Inside a Social Impact Bond Agreement

Exploring the Contract Challenges of a New Social Finance Mechanism

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The Social Impact Bond, a promising new model for funding some social programs, is best understood as an agreement between a government agency and an outside organization in which payment from the government is entirely contingent on the organization achieving measurable, positive social outcomes. There is particular excitement in state and local governments and among philanthropic foundations and social service providers about using these agreements to finance preventive social programs that often save government money down the road but are still vulnerable to budget cuts in fiscally tight times.

Social Impact Bonds also pose significant challenges because they require government agencies to act in unfamiliar ways. Most obviously, agencies accustomed to paying service providers for performing a proscribed set of activities may find it challenging to make the switch to only paying for results in a SIB agreement. The government will also need to clearly define the beneficiary population receiving social services and must provide safeguards to make sure the external organization doesn’t just “cream skim” or work with only the easiest cases to achieve the outcome. And, of course, the government must continue to cooperate with the external organization throughout the full term of the agreement.

These challenges mean that the agreement itself—the contract signed by the government agency and the external organization—is critically important to the success or failure
of a Social Impact Bond. Among other things, the contract will define the relationships and responsibilities of all the parties in this unusual arrangement, will set out the circumstances under which the external organization can expect to earn their payment, and will determine when either the government or the external organization can terminate the agreement. Writing the agreement well will help guarantee transparency and cooperation between the government and the external organization, help protect the vulnerable populations that the agreement serves, and make better outcomes possible.

In this issue brief, we present some draft language that could be included in a Social Impact Bond agreement. It is meant to help readers understand some of the complexities of SIB arrangements and the ways to address them. As an example, this SIB contract focuses on improving employment outcomes for the long-term unemployed, but SIBs can also be used in many other policy contexts.

This draft language is not intended to be legal advice and is not a model contract. Every agreement will be different, and parties to a Social Impact Bond should always consult their lawyers to establish which clauses are required in their particular context. Please note that in a number of places we refer to appendices where additional detail would be included. These appendices would need to be agreed upon by the parties in each instance, and we have not sought to draft language for them. Also in some cases we have included suggested timelines that are meant to illustrate how the agreement might work. But the timetable will differ based on the local circumstances in each agreement. These instances are marked in red.
Draft language for inclusion in an agreement

Parties

1. This agreement is made between _______, the government agency, and _______, the external organization.1

Broad responsibilities2

2. Under this agreement, the broad responsibilities of the parties are as follows:
   2.1. The government agency is responsible for defining the outcomes that it wishes to see accomplished.
   2.2. The external organization is responsible for devising and implementing a strategy to accomplish the outcomes.
   2.3. The government agency should not seek to direct the strategy or operations of the external organization, but it must cooperate with the efforts of the external organization to achieve the outcomes.
   2.4. The government agency will pay the external organization if one or more of the outcomes are achieved.

3. In addition, this agreement sets out responsibilities for the independent assessor and the arbiter:
   3.1. The independent assessor is responsible for determining whether outcomes have been achieved and the level of payment that is due.
   3.2. The arbiter is responsible for resolving disputes that may arise between the government agency and the external organization.

1. We believe that Social Impact Bonds are fundamentally an agreement between government and an external organization where payment is promised in return for achieving one or more outcomes. Both parties must work together to achieve the outcome. We do not believe that other parties such as investors should be a party in the agreement.

2. This clause seeks to set out the broad responsibilities of the parties but omits details about how the arrangement will work. Many of those details are included in later clauses.
Key dates

4. Key dates for this agreement are as follows:
   4.1. The **agreement date** is the date this agreement is made.
   4.2. The **cohort date** is four months after the agreement is made.
   4.3. The **commencement of services date** is six months after the agreement is made.
   4.4. The **term of the agreement** is seven years from the agreement date.

The program group, comparison group, and cohorts

5. The initial pool is defined as all persons who have been unemployed in the state of ______ for more than nine consecutive months at the cohort date.⁵

6. On the cohort date, the **government agency** is responsible for identifying two substantially similar groups of persons from the initial pool.
   6.1. One such group is defined as the cohort 1 of the program group.
   6.2. The other such group is defined as cohort 1 of the comparison group.
   6.3. Allocations from the initial pool to the program group and the comparison group will be made in line with the methodology agreed between the parties and described in Appendix A.⁶
   6.4. Any deviations from this methodology must be agreed upon by the parties and the **independent assessor** before being implemented.⁷

7. The additional pool is defined as persons who been unemployed in the state of ______ for more than nine consecutive months during the term of this agreement so long as they:⁸
   a. are not part of the initial pool; and
   b. have been unemployed for nine consecutive months within three years of the cohort date

3. In this example we envisage that the first cohort of long-term unemployed enter the program four months after the agreement is made. The correct date, however, will always depend on the local circumstances—and so the dates included in these clauses should be read as examples. That is why we have always marked them in red.

