

Development Impact Bond Working Group Summary Document: Consultation Draft

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Summary

As domestic revenues and private financial flows to developing countries grow, the relative importance of official aid is diminishing. Traditional donors, once dominant players, are now part of a much broader group that provides financing to developing countries, including emerging donors, philanthropic organisations and private investors. Within this group are an emerging class of impact investors, who are motivated by both social and financial returns. Growth of the impact investment market could provide not only a new way of funding development but also new ideas and private sector expertise that could help drive faster development progress.

Furthermore, the growing complexity of today's development problems requires new ways of doing business. Traditional, publicly funded social programmes can limit risk-taking and innovation by design: they are often pre-occupied with tracking inputs and processes and, because they prescribe strategies at the outset, they generally leave little room for learning and experimentation. What's more, these rigid approaches do not provide adequate incentives to focus on outcomes or even to collect information about them. Donors now need to catalyse and complement other financial flows and meet the growing demand to demonstrate effectiveness against rigorously defined and measured outcomes, in ways which respect the complexity of delivery and the need for adaptation and flexibility.

Development Impact Bonds (DIBs) respond to both of these imperatives. They use private investment flows to provide upfront risk capital for development programmes, only calling on donor funding to repay that capital (plus a potential return) once clearly defined and measured development outcomes are achieved.

Under a DIB, all interested parties agree a desired social outcome and a metric for measuring success. Private investors bank-roll a programme to achieve the outcomes. The programme itself is carried out by specialised service providers, and investors are paid back by an outcome funder (usually a donor agency) if – and only if – independently verified evidence shows that the programme has been successful. The greater the measured success of the programme, the greater the return to investors, up to a cap. Typically, an intermediary organisation will coordinate between investors, the outcome funder, and service

providers, representing the parties not in the room and negotiating an agreement that fits the needs of all.

DIBs have several advantages over existing funding mechanisms:

- DIBs transform social problems into “investible” opportunities, and create incentives for investors to put in place the necessary feedback loops, data collection and performance management systems required to achieve desired outcomes, resulting in a bottom-up, client-centred, and generally more effective, approach.
- DIBs could help to shift more aid to results-based contracting by overcoming some of the obstacles associated with existing results-based approaches. By having investors provide working capital - and assume risk - for interventions expected to lead to improved social outcomes, DIBs could attract funding for interventions that donor agencies and governments might not be able to fund under existing models.

DIBs hold enormous potential as a new type of outcomes-based contract that can bring together the private sector, civil society organisations, governments and donors, in a way that captures and complements the strengths which each player can bring to achieve development outcomes, and buttressing their respective weaknesses. Developing DIBs will at first take time, resources and new skills and expertise. To ensure that initial DIB pilots get off the ground and a market for this approach gradually begins to form, the Working Group makes the following general recommendations:

- Donors should establish a **DIB Outcomes Fund** and investors should establish **DIB Investment Funds**, which would enable these actors to share risks and **pilot a range of DIB models** (see p. 8).
- DIB pilots should be **evaluated rigorously** and a group of donors and philanthropic organisations should set up a **DIB Community of Practice** to share and accelerate learning (see p. 9).
- DIBs should be **open by design**. Openness will accelerate confidence in DIBs for investors, governments, service providers and taxpayers and help to build a high quality market. Donors and foundations should establish a **research data protocol** which would provide a standard of data and facilitate information-sharing (see p. 9).

- DIB parties will have to accept the high transactions costs of early DIB pilots. Foundations should consider subsidising these costs by providing funding to **catalyse the development of a DIB market** (see p. 10).

Detailed recommendations, including for each actor, can be found below.

Development Impact Bond Working Group Recommendations

OVERALL RECOMMENDATIONS

The Development Impact Bond Working Group makes the following recommendations to encourage the development of early DIBs and the establishment of a viable market:

1. ESTABLISH OUTCOMES AND INVESTMENT FUNDS TO PILOT A RANGE OF DIB MODELS

We recommend that a consortium of donor agencies establish a **DIB Outcomes Fund**. The Fund would pay for outcomes achieved in DIB contracts and enables donor agencies to pool risk – political, operational, and reputational – and help get the first transactions off the ground. The Fund could be set up as a challenge fund, from which DIB specialist intermediaries and other potential project implementers compete for funds, leading to innovation in design and the channelling of funds to the best-designed DIB proposals. A range of models – in terms of target outcomes, locations and structures – should be piloted to enable testing of different models of intervention.

