some differences between the databases arise because of definitions of what is a SIB and whether they are in the design or implementation phase. Emma Tomkinson also maintains a blog with a world map and other material with an emphasis on Australia¹⁵. A recent Brookings study (Gustaffson-Wright et al., 2015) surveyed most of these SIBs. They concluded that there were 43 SIBs in developed countries and analysed 38 of them based on data availability as of April 2015. The tables prepared below were based on combinations of these sources.

¹¹ <http://emmatomkinson.com/category/world-map/>

¹² SIB tracker website at <http://financeforgood.ca/social-impact-bond-resources/sib-tracker/>

¹³ Centre for SIBs world map https://data.gov.uk/sib_knowledge_box/map

¹⁴ <http://www.instiglio.org/en/projects/>

¹⁵ <http://emmatomkinson.com/category/world-map/>

Table 2: SIBs implemented worldwide by country and region/city

Country	Number	Location
Australia	2	New South Wales
Belgium	1	National
Canada	1	Saskatoon, Saskatchewan
Germany	1	Augsburg, Bavaria
Ireland	1	Dublin
Netherlands	2	Rotterdam, Utrecht
Portugal	1	Lisbon
South Korea	1	Seoul
Switzerland	1	Bern
UK	24	Multiple
US	8	Multiple
Total	43	

Source: OECD adapted from tables in Gustaffson Wright et al., 2015; Instiglio website & SIBs tracker website

Cities, sub-national authorities and SIBs

20. Cities and sub-national authorities (counties, states) are playing a major role in the development and the delivery of SIBs. Sometimes cities act as a delivery partner in SIBs that have been led by the central government. For example, in some of the DWP sponsored Innovation Fund SIBs involved Manchester, Cardiff, Newport, Nottingham, Liverpool and London.

21. More recently, some sub-national authorities have acted as the commissioner responsible for the outcome payments and procurement. Examples involving federal states include New York, Utah, Massachusetts and New South Wales. Examples involving cities include the Chicago pre-school education SIB, London and Street Impact SIB (see box 2 below). Other independent SIBs set up by cities include Manchester, Birmingham, Nottingham, Cardiff, and Rotterdam and Augsburg. This growing interest of cities reflects both their need to seek out new forms of finance as well as their interest in innovating in service delivery (Gustaffson et al., 2015).

22. Foundations have worked closely with cities in setting up SIBs. For instance, the Lisbon Junior Code Academy SIB was set up with financial and technical support from the Gulbenkian Foundation. Furthermore, the Youth Employment SIB in Augsburg was set up with assistance from the Benckiser Foundation. Several of the UK city-led SIBs have received technical support from Social Finance, which also acts as an intermediary and was itself set up with the support of the Big Lottery Fund.

SIBs are mainly focusing on employment, social care and recidivism

23. The scope of SIBs sees youth and employment dominating the picture in terms of numbers. Seventeen of the British SIB pilots are focusing on youth unemployment and homelessness among NEETs while six others in Europe and the USA address youth unemployment issues. Four SIBs across countries have focused on recidivism; the reduction of reoffending among short term prisoner populations. The largest SIB investment made to date was to reduce recidivism in Massachusetts (US) at \$23 million USD, the first SIB was in Peterborough Prison (UK) and the first SIB in the US at Ryker's Island Prison in New

York. FiveSIBs address foster care, foster care avoidance, adoption and support for vulnerable single mothers, which show that social care is an important and growing field (see table 3 below).

Table 3: The Thematic Scope of SIBs by country

Country	Number	Thematic Scope
Australia	2	Family care & foster care avoidance
Belgium	1	Young migrants employment
Canada	1	Housing for vulnerable single mothers
Germany	1	Youth employment
Ireland	1	Homelessness
Netherlands	2	Youth employment
Portugal	1	School performance
South Korea	1	Child welfare
Switzerland	1	Integration of refugees in the labour market
UK	24	Youth unemployment (11), youth-homelessness-NEETs (6), foster care (2), recidivism (1), adoption (1), homelessness (1), long-term health conditions (1), elderly (1)
US	8	Recidivism (2), early childhood development (2), employment for former incarcerated (1), family & foster care (1), homelessness (1), housing & child welfare (1), asthma management (1)
Total	43	

Source: OECD adapted from SIBs tracker website & Instiglio website

Development Impact Bonds implemented in developing countries

24. SIBs in developing countries have been called Development Impact Bonds (DIBs). The situation regarding DIBs is at an earlier stage with many in the pipeline, but not launched yet. The first DIB was launched in 2014 and was recorded by the Instiglio database. It focused on girls' education and implemented in Rajasthan, India, where 40% of girls drop out of school before the fifth grade in the State.¹⁶ This DIB has the aim of increasing the enrolment of girls and to improve children learning outcomes.