5. In this example we define long-term unemployed as people who have been out of work for at least nine consecutive months.

6. Appendix A defines the methodology for defining cohorts. (not included)

7. In this example the external organization is allocated a subset of the long-term unemployed in the state (called the program group). Those who are not allocated to the program are put into the comparison group, and successful achievement of the outcomes is dependent on the program group having better employment outcomes than the comparison group. The comparison group might be larger than the program group, but what is important is ensuring that they remain substantially similar. One way to allocate people to the program group would be by randomization. Random assignment should be used when logistically and politically feasible. If not, then the most scientifically rigorous alternate method should be used.

Often, the two parties will want to agree on an allocation methodology prior to signing the agreement. This clause refers to Appendix A as the place where the agreed methodology would be laid out, but we have not sought to draft language for the appendices.
8. While clauses 5 and 6 cover allocation to the program for those people who are long-term unemployed at the cohort date, clauses 7 and 8 address the way that people who become long-term unemployed after that date but during the program’s life are allocated to the program and comparison groups. Again, we assume the two parties have already agreed upon a methodology and appended that to the agreement.

9. Appendix A defines the methodology for choosing cohorts. (not included)

10. In this example, we assume that people who join the program at different dates are placed into different cohorts. This helps ensure that the comparison process is between similar groups, and it also allows separate outcome payments to be calculated for different cohorts. Cohorts will not be necessary in many cases, and there are also other ways to generate cohorts—for instance, by setting the number of people in each cohort.

11. This clause is included to ensure that both parties are able to plan for the arrangement with some certainty about the number of people who will be served. Without such a clause, in this example there would be a risk to the external organization that the government fail to include enough people in the program for it to be financially viable.

12. One of the most challenging aspects of a Social Impact Bond is identifying ways to determine whether the external organization achieves
Outcomes

12. Outcome 1 is measured by determining the ratio between:
   a. The proportion of people in the program group in a particular cohort who are employed and have been in continuous employment for at least the past month, observed 12 months after the last date that a person could enter the cohort; and
   b. The proportion of people in the comparison group in a particular cohort who are employed and have been in continuous employment for at least the past month, observed 12 months after the last date that a person could enter the cohort.

12.1. If the ratio is greater than _______, then the external organization has successfully achieved outcome 1 for a particular cohort.

13. Outcome 2 is measured by determining the ratio between:
   a. The proportion of people in the program group of a particular cohort who have been employed for at least 18 months over the past 24 months, observed 36 months after the last date that a person could enter the cohort; and
   b. The proportion of people in the comparison group of a particular cohort who have been employed for at least 18 months over the past 24 months, observed 36 months after the last date that a person could enter the cohort.

13.1. If the ratio is greater than _______, the external organization has successfully achieved outcome 2 for a particular cohort.

14. Outcome 3 is measured by determining the ratio between:
   a. The median earnings of people in the program group of a particular cohort over the past 12 months, observed 36 months after the last date that a person could enter the cohort; and
   b. The median earnings of people in the comparison group of a particular cohort over the past 12 months, observed 36 months after the last date that a person could enter the cohort.

meaningful outcomes. Government agencies should try to avoid defining outcomes that the external organization could achieve by sheer chance. Similarly, external organizations will want to protect themselves against the risk that factors beyond their control will make it increasingly hard for them to achieve outcomes.

In this example, we have outlined three outcomes—one focused on short-term employment, one on long-term employment, and one on earnings. In each case success is measured by comparing the performance of a cohort in the program group to the same cohort of the comparison group. If the former group performs significantly better than the latter, the outcome is achieved for that cohort, and the government pays the external organization. But if the program group’s performance is similar to the comparison group, or the difference does not meet the threshold level defined in this section, outcome payments are not triggered.

There are many different ways to define outcomes. In this example, another option would be for the government to make a payment per individual in the program group who secures employment for a specified length of time. That kind of payment schedule will inevitably mean the government will make some payments for individuals who would have gained employment even if the program did not exist (so-called deadweight cost), so government agencies may want to set less generous payments to account for this. This payment schedule also means, from the external organization’s point of view, that it carries greater risk for factors outside its control that affect how hard it is for people to obtain jobs (such as a recession). But these payment schedules are also much simpler to administer than the one outlined below.
14.1. If the ratio is greater than ________, the external organization has successfully achieved outcome 3 for a particular cohort.