Similarly, we recommend that investors set-up **DIB Investment Funds**, which provide ready pools of capital for investment into DIBs. This would help to reduce the amount of time and resources needed to raise capital for each DIB opportunity, and also would improve efficiency of due diligence and transaction structuring, catalysing the launch and implementation of a range of early DIB pilots.

2. EVALUATE RIGOROUSLY AND ESTABLISH A COMMUNITY OF PRACTICE TO ACCELERATE LEARNING

Early DIBs should be rigorously and independently evaluated. Evaluations should include information on intervention costs and pricing of outcomes and results, and assess whether and how the structure helped to lead to improved outcomes in addition to including details of any positive or negative externalities. DIB actors should use learning from evaluations to improve the future design of results-based contracts.

To ensure that learning is shared, we recommend that a group of donors and philanthropic foundations establish a **DIB Community of Practice** of potential donors, investors, DIB development intermediaries and government agencies from developing countries to share learning from early DIB pilots and advise on the development and application of the model going forward.

This group should also consider lessons from Social Impact Bonds in developed countries and from other forms of payment-by-results contracts. DIBs involve many of the same challenges including defining appropriate outcome metrics; the need for multi-year donor funding commitments; and addressing public sector agencies' need to be accountable for programmes when they are not defining the way in which outcomes should be achieved.

3. MAKE DIBS OPEN BY DESIGN

We recommend that Development Impact Bonds are open by design. DIBs are a mechanism that encourages innovation and learning in service delivery and those lessons are most valuable if they are widely shared. Openness will accelerate confidence in DIBs for investors, governments, service providers and taxpayers and help to build a high quality market.

To enable the sharing of data, we recommend that donors and foundations consider establishing a **research data protocol**, which could build on existing reporting standards and be used to collect project-related data, including data on intervention costs, value of outcomes and impact data, which should be made available upon request from the public. The protocol could be enforced on all projects that receive outcomes payments from the

DIB Outcomes Fund (as per Recommendation 1) and could become standard contractual practice thereafter.

DIB actors should accept the principles that data should be made available for free, in a timely manner, and in accordance with agreed standards that will make data comparable. More specifically, to ensure openness in the design and implementation of DIBs:

- Outcomes data should be made public when outcomes are measured to trigger payments
- DIB contracts should be publicly available
- More detailed information, such as intervention costs, additional input costs, breakdown of outcomes by different populations or areas etc. should be made available over time.

4. ACCEPT ONE-OFF COSTS OF BUILDING A NEW MARKET AND INTRODUCING A NEW TOOL

The first DIB pilots will involve high transactions costs as all actors involved adapt to a new model of outcomes-based contracting that is backed by private investment. DIB actors, particularly outcomes funders, will need to invest resources in understanding and assessing the feasibility of implementing DIB structures, valuing outcomes and pricing risks (described in detail in Section 3). To ensure that initial pilots are not prohibitively expensive, funding should be made available for the design costs of early DIBs. This type of catalytic funding could ensure that outcome funders and investors do not absorb the costs of “building a market” into the costs of early DIB pilots.

We recommend that foundations consider investing in the development of a DIB market, for example by providing funding to intermediaries to do this design work, as a catalytic public good. Experience from the development of Social Impact Bonds has shown that specialist intermediaries have a key role to play in pulling together early pilots. Having a specialised organisation acting as the champion of the project, undertaking crucial feasibility work, coordinating DIB actors, representing parties not in the room and negotiating an agreement that fits the needs of all those engaged in the process is likely to be just as important in the context of DIBs.

5. SUPPORT THE BROADER ADOPTION OF SOCIAL IMPACT BONDS (SIBS) IN DEVELOPING COUNTRIES

As economies grow and tax collection improves, governments in developing countries have a growing pool of domestic revenues to finance government spending. We recommend that governments in developing countries consider using these revenues to pay for outcomes under Social Impact Bonds, and that donor agencies or foundations encourage the effective and efficient use not only of their own development funding (through DIBs) but also that of the partner countries they support (through SIBs, as they have been designed in industrialised countries). Because we expect developing country governments to face the same – if not higher – start-up costs in getting early SIBs off the ground, we recommend that donors and foundations consider funding some of the start-up costs associated with developing SIB markets, share learning, and provide technical assistance as needed.