25. DIBs are being considered in Brazil, Chile, Colombia, Mexico, Pakistan, Swaziland, and Uganda. Internet searches suggest that there are plans for DIBs to reduce the incidence of malaria in Mozambique and India, as well as the adolescent HIV regime in Rwanda (see box 2 below). The National Audit Office (NAO) reported in 2014 that the Mozambique project on malaria had not used a payment by results method because the number of bed nets had been used as the outcome indicator. According to NAO, these are an output not an outcome.

¹⁶ <http://www.instiglio.org/en/girls-education-india/>

Box 2: Rwanda: Support to young people with HIV led by Y-Bank.org

This DIB is still in its design phase and will be overseen by the Rwanda Biomedical Centre, which is a government agency for health research. The challenge this DIB will address is that adolescents are the group least likely to consistently take anti-retroviral medication. The delivery model is based on a triple therapy using clinical practice, peer support and financial incentives for transport costs in order to encourage young people to attend monthly clinics. A reduced viral load would be the main indicator used to measure success with financial returns through reduced hospitalisations. It is intended to be launched in 2016 and run until 2021.

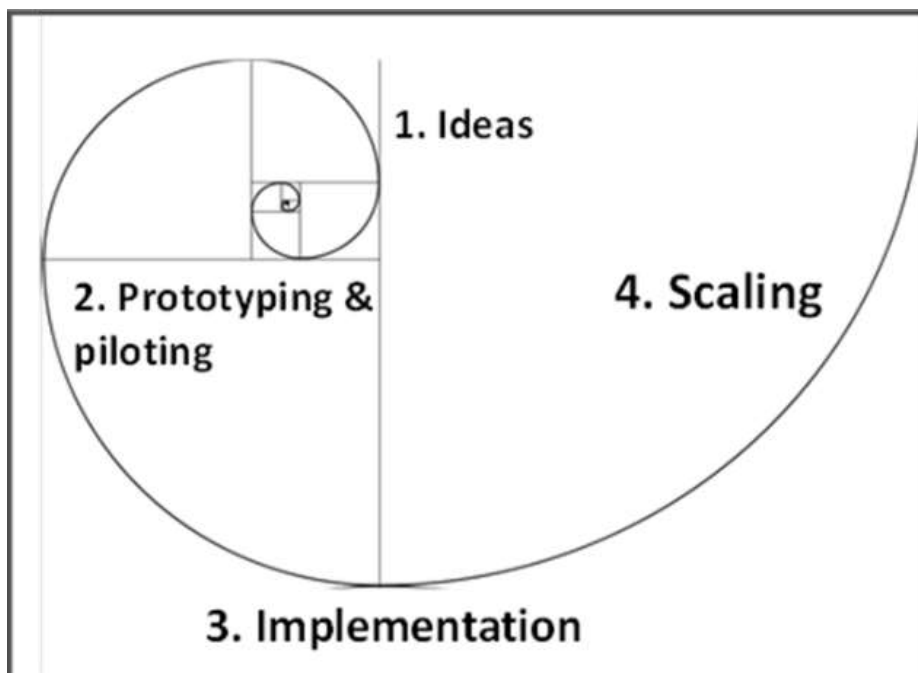
Source: Y-Bank.org contribution at the OECD experts meeting, 15 April 2015

3. Social Innovation and Partnership in SIBs

26. This section asks whether SIBs stimulate social innovation in the delivery model and at what stage of this process innovation takes place. Geoff Mulgan and the Young Foundation (O’Sullivan 2013) have used the social innovation spiral in figure 3 below to illustrate that as social innovations become more developed and mainstream, they become larger. Whereas pilots and prototypes are inevitably small, they need to be implemented at scale until they become the dominant paradigm through system change. Not all social innovations will reach system change. Although many SIBs are interested in scaling, there is also space for smaller ones. For instance, the Sweet Dreams Supported Living Project, a SIB implemented in Saskatoon, Saskatchewan, Canada, aims to work with 22 clients.

27. It could be argued that SIBs are a social innovation in their own right. They appear also to encourage social innovations through some of their structural aspects – particularly through coordination and integration of services. A key advantage of the payment by results contracts appears to be that whereas the outcome indicators are included in the contracts, the outputs required to achieve them are not specified. This contrasts with the belt and braces approach in many modern funding programmes in which outputs and outcomes are required. Because outputs relate directly to inputs, the specification of outputs risks locking the service provider into a particular mode of delivery. The advantage of only specifying outcomes is that more freedom is given to the service provider to innovate. However, this also comes with risks. It may be possible for the service provider or intermediary to game the system.