15. Each date where an outcome is observed is defined as a measurement date.

16. The table below summarizes outcomes, cohorts, and the measurement dates for outcomes.

<table>
<thead>
<tr>
<th>Cohort number</th>
<th>When do subjects enter the program group and comparison group?</th>
<th>Measurement date</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>For outcome 1: Continuous employment for at least one month at the measurement date</td>
<td>For outcome 2: Employment for 18 of the past 24 months at the measurement date</td>
</tr>
<tr>
<td>1</td>
<td>The cohort date</td>
<td>One year after the cohort date</td>
</tr>
<tr>
<td>2</td>
<td>Within one year of the cohort date (but not on the cohort date)</td>
<td>Two years after the cohort date</td>
</tr>
<tr>
<td>3</td>
<td>Between one year and two years of the cohort date</td>
<td>Three years after the cohort date</td>
</tr>
<tr>
<td>4</td>
<td>Between two years and three years of the cohort date</td>
<td>Four years after the cohort date</td>
</tr>
</tbody>
</table>

Outcome data

17. The government agency will have lead responsibility for gathering data to establish whether outcomes have been achieved.

13. It’s important to structure outcomes to reduce the incentive for perverse behavior. For example, the requirement in outcomes 1 and 2 for people to be employed for at least a specified length of time is designed to reduce the risk of the external organization directly employing members of the program group for a short period of time at the measurement date. But it is impossible to entirely eliminate these risks. Even in this example, the external organization has an incentive to employ people for one month to increase its chances of achieving outcome 1. Government agencies should take a pragmatic approach to this problem by guarding against such practices as they become apparent, rather than trying to eliminate all risks, as that would be too complex.

14. Where possible, outcomes should be measured using data sources that already exist or are inexpensive to generate. Government agencies and external organizations should agree on the methodology for collecting data prior to entering into an agreement. That’s why this clause references Appendix B, where the methodology might be laid out (not included here). While this clause assumes that government will have lead responsibility for collecting the data, in some instances it may make sense for the external organization or a third party to take the lead.
17.1. It must do so following the methodology agreed upon by the parties and laid out in Appendix B.\textsuperscript{15}

17.2. Any deviations from this methodology must be agreed upon by the parties and the independent assessor before being implemented.

17.3. The independent assessor can require the government agency to revise the manner in which outcome data is collected so long as the external organization is content with the changes.

\textbf{Outcome payments\textsuperscript{16}}

18. The government agency agrees to make payments to the external organization if it achieves outcomes for one or more cohorts.

18.1. Payments will be calculated separately for each outcome and each cohort.

18.2. If outcome 1 is achieved for a cohort, the government agrees to pay $____, multiplied by the outcome 1 ratio observed for that cohort, multiplied by the number of people in the program group for that cohort.

18.3. If outcome 2 is achieved for a cohort, the government agrees to pay $____, multiplied by the outcome 2 ratio observed for that cohort, multiplied by the number of people in the program group for that cohort.

18.4. If outcome 3 is achieved for a cohort, the government agrees to pay $____, multiplied by the outcome 3 ratio observed for that cohort, multiplied by the number of people in the program group for that cohort.

18.5. The government agency commits to making payments within three months of a final report being prepared by the independent assessor (under clause 19 below).

\textsuperscript{15} Appendix B defines the methodology for measuring the outcome. (not included)

\textsuperscript{16} In this example payments are determined by looking at the extent to which a cohort of the program group outperforms its comparison group. In order for payment to be triggered, an outcome needs to be achieved for a particular cohort, as defined in clauses 12 to 14 above. Payments increase for better performance once an outcome is achieved. The formula suggested here does not contain a cap on payments, but government may want a cap to plan for future expenditures.