RECOMMENDATIONS BY ACTOR

A. DONOR AGENCIES

- ***Make room for new partnerships to develop DIBs:*** Development Impact Bonds are a new approach, and projects cannot be easily put together using the existing procurement systems of most public sector agencies. We recommend that donor agencies consider how current systems can be adapted to allow them to take on the role of buying outputs and outcomes, thereby creating space for local actors to be innovative in their approaches to service delivery. Essentially DIBs are about forming partnerships, and to adopt this new approach donor agencies should work collaboratively with recipient country governments, potential investors, intermediaries and service providers. This collaboration will help ensure that DIB contracts developed are attractive to investors, create the right incentives for service providers and offer good value to outcomes funders, and so establish a good starting point for future deals.
- ***Establish a DIB Outcomes Fund:*** Given the novelty of the approach and higher transaction costs likely to be associated with initial DIBs, individual donor agencies may find it easier to jointly fund outcomes for DIB projects. We recommend that a consortium of

donors set up a DIB Outcomes Fund to pool risk for initial DIB projects and to more easily share lessons learned. The Fund could be set up as a challenge fund, from which DIB specialist intermediaries and other potential project implementers compete for funds, leading to innovation in design and the channelling of funds to the best-designed DIB proposals.

- ***Convene and participate in a DIB Community of Practice:*** To ensure that such information is shared, disseminated, and ultimately applied, we recommend that an organisation of global reach and convening power (perhaps using the platform of the Global Partnership for Effective Development Cooperation) establish a DIB Community of Practice, consisting of donors, investors, DIB development intermediaries, government agencies from developing countries and larger service provider organisations, who would share their experiences and provide a forum for disseminating lessons that will inform the development and use of these instruments going forward. It is recommended that a Community of Practice use lessons from Social Impact Bonds in developed countries and other forms of payment-by-results contracts.
- ***Insist on credible independent measurement and/or verification.*** Where possible, we recommend that donor agencies request that outcome metrics be independently measured and reported by a third party. Where this is not practicable, donors should insist on the appointment of a third-party auditor of results with a strong interest in preserving its reputation for integrity.
- ***Promote openness and transparency:*** To reduce transaction costs and help build an evidence base for DIBs, pilots should be developed, implemented and evaluated in a transparent and “open source” way. Donor agencies should require that outcomes data be made public, and contracts also be published.
- ***Support SIBs in developing countries:*** Donors should support the effective and efficient use not only of their own development funds (through DIBs) but also that of the partner countries in which they operate (through SIBs). Donors could do this either by setting aside grant funding for this purpose or by knowledge sharing through the DIB Community of Practice and other vehicles.

B. TRUSTS AND FOUNDATIONS

- ***Help lay the groundwork for early pilots:*** In the short term, designing, developing and implementing early DIBs will involve high transaction costs. Given the newness of the approach, donors and/or investors may be unwilling to be the first to invest resources into building the DIB market. Foundations can make a big difference by providing subsidies that would catalyse the development of this market. Funds could be used to generate awareness of the DIB approach and its potential value; support the technical work of specialist intermediaries who are likely to be pulling the first transactions together; and fund research to pool learning from early DIBs to help build an evidence base. The challenges that donors will face in piloting the first DIBs will also apply – arguably to an even greater extent – to governments in developing countries trying to pilot SIBs. Thus, foundations should consider subsidising some of those same start-up costs in developing countries.
- ***Invest in DIBs:*** In the longer term, trusts and foundations could consider investing more of their assets in impact investments more generally, and DIBs in particular, to gain both financial and social returns from their transactions.

C. INVESTORS

- ***Bring discipline and rigour to DIB implementation:*** DIBs align incentives by tying investors' financial returns to the achievement of social outcomes. To ensure that this leads to more effective service delivery and improved results, investors – or investment funds or intermediary organisations on their behalf – must be actively engaged and willing to offer their expertise. For example, by bringing discipline and rigour to DIB service delivery, performance management and outcome measurement, investors can play an important role in driving performance to achieve better social outcomes.
- ***Be the early adopters of DIBs:*** The first DIBs are likely to be regarded as high risk by commercial or institutional investors as they are an unknown structure without a track record and involve implementing programmes through non-government

organisations in developing countries. Social impact investors, who may be willing to take on higher risks in order to generate greater social impact, can be the trailblazers who make the first investments into DIBs/SIBs, thereby helping to crowd-in other private investors catalysing the emergence of a deeper and broader market for investment in development outcomes.

- **Set up DIB Investment Funds:** Given the innovative nature of DIBs, raising capital for the first DIB transactions on a deal-by-deal basis could be a labour-intensive and time-consuming process. Set up DIB Investment Funds – ready pools of capital that invest in DIBs – investors could enable the launch and implementation of early DIBs within a significantly shorter timeframe and help catalyse market growth.