Figure 3: Social innovation spiral: from ideas to scaling



Source: O'Sullivan et al., 2013

28. In two SIBs, project level evaluations are available: the Peterborough One Service and the London Street Impact. The practices deployed were already known, but they had not been applied at scale or in holistic or integrated combination. While SIBs themselves can be considered to be in a pilot phase, their intervention approaches seem more often to be at the implementation and scaling part of the spiral rather than the earlier ideas and piloting part. It seems that in these cases the SIB was an opportunity either to implement a full scale model (e.g. the Peterborough One Service SIB with a whole prison) or to scale up in order to cover a wider area and work with more clients, as for example in the case of the London Street Impact SIB, which covered the whole London. In the American recidivism examples, the Rikers Island SIB sought to test a known technique across a whole juvenile offender institution. In this event, the pilot “failed”, but by testing a known approach in a new setting provided a valuable service (see the section 4 on outcomes below). In the case of the Massachusetts Juvenile Justice SIB, it provided an opportunity to scale across the whole State.

29. In Peterborough SIB, a complex integrated delivery service model was developed for the One Service. The original approach centred on the St Giles Trust and its “through the door” approach (support in the prison and after release). This was combined with a service provided by the Ormiston Trust, which supported prisoner families back at home. Other elements were found to be lacking and so Mind - a charity dealing with mental health issues - was brought in by Social Finance part-way through to deliver mental health support to clients. In addition, a drop-in service was set up and courses delivered on maintaining family ties while in prison. Much of the innovation was in the packaging, coordination and integration of services. The role of navigator which was part of the One Service approach was mirrored in the use of coaches and key workers in many of the other SIBs. Fragmentation of existing systems was overcome through a relationship based method of support using a single contact person. This challenges one critique of SIBs that they are too instrumental and mechanistic. It appears that for the service user, the opposite may be the case. Often SIBs are bringing together existing services that are already being delivered through rigid departmental siloes that lacked coordination.

The combination of partners is part of the innovation

30. A bewildering array of partners that might be involved in a SIB as illustrated above in figure 1, for instance, for the Peterborough One Service SIB. This complexity compares to a typical bilateral contract between a commissioner and service provider. This complexity can have impact on costs, especially when setting up the SIB. Goldman Sachs reported that the contracts for the Massachusetts Juvenile Justice SIB, one of the largest in the world involving multiple investors and delivery partners, took 1100 hours of consultant time (Gustaffson Wright et al., 2015). The three core partners in any SIB are:

- Commissioners (also known as outcome payers) who are outsourcing a service and pay when agreed outcomes are achieved.
- Investors who provide finance – usually through a special purpose vehicle.
- Service providers who deliver the service to the end user or client.

31. Other actors are frequently involved as well including:

- Intermediaries that may structure the deal, manage the relations between partners and the service providers' performance.
- Evaluators who verify that the outcomes have been achieved.
- Lawyers to draw up contracts.

32. The complexity of partnerships, especially on the delivery side, is one argument for the use of intermediaries to coordinate and manage the performance of the service delivery partners on behalf of the investors. This was the role of Social Finance in the Peterborough One Service SIB. Coordination extends beyond the partners that are being paid for services and may include many other agencies that work with the target group whether on a statutory or non-statutory basis. This extra coordination and the synergies that can be achieved appear to be one advantage of the SIBs, but are not exclusive to them.. Integrated and joined up approaches have been at the core of approaches to tackle intractable urban problems by the city-to-city peer learning URBACT programme. Many of their local action plans have addressed similar inclusion-related themes to the first generation of SIBs, such as Roma Inclusion (Romanet), school dropout (PREVENT), and working with young people (My Generation)¹⁷.

33. When it comes to investors, SIBs in the US and Australia have had more success in raising private finance, with Goldman Sachs in the US investing in four SIBs. Many of these deals with private sector investors have been underwritten either by guarantees (e.g. Bloomberg Philanthropies in the US) or by tiered investment structures both in the US and Australia. Outside of the US and Australia, most of the investors have been foundations operating within the spirit of venture philanthropy and other social impact investors (OECD, 2014a; OECD, 2014b). Some social impact investors have set up specific SIB funds. An example is Bridges Ventures whose SIB fund has invested in eleven SIBs in the UK.

34. To-date only one investor has lost its investment. Goldman Sachs lost 7.2 million USD after the termination of the SIB contract at Rikers Island, but it appears to be relatively sanguine about this loss. This may have been because they had a 75% guarantee with Bloomberg Philanthropies, which paid out 6 million USD to Goldman Sachs.

¹⁷ See URBACT networks at <http://urbact.eu>

35. The majority of service provision has been from third sector organisations, either structured as charities or as social enterprises or as both. Charities, such as St Mungo’s Broadway, have reported high levels of satisfaction (“the best funding we have ever had”) as it has been provided for a longer period of time, focused more on results and allowed for more flexibility in the delivery model.¹⁸ The service providers appear to be mainly medium sized (50-250 employees) or large (>250 employees) organisations. For example, St Mungo’s Broadway employs 1700 people in the UK.

36. Front-line staff working on London Street Impact SIB were positive about the way finance had influenced the delivery model that they were in charge of implementing it. They reported being motivated by the outcomes focus and the flexibility to find solutions that had not been available in previous projects, which had a more rigid output- related delivery. They appear to have bought into the outcomes indicators and saw them as a good proxy for the transformation that they have been trying to achieve with their clients under other more restrictive funding mechanisms.