Calculating the correct level of payment in any payment formula is not easy. In many cases, government agencies will want to develop payment schedules in line with the amount of money they believe they will save from the outcomes being achieved.
Role of the independent assessor in outcome payments

19. The independent assessor is responsible for determining whether the external organization achieves each outcome at each measurement date and the level of outcome payment that is due. The independent assessor must:
19.1. Prepare a separate report for each measurement date
19.2. Seek input from the government agency and the external organization prior to preparing the report
19.3. Share a draft report with the government agency and the external organization, and give them both two weeks to comment
19.4. Prepare a final report within four months of every measurement date

Working relationship between government and external organization

20. The external organization and government agency will maintain regular communications to facilitate a strong and collaborative mutual working relationship.
20.1. The external organization and government agency have both nominated a senior-level lead officer for the arrangement (named in Appendix C).19
20.2. Senior-level lead officers from the government agency and external organization will convene a meeting at least every month to review progress toward accomplishing the outcomes and to examine ways in which the parties, subcontractors, and other relevant government agencies can better work together to achieve the outcomes.
20.3. The external organization and government agency have both nominated a working-level lead contact for the arrangement (named in Appendix C).
20.4. In the event that either party needs to nominate a new senior-level lead officer or working-level lead contact, they should do so by writing to the other party at least one week in advance of the change taking effect.

17. The role of the independent assessor in this example is relatively simple. The government generates outcome data, and the assessor uses that data to establish whether the external organization achieves the outcome and the level of payment due. In some instances an independent assessor is not necessary if the parties are confident enough in the data source. Conversely, there may be instances when the assessor has a stronger role—for example, if the data needs significant manipulation to establish whether outcomes have been achieved.

18. Social Impact Bonds are a partnership between government and an external agency with clearly defined roles for the two parties. It is essential that they work together throughout the arrangement and seek to maximize the chances of achieving outcomes. This clause describes how the working relationship might be structured. For example, it could be structured with senior lead officers (responsible for strategy) and working-level leads (who run day-to-day operations) nominated by each party. This clause assumes that the names of those individuals would be included in Appendix C.

19. Appendix C names senior lead officers and working-level contacts. (not included)
Subcontractors

21. The **external organization** may subcontract with other organizations to provide services to the program group or to advise it as it develops or implements its strategy.

21.1. The **external organization** must notify the **government agency** before entering into any arrangement with a subcontractor.

21.2. The **government agency** should respond to the **external organization** within 14 days with its views on the potential subcontracting arrangement.

21.3. The **external organization** should take into account the **government agency's** views before entering into the arrangement.

21.4. If the **government agency** reasonably believes that a potential subcontracting arrangement is likely to result in:
   a. Harm to any person
   b. Additional costs to government, citizens, or business (except those envisaged at the outset of this arrangement and detailed in Appendix D) 21, or
   c. Significant reputational harm to the government
... then the **government agency** must inform the **external organization** the reasons for its concerns and a set of alterations that it believes are necessary to resolve the issues that arise. In such circumstances the **external organization** may not proceed with the arrangement until it has made the alterations requested by the **government agency**.

21.5. If the **external organization** believes the **government agency** is unreasonably objecting to a subcontracting arrangement, it can refer the issue to the arbiter, who will determine within 14 days whether the government has acted reasonably. The arbiter may allow a subcontracting arrangement to proceed even if government objects, or it may allow an arrangement to proceed under a different set of conditions to those proposed by government.

21.6. All obligations on the **external organization** as a result of this agreement or federal, state, or local laws also apply to the **external organization’s** subcontractors.

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20. In a Social Impact Bond, the external organization needs considerable freedom to devise and implement a strategy to achieve outcomes. But there are instances where government will need to exercise some control. We see three situations where the government might want to exercise greater control: (a) if the program group or other persons are at risk of harm; (b) where the external organization’s actions could increase costs to government or others; or (c) where there is significant reputational damage to government.

We have included these situations in a number of clauses, including this one. There will be some instances where additional costs to government are acceptable—for example, where both parties agree that one way to achieve the outcomes is to increase take up of other government services available to the program group. But these instances need to be agreed upon by the parties before the agreement is made (and included in Appendix D).

This clause gives the government limited power over the external organization’s subcontractors. Government must be notified of subcontracting arrangements and can only object if it believes that one of the three situations above holds true. In such situations government is required to suggest ways to overcome the issues that arise, and the external organization is expected to comply.

There is clearly a risk of a dispute in these situations—for example, if government unreasonably objects to an arrangement. In these instances this clause states that the issue should be referred to the arbiter, who is responsible for settling disputes.

21. Appendix D defines instances where increased cost to government is an acceptable result of the SIB agreement. (not included)
Investors

22. The agreement allows the \textit{external organization} to raise capital from investors and pay them returns as it deems appropriate.

22.1. The \textit{external organization} should notify government of any investors who have invested more than $1 million.

