
A New Twist on 'Pay for Success' Programs.

A variation on the existing model would provide a money back guarantee should a project fail.

This year has already seen a flurry of activity when it comes to governments and the private sector partnering on social programs. Fewer than three months into 2016 and three governments have announced so-called pay for success or social impact bond projects, boosting the total number of such programs to 11 across the country.

Now, there may be a new option for governments interested in the model, but wary of its complicated nature. Under a pay for success or social impact bond program, private funders finance a preventive social or health program and only get paid back if the project meets its goals over the course of a predetermined set of years. The new model, announced by Third Sector Capital Partners on Thursday, offers a money back guarantee.

With a "social impact guarantee" or SIG project, governments front the money (instead of a private investor) and get paid back if the project doesn't meet its goals. Specifics are sparse, but Third Sector co-founder George Overholser says he's currently working with two states on creating the country's first SIG projects and hopes to announce them by the end of this year.

The main objective of the new tool, which is the brainchild of Overholser, is to give governments a simpler alternative to the existing structure. Third Sector helps governments develop social impact bond projects and Overholser says two main complications tend to arise under the current model.

For one, private investors like Goldman Sachs and JP Morgan are wary of financing these projects over the long-term without a guarantee from the government that it will pay them back if the project meets its outcomes. Governments have taken to creating escrow accounts to assure investors. "It's tying up capital that could be used in different ways," Overholser says. If governments are setting aside money each year anyway, he asks, wouldn't it be simpler just to pay for the social program directly?

The second complication is that governments have to pass new laws or regulations — which can take years — to even begin creating a social impact bond program. That's because governments generally aren't allowed to contract for longer than they can appropriate funds. That means they're limited to one- or two-year contracts. But outcomes-based programs can take several years before they start showing real results, so social impact bond projects tend to contract for between five and seven years.

Overholser says SIGs avoid these complications because governments would simply continue to contract with social services providers just like they already do. The difference is the deal would include clawback provisions for governments to recover their money if program goals aren't met.

Although its objective is to be more simple, SIGs are still tricky. Part of what motivates financiers to back a pay for success project now is that if the program exceeds its goals, financiers not only get their initial investment back but they get a bigger interest payment as well.

To keep that financial sweetener in place, Third Sector has structured SIGs so that a private financier basically plays the role of an insurer. In the new scenario, a service provider contracting with the government would be on the hook for paying back the money if the goals aren't met. So the service provider turns to a private financier to provide insurance on the agreement. The service provider pays the financier premium payments, much as we do with car insurance. The premium payments would likely be baked into the provider's costs and passed on down to the government. If the project fails, the service provider refunds the government and collects those losses from the financier. But the far more likely outcome, says Overholser, is the financier simply pockets the premiums.

Still, some question whether the new proposal would offer enough incentives for nonprofits to opt for a SIG over a social impact bond. If the contracting structure is more like what governments already do with nonprofits, says Lili Elkins, then what is the motivation for a nonprofit to take the extra step of going with a SIG and finding insurance to offer a money back guarantee? Elkins' nonprofit Roca provides counseling, job training and other services for a social impact bond project in Massachusetts aimed at reducing recidivism and increasing employment among high-risk young men. (Third Sector helped put the project together.) Elkins says a SIG project would have to offer something more than the status quo, whether it's funding stability or something else.

Financial stability in particular is a big draw for nonprofits when it comes to pay for success projects. For Roca, rather than scraping together funding every year, the opportunity to be guaranteed funding for 900 young men over multiple years was a big incentive to be part of the Massachusetts project.

"The tricky thing now," Elkins says, "is getting people into that model. The reason we jumped into pay for success is there was an incentive for us to jump."

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