37. The most innovative SIBs co-produce solutions with service users to ensure that the service is relevant and focused. In the London Street Impact SIB, the clients or service users have reported on the value of the care that they receive (St Mungo’s Broadway, 2014). Their personal accounts and those of front-line staff testify to the need for quality, long-term relationships between clients and key workers, who are able to develop sustained wrap-around solutions that were not possible in output driven funding models. In the client case-histories, these relationships have clearly been central to transforming their lives. The ability to provide wrap-around tailored support to the individual is very important, given that the dominant model in the sector is one of unstable and often dangerous hostel provision rather than of a “housing first”, which was the model used by the London Street Impact SIB.

38. It seems possible that private sector providers could bid to deliver some of these SIB contracts depending on how the invitations to tender are structured. Indeed it is curious that so many of the SIBs are being delivered by social enterprises or enterprising charities, whereas most pure payment by results are delivered by private sector prime contractors with social enterprises and charities playing minor sub-contracting roles in both bids and contract delivery. SIBs have been used by mainly larger social enterprises to increase their funding in a payment by results market dominated by a small coterie of well organised private sector contractors.

4. Evaluation, monitoring and outcomes

39. Advocates of SIBs place great emphasis on the robustness of the outcomes. Because of the way that payments are linked to outcomes, it is perhaps inevitable that great care has been taken in drawing up contracts and in defining indicators to measure results. From the two SIBs for which detailed interim evaluations were available (Peterborough One Service and London Street Impact), it is possible to say that in these cases the level of evaluation at project level is equivalent to that of social experiments and that the use of randomised control groups in the Peterborough One Service case reflect best practice guidelines. The two SIBs described above use the following indicators:

- Peterborough One Service SIB focuses on the reduction in the frequency of reconviction events within 12 months after discharge. The mean number is compared with an equivalent matched comparison group. The evaluators use a propensity scoring method based on regression analysis with specific predictive variables from the whole prison population (e.g. demography, male/female, age, historic offences, convictions, sentences)
- London Street Impact SIB uses a rate card designed by the Department of Communities of Local Government and the Greater London Authority made up of five weighted indicators (ICF GHK,

¹⁸ Comment by Mike McCall at the OECD experts meeting on SIBs, 15 April 2015 Paris

2014). Payments are made on the basis of these outcomes and in proportion to following the weighting:

- Rough sleeping (reduction below a specific target): 25% of weighting
- Accommodation (tenancies held for over 12 months): 40% of weighting
- Sustained reconnections (six months minimum reconnection with country of origin): 25% of weighting
- Health (reduction in A&E visits): 5% of weighting (this indicator proved to be unverifiable because of health service confidentiality of patients)
- Work (sustained volunteer, part time, full time work at three months and at six months): 5% of weighting

40. There is a strong focus on evaluation among SIBs. Some of the evaluations are being carried out at project level (e.g. Peterborough One Service, London Street Impact, and other US or Australian examples). Other evaluations are being done for whole social impact funds (e.g. the ten projects launched in 2012 for the DWP Innovation Fund). However, not all SIBs are evaluated.

41. There is considerable experience in the EU and national funding schemes regarding programme level evaluation. A good example is the EU Structural Funds, where the fund regulations require programmes to be evaluated ex-ante, interim and ex-post. In the new programme period, a shift has been made towards results that will assess the progress made on achieving objectives. However, there is a lack of follow-through at the project or individual contract level, because no equivalent requirements are made even for relatively large revenue projects.

42. It would appear that SIB commissioners are focusing more on project level evaluation than is typical. These evaluations are often also independent of the service providers because the commissioner of the service is the funder and needs to verify the outcomes before a payment can be made. However, such external evaluations may be of less use to service delivery organisation for improving performance in service delivery. In some cases, third party funding has been raised to pay for these evaluations (e.g. in the Child-Parent Centre Pay for Success SIB in Chicago the Finnegan Foundation supports part of the costs). Finally, the evaluations have been published, which is a good practice but not a universal one. Although difficult to estimate, it is likely that a higher level of resource is going into the drawing up of indicators, reporting, monitoring and evaluation. This could be a lesson for other conventionally funded projects; improvements in efficiency and effectiveness could occur, if similar efforts were made to improve measurement.

43. SIBs typically have a monitoring framework based on quarterly board meetings of the special purpose vehicle or intermediate managing agent. However, this will vary according to local circumstances. At these meetings, the service delivery body is required to report progress on the outcome indicators and other aspects of performance management. The board is able to ask questions concerning progress and find out whether delivery targets have been met or not and why this is the case. This level of scrutiny and supervision is more independent, verifiable, and intensive, than is common in many other projects. Such scrutiny of indicators compares favourably with the somewhat mechanical completion of output forms required by many national and EU programmes.