D. GOVERNMENTS IN DEVELOPING COUNTRIES

- **Help identify DIB suitability:** No one knows developing country needs better than their own governments. Thus, governments, including regional and local authorities,¹ should play a key role in selecting/screening DIBs, for instance by identifying complex social issues that could benefit from results-based approaches, a greater shift of resources towards preventative efforts, and/or private sector expertise.
- **Give space for service providers to innovate:** DIB contracts are structured around desired programme outcomes and are designed to allow local service providers more flexibility than they would have under traditional input-oriented contracts to tailor solutions to circumstances on the ground. Partner governments should allow space for service providers to innovate and adapt interventions such that they are better able to adapt to the needs of the local population and achieve better development outcomes.
- **Stay involved throughout the DIB lifecycle:** The involvement of developing country governments in the design and implementation of DIBs – whether as outcome funders, co-managers of contracts, service providers and/or observers/consultants – will ensure that DIBs reflect national priorities, take into account the local context, and spread learning to other public services.

¹ Taken throughout to include other public entities such as public utilities etc.

- **Consider funding SIBs:** Where domestic resources for funding outcomes are available, emerging economy governments, including local authorities, could develop SIBs, with funding and assistance from donors if necessary.

E. SPECIALIST INTERMEDIARY ORGANISATIONS

- **Help bring together DIB parties to make transactions happen:** Intermediaries can help represent parties not in the room and support the negotiation of an agreement that fits the needs of all those engaged in the process. The experience of developing the Social Impact Bond market shows that specialist intermediaries can play a critical role in getting transactions off the ground.
- **Support DIB design and implementation:** Particularly in early DIBs, intermediaries can play an important part in supporting DIB design and implementation, beyond the role of intermediation. In particular, intermediaries can provide support to DIB parties in: feasibility assessment, contract development, capital raising, due diligence, performance management, service commissioning and capacity building.
- **Contribute to the Research Data Protocol:** Intermediaries should embrace openness in DIBs, including providing input into the design and setup of the Research Data Protocol and sharing data from DIB projects according to agreed Protocol data standards.
- **Share learning and help further understanding of DIBs:** Intermediaries should participate in the proposed Community of Practice and help further understanding of DIBs via conferences, publications, secondments and partnership working.

F. SERVICE PROVIDERS

- **Contribute to development of DIB intervention models:** Service providers hold existing relationships to service users and their communities and may be well placed to assess what intervention is needed. Where relevant, providers should collaborate with donor agencies, national and local authorities in developing countries and other DIB parties to develop the DIB intervention model to ensure its relevance to the target population.

- **Adapt systems for results-based contracting:** Service providers may be unfamiliar with the requirements for delivering in an outcomes-based contract. Being open to adaptations in terms of resources, processes and systems necessary for results-based contracting can help increase providers' ability to adjust their services in response to the emerging needs of the population and increase their impact.
- **Be open to rigorous evaluation:** Rigorous evaluation of early pilots are needed to assess: whether and how interventions led to better outcomes; whether and how the structure led to greater innovation; and whether and how it resulted in greater efficiency in terms of services, stakeholders relations and value for money. Service providers should collaborate with DIB parties to ensure that lessons from early DIBs are captured and shared.

FIGURE 1. RECOMMENDATION BY ACTOR

Investors	Trusts and Foundations	Specialist Intermediaries
<p>DIB Investment Funds – pools of capital that invest in DIBs and take on outcomes delivery risks</p> <ul style="list-style-type: none">• Be the early adopters of DIBs• Bring discipline and rigour to DIB implementation	<ul style="list-style-type: none">• Help support pilots by investing in early DIB design• Invest in DIBs	<ul style="list-style-type: none">• Bring together DIB parties• Support DIB design and implementation• Share learning
<p>Research Data Protocol - a standard for reporting DIB data that can then be used for learning and research</p>		
<p>Community of Practice - a group of practitioners to share and accelerate learning</p>		
<p>Develop DIBs in Partnership, invest in measurement and evaluation, promote openness and transparency</p>		

Donor Agencies	Partner Governments	Service Providers
<p>DIB Outcomes Fund - joint pool of capital from donor agencies to pay investors for outcomes achieved in DIBs</p> <ul style="list-style-type: none">• Insist on credible independent verification• Promote transparency• Support SIBs in developing countries	<ul style="list-style-type: none">• Help identify DIB suitability• Provide space for service providers to innovate• Stay involved• Consider funding SIBs	<ul style="list-style-type: none">• Contribute to DIB development• Adapt systems for results based contracting• Be open to rigorous evaluation