44. There may be a pilot effect – similar to the Hawthorne effect¹⁹ - whereby because of the increased interest that a SIB generates more resources are applied to measurement and evaluation. This has an impact on staff motivation and subsequent attainment of outcomes. It may derive from the fact that agencies have been subsidised to work on SIBs with Social Finance being the most well-known example. In the private sector, there have been considerable pro bono contributions.

45. The questions that meta-evaluations of SIBs would need to ask is whether this additional cost of measurement is proportional, whether it detracts from or enhances service delivery, and whether other types of project funding might benefit from a similar level of investment in measurement. Both SIBs and social experiments²⁰ have opened up major questions about the need for more project level evaluations to be carried out at the instigation of funders rather than as internal exercises by service delivery organisations, which are prone to hush up the findings when negative for fear of turning off other donors. The recent collapse of UK charity “Kids Company” has raised many questions about the need for external evaluation as well as financial probity and working capital.

46. The main advantage of payment by results contracts in general and, perhaps of SIBs in particular, is that they can draw a more direct link between outcomes and payments. This can lead to cashable savings on outsourced services. However, these are not always as large as anticipated. According to National Audit Office (2014), the use of a £3 billion GBP payment by results contract for the Work Programme, achieved in 2014 costs that were 2% below what was expected.²¹ The programme appears to have worked well for those receiving job seekers allowance, but less well for those hard to reach groups including for those with disabilities.

47. There is a fear that this strong focus on results can change the public service ethos or lead to a narrow mechanical determinism in service delivery. It may be possible to game the results by selecting clients that are easiest to reach (“cream skimming”) while leaving those that would be most expensive without service (“parking”). Evaluation studies on some of the first SIBs, such as London Street Impact and Peterborough One Service, have not found these practices. However, in both cases these services were being delivered by dedicated social enterprise organisations demonstrating a strong organisational ethos. It is not possible to say whether this absence of “gaming” is the result of “good” organisations delivering the service or an intrinsic aspect of the way that these contract results were specified.

48. Some social enterprises appear to like this form of instrument because they provide more financial continuity and flexibility. Both problems exist with many output-based or project finance from national, federal or EU programmes. The flexibility allows a more holistic approach. The duration and the continuity allow forward planning. It is worth noting that in both intermediate and managed SIBs, the charities and social enterprises delivering the service are not normally themselves held to payment by results in contracts with the special purpose vehicle or an intermediary representing the investors. However, the service providers are held to account by very tight monitoring by either the special purpose vehicle or the investors.

¹⁹ The Hawthorne effect is named after experiments at the Cicero works in Illinois where productivity of workers improved because of the very act of measurement and observation. https://en.wikipedia.org/wiki/Hawthorne_effect Pilots are particularly prone as they often involve more intensive management and measurement.

²⁰ Social Experiments are a sub group of social innovations in which efficiency and effectiveness of new approaches is measured carefully, often against a randomised control group. See for example <http://ec.europa.eu/social/BlobServlet?docId=7100&langId=en>

²¹ <https://www.google.com/maps/place/Thiais/@48.7604484,2.3868855,11z/data=!4m2!3m1!1s0x47e6746c1d65f8d5:0x40b82c3688b37b0?hl=en-GB>

The risks and returns to investors

49. Managing risk is at the centre of the SIB models. The key is that risk is transferred from commissioners to their contractors. The three different models place risk in a different way because the contracts are held by different parties. Table 4 below illustrates how risk is dealt within the three main models: direct, intermediated and managed. However, while financial risk may be mitigated, there are continued moral risks to commissioners in all three models.

Table 4: How risk is transferred in the three models of SIBs

	Risk to commissioner	Risk to service provider	Risk to intermediary	Risk and return to investors
Direct SIB	No financial risk Savings achieved if outcomes are positive Moral/reputational risk in case of poor performance	Risk of non-payment for not achieving outcomes	No intermediary	Risk: The lender would lose its capital if the social enterprise was to go into liquidation and there was insufficient collateral to repay the loan Return: commercial loan (x over base rate)
Intermediated SIB	No financial risk Savings achieved if outcomes positive Moral/reputational risk in case of poor performance	Fee for service paid by intermediary usually on quarterly basis. Risk of termination in case of poor performance	Special purpose vehicle (This is a shell company with limited liability that protects investors)	Investors carry the main financial risk if the special purpose vehicle fails to deliver Investors accrue main return if outcomes exceed threshold
Managed SIB	No financial risk Savings achieved if outcomes positive Moral/reputational risk in case of poor performance	Fee for service paid by management organisation on quarterly basis.	Financial risk borne by the management organisation and by investors in the special purpose vehicle, which is controlled by management organisation.	Investors carry main risk Investors accrue main return if outcomes exceed threshold

Source: adapted from Goodall, 2014

50. The harsh terms of the original SIB at Peterborough, whereby bondholders would lose their original investment if floor targets for outcomes were not achieved, have often been mitigated. This has been done in two distinct ways either by the use of guarantees or by setting tiers for investors in the SIB.

51. These early SIBs except in the US and Australia have tended to rely on social impact investors, such as foundations and other specialists that already lend to social economy organisations (OECD, 2014a; OECD, 2014b). Most SIBs have been structured in a way that if a particular threshold of outcomes is not reached, the investor loses its investment. As a result, few private sector investors are prepared to take such a risk on an untried product and so various solutions have been found to underwrite the risk.

- Big Lottery Fund contributed £6.25 million GBP to the Peterborough One Service SIB as a guarantee to the 17 investors.
- The Goldman Sachs investment in Rikers Island SIB was guaranteed at 75% by the Bloomberg Philanthropies. This guarantee fund paid out \$6 million USD as the SIB failed to achieve its targets and evaluations showed that the version of cognitive behavioural therapy deployed had not made a statistically significant contribution to reducing recidivism.
- The Utah fund had \$2.4 million USD of subordinated debt provided by the Pritzker Foundation and \$4.6 million USD from Goldman Sachs for the High Quality Preschool Programme.
- The \$16.9 million USD funded the Child-Parent Centre Pay for Success SIB in Chicago was structured with tiered funding in which the Pritzker Foundation provided subordinated debt of \$4 million USD, Goldman Sachs \$7.4 million USD and Northern Trust Corporation \$5.4 million USD from its community development portfolio.
- The Benevolent Society Social Benefit SIB in Australia used tiered financing to structure the deal. The first tier of 2.5 million AUD had no protection for investors of their principle and paid a higher rate of return up to 30%. The second tier of 7.5 million AUD protected investors and paid a lower rate of return. Perhaps counter-intuitively the first tier had more subscribers than the second.²²

52. In payment by results contracts it is common to include an element of fee for service as this guarantees the contractors some income even if their interventions do not achieve result targets. This mix between fee for service incentives and payments for results needs to be carefully judged and is easy for commissioning bodies to get it wrong. When using both mixed approaches and pure payment by results the incentive structure may need to be piloted in order to avoid being too severe or too generous. For the moment, most of the SIBs contracts focus exclusively on outcomes. However, this situation is likely to change as payment for service may be a way of providing an implicit guarantee to investors. This could in turn encourage more private sector investors.

53. An example that combines payment for service with payment by results is the Child-Parent Centre Pay for Success SIB at Chicago.²³ The outcomes indicators are the decrease in need for special education services from kindergarten to 12th grade, the increase in kindergarten readiness and increase in 3rd grade reading scores. One of the two commissioners, Chicago Public Schools, will pay out \$9 100 USD annually compounding at a rate of 1.0% for each student that avoids special education after attending the Child- Parent Centre programme. The payment for service element is \$ 2 900 USD for each student that is

²² Source Emma Tomkinson A stream of social consciousness blog <http://emmatomkinson.com/>

²³ <http://www.payforsuccess.org/sites/default/files/chicago-sib-fact-sheet.pdf>

prepared for kindergarten after attending the Child-Parent Centre. There is also a payment for increases in 3rd grade reading scores of \$750 USD for each student that scores above the national average on the nationally administered reading test. The Child- Parent Centres have been running since 1986 and have been evaluated over a 20 year period using a longitudinal cohort study. Early intervention in pre-school as practiced in Chicago through these centres is a tried and tested social innovation. The SIB has enabled scaling up.

54. SIBs along with other result based financing mechanisms are subject to what Brookings (Gustaffson-Wright et al., 2015) calls the “wrong pocket problem” and what the Young Foundation ascribes to the lack of “virtuous financial circuits” (O’Sullivan et al., 2013). Brookings identifies two types: horizontal and vertical. Horizontal “wrong pockets” occur where one actor or entity at horizontal level benefits from savings achieved by another agency or department at the same level. An example is where one ministry spends money but the savings accrue to other ministries. In the Peterborough One Service SIB, the savings accrue to a variety of ministries including Justice, Communities and Local Government and the Treasury.

55. The “vertical wrong pocket” problem is where a national level agency benefits from an investment made at lower level. Local governments invest in local services – for example providing counselling, childcare and training to help NEETs or the long term unemployed into work- while the national or federal government gains most of the financial returns through reduced welfare payments and taxation of incomes. Some financial circuits suffer from both vertical and horizontal “wrong pockets”.

56. It is difficult to create alternative “virtuous financial circuits” without either devolving competences to the local level (as has been achieved in Denmark with active labour market policy) or centralising them to the national or state level but governments can help to overcome the problem with financial support. In both the US and the UK the use of social innovation funds, supported by the White House and the Cabinet Office respectively aim to offset this problem by complementing funding provided by a single ministry.

5. Main messages

SIBs are an attractive proposition in post-crisis Europe but also controversial

57. For public authorities operating in a period after the crisis in the context of tight public sector budgets, SIBs represent an attractive option. They enable public authorities to strive for policy objectives in challenging fields while reducing the risk of non-delivery and non-performance.

58. There is something intrinsically appealing yet controversial about SIBs. They bring out strong opinions for and against. Their attraction lies in their neatness and completeness in combining finance, entrepreneurship, performance management, and a delivery mechanism in a single tool. Their direct linking of outcomes with financial incentives means that these are treated with great seriousness by all actors in the delivery chain. The engagement of the private sector as a financial partner carrying risk while using delivery models developed by the social sector succeeds in combining private sector investment and performance management with social impact. However, opponents of SIBs consider them to be another form of privatisation in which the profits for investors are gained from social problems. They are concerned that social enterprises involved in SIBs will be tarnished by the profit motive of the investors and even driven towards poor practice such as “cream skimming” or “cherry picking” clients in order to achieve performance targets.

There is a strong argument for pilots and innovation in areas of policy failure or poor performance

59. For the proponents of SIBs and the critics of existing public service delivery, SIB is a perfectly formed tool that can iron out the inefficiencies of non-performing public services. They point to the continued high levels of homelessness, young people unable to access the labour market, children going into care, recidivism, and years of delays in the adoption process. However, SIBs still rely on a commissioner to pay outcomes and so are ultimately dependent on the scale of public budgets for their success.

The main social innovations in delivery are about scaling up existing models and better coordinating with other agencies

60. The methods used by this first generation of SIBs were first developed by social enterprises as pilot social innovations. Some, such as the “through the door” model of the St Giles Trust or the Chicago pre-school model had already been independently evaluated and proved to be successful. It is possible that all they needed was a simplified funding model without the full panoply of a SIB.

SIBs may be of more value in testing new social innovations than in scaling up

61. A key question facing SIBs is whether they represent an alternative finance model for the long term, or they will tend to be used as an interim solution by public organisations seeking to test out new solution and mitigate their risk during this process. The alternative finance model is the route that the UK government has taken with payment by results with around £15 billion GBP being contracted in this way since 2010. The piloting approach, which was adopted by the New York City for the Rikers Island SIB, tested a version of cognitive behavioural therapy with juvenile offenders. There is no right and wrong between these two and perhaps they will continue to coexist.

Commissioning, capacity building and creating a supportive framework

62. There are many aspects of the policy system that can support the emergence and launch of SIBs. These include among others feasibility studies, support for guarantees, publication of unit costs, creation of social investment tax credits, and support for new intermediaries. The use of social clauses and smaller lot sizes can open up procurement contracts in general. However, this requires an active effort by all levels of government. Annual budget cycles in the public sector can make it difficult for them to commit to long term result payments in the future and some financial.

The capacity needs for commissioners are significant

63. Few public authorities currently have the skills required to draw up complex results based contracts that are required for SIBs. This is true whether they are designing a fund model using rate cards or individual transaction models. The call for tender needs to be specified in such a way to be generous enough to incentivise bidders while not over-rewarding success. Specific legal skills in drawing up contracts, accounting skills in calculating financial rates of return, and policy skills in achieving goals are all required and need to be integrated. Few investors have detailed understanding of the types of social outcomes that are needed to address complex social challenges or of the barriers that need to be overcome to achieve better results. People who look at the world through a financial lens may think that everything can be fixed through incentive structures. Focusing too much on narrow metrics may lead to unintended consequences and gaming in fields where cooperation and holistic approaches may be required. The considerable cost of capacity building, investment readiness and other measures to stimulate and support the SIB market may be daunting for national actors. There is a major opportunity for coordinated support and capacity building actions by the EU, charitable foundations and other philanthropic funders to develop the market for SIBs investments (OECD, 2014b).

Greater transparency on pricing and unit costs would benefit all the public actors in Europe

64. The creation of unit cost databases, similar to the ones produced by New Economy in the UK, would be a valuable exercise for all programme funders whether or not they plan to use SIBs. Transparency can drive down costs by comparing the cost of equivalent provision within a country or even between countries. Key organisations that may be able to drive an approach towards achieving more transparency over inputs, outputs, and outcomes would include charitable foundations, national ministries and managing authorities for the EU Structural Funds, where national level technical assistance resources could be deployed for this purpose.

SIBs as a form of outsourcing

65. SIBs are a subset of payment by results contracts and as such are a variant on an existing form of outsourcing. They permit the entry of social enterprises and charities into an existing market by investors providing up-front financing and working capital. However, the market for SIBs is relatively small compared to the much larger market for outsourcing. It is estimated that in the UK SIBs represent less than 0.5%²⁴ of the payment by results market that is calculated at 20 billion EUR (Comptroller and Auditor General, 2015).

SIBs are most likely to benefit larger social enterprises

66. For large social enterprises SIBs offer a gateway into the growing arena of payment by results contracts. However, the scale of their participation is likely to be modest. In developed payment by results markets, most of the contracts are won by large private sector service providers who may use social enterprises as window dressing. Smaller social enterprises are less likely to participate because of lack of working capital, capacity and infrastructure. However, some smaller social enterprises have succeeded in becoming part of SIBs (e.g. Saskatoon, Canada).

For social enterprises a key aspect is more reliable multi- annual funding

67. SIBs address two financing problems faced by social enterprises when bidding for contracts. The first is working capital. SIBs bring funding to the service delivery organisation from the start of the contract. The second is the continuity of funding over several years compared to annual funding cycles. However, this begs the question as to whether the real innovation of SIBs has been to offer social enterprise providers with more flexible and longer term funding that could have been achieved in other ways had governments wished.

SIB contracts can be delivered by any provider

68. SIBs are not a “chasse privée”²⁵ for social enterprises. The contracts can be made open to all comers. However, private sector service providers are less likely to use SIB models to raise capital as many will be able to finance their own bids either through working capital or through loans. In the future, social enterprises could find themselves providing sub-contracting services to larger prime contractors from the private sector as it happens in the other outsourcing markets.

²⁴ Author calculation estimating value of SIB investments in UK compared to £15 billion GBP of payment by results

²⁵ A “chasse privée” means a private hunting area

The user of the service is unlikely to know that they are benefiting from a SIB, but many SIBs incorporate a relational model of care

69. The users of service may never know whether the support they receive is the result of one type of contract or another. Their interaction is with the service provider and the key for them is whether the provider can deliver the holistic mix of service that they need to address their problem. Many SIBs appear to have opted for a navigator or relational model of support in which the service user is guided through the system.

The thematic scope of SIBs is usually limited to those challenges that can demonstrate cashable savings

70. Only selected policy problems can be addressed by a payment by results contract and only a proportion of these can be financed with a SIB. This inevitably limits the markets for SIBs. They are likely to be most relevant in policy areas where previous interventions have failed or at best achieved mixed results, where any cashable savings accrue to a limited number of departments or agencies and where the results can be clearly measured in a robust manner. They are also only likely to spread widely in countries with established contracting-out cultures.

6. Conclusions

71. The cheapest way of financing public services is usually to pay for them directly because governments can raise funds either through general taxation or on bond markets at lower interest rates than private or third sector organisations. However, SIBs can be more effective as they combine stronger outcomes focus and better performance management. This allows them to yield significantly better results than traditional forms of public sector delivery. At the same time, the cashable savings must outweigh the higher cost of capital and considerable set up costs of a SIB.

72. SIBs attract passionate debates from both advocates and critics. The advocates argue that they are a way of enabling access to vast private sector investment resources. They also suggest that because of the strong connection between the investors and the social returns, SIBs are both more efficient and more effective than other forms of public investment in social challenges.

73. By mid-2015, no known SIBs had completed and published ex-post evaluations. There are some interim evaluations available. The Peterborough One Service SIB had two interim evaluations before its premature shut-down in 2015 and should produce a final evaluation in 2016. The London Street Impact SIB has published two interim evaluations and is expected to produce a final evaluation in late 2015. The lack of evaluations at this stage makes it difficult to draw any conclusions about whether SIBs are better than alternative approaches, but the interim evaluations made some useful comments about perverse incentives raised earlier in this report and, in particular, looked at issues around “creaming²⁶” and “parking”, which do not appear to be major problems.

74. One issue that has been insufficiently addressed in the existing literature on SIBs is the high cost of policy failure of existing approaches in many policy fields, including some of those covered by the first generation of SIBs. Whether we look at recidivism, fostering and adoption, homelessness or NEETS, it is apparent that the status quo is often both expensive and ineffective. These policy failures do not mean that SIBs will perform better. Still, there needs to be a better understanding of why these policies are failing and, in particular, whether it is a systemic failure or a problem of poor design and short-term funding. The entry of SIBs into these policy environments may help to focus attention on what really works and why funding has not been directed towards those mechanisms that show promise and instead is captured by

²⁶ Creaming is also sometimes referred to as cream skimming

incumbent organisations that may be better at financing themselves than turning around the lives of their clients.

75. It is premature to judge whether SIBs have produced performance improvements. Evaluations will be needed to unpick whether better performance is the result of a better model of implementation or of improved management. In the Peterborough One Service case, the interim evaluation suggests that both improved coordination and the use of the proven “through the door model” were important factors. In the London Street Impact SIB, the social enterprise uses an adapted “housing first” model with more wrap-around support. Some of the improvement may well be down to the impact of increased measurement and observation on staff and clients involved in the pilots. Hawthorne effects are common in social situations.

76. SIBs illustrate the need for continued experimentation in financial models for public service delivery. They may not answer all the questions that they raise, but they have succeeded in asking some important questions about how public money is used to achieve social outcomes and what changes when private money is brought into the mix.

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