Expectations of government

23. The \textit{government agency} must:

a. Cooperate with the efforts of the external organization throughout the term of this agreement
b. Consider fully any request for changes to the policies or practices of the \textit{government agency} that could help the external organization accomplish the outcome
c. Provide access to the program group and any information or data that the government holds in relation to the program group that it is legally permitted to share

23.1. The \textit{government agency} cannot deny any reasonable request from the \textit{external organization} regarding (a) to (c) above, provided it is legally permitted to do so, and it does not believe that complying with the request would cause harm to citizens or additional costs to citizens or business (except where detailed in Appendix D).\footnote{24}

23.2. The \textit{government agency} may make approval of any request contingent on recovery of reasonable costs incurred by government as a result of changes to government policy or practice.

23.3. Where a request relates to the policy or practice of a different \textit{government agency} within the same administration, the \textit{government agency} will use its best efforts to secure changes to policy or practice.

22. One risk of Social Impact Bonds is that government will seek to exercise more control than is appropriate over the relationship between the external organization and its investors. This clause seeks to guard against that risk by making it clear that the government’s powers in this area are limited.

The drafting here assumes that government will be informed of major investors with a stake of more than $1 million, but the threshold will vary from case to case (and government agencies may want to set a threshold that relates to a percentage of the likely value of the contract). We propose that government have no power to veto any potential investor, nor should it have the power to seek additional information about the nature of the arrangement between an investor and the external organization. This is to ensure that government does not become a barrier to the external organization’s ability to raise money. For many government agencies this will be a significant change to their normal practice.

23. Government must cooperate with an external organization for a Social Impact Bond to work. This clause sets out expectations of government, including an obligation to share any information or data about the program group that it is legally permitted to share. The government also has an obligation to consider changes to policy or practice that could increase the external organization’s chances of achieving the outcome, but it is permitted to seek to recover any additional costs it incurs as a result of such changes.

24. Appendix D defines instances where increased cost to government is an acceptable result of the SIB agreement. (not included)
23.4. Where a request relates to information or data held by another government agency within the same administration, the requirement to release information applies to that agency in the same way it does to the government agency that is party to this agreement.

23.5. Where the government agency is unable to release data for legal reasons, it may instead release data in an aggregate form, or some other form that is legally permitted.

23.6. The government agency (or any other agency within the same administration) will not seek to exert any control over the strategy or methods used by the external organization except where expressly permitted by this agreement.

23.7. The government agency (or any other agency within the same administration) will not seek to exert control over the means by which the external organization raises capital.

23.8. The government agency (or any other agency within the same administration) will not impose reporting requirements on the external organization except where detailed in this agreement.

23.9. The government agency will treat any data or information received from the external organization as commercially confidential (except where specified in Appendix E).

Expectations of the external organization

24. The external organization must use its best efforts to seek to accomplish the outcomes.

24.1. The external organization must commence services to the program group no later than the commencement of services date.

24.2. In carrying out work under this agreement, the external organization must ensure that it:
   a. Complies with good industry practice and maintains high ethical standards

25. Appendix E concerns the confidentiality of data and information, and explains where Freedom of Information laws apply. (not included)

26. This clause sets out the expectations of the external organization. In particular, it is expected to comply with good industry practice and maintain high ethical standards. It is also prohibited from actions that it thinks could harm people, add to costs, or significantly harm government’s reputation.

This clause also states that the external organization will follow procedures to ensure confidentiality of information received from government and assumes those procedures are appended to the agreement.
b. Does not do anything that it reasonably believes could cause harm to any person

c. Does not do anything that it reasonably believes will result in increased costs for government agencies, citizens, or business (except where specified in Appendix D)

d. Does not do anything that it reasonably believes is likely to significantly harm the government’s reputation

24.3. If the external organization becomes aware of anything that pertains to this agreement and may breach (a) through (d) above, it must inform government within seven days.

24.4. The external organization will treat any data or information received from the government agency (or other government agencies) as confidential and will comply with the conditions set out in Appendix E.

24.5. The external organization must ensure that any of its employees who have access to the program group or data and/or information that relates to the program group receive satisfactory background checks to ensure that they are trustworthy.

24.6. The external organization must ensure that all those who come into contact with data and/or information pertaining to the program group take all reasonable steps necessary to ensure that the data and/or information are protected.

Appointment and powers of the independent assessor

25. The government agency must appoint an independent assessor within two months of the agreement date.

25.1. The primary role of the independent assessor will be to provide an assessment of whether the external organization has achieved outcomes and the level of payment due in accordance with the provisions of this agreement.

27. Appendix D defines instances where increased cost to government is an acceptable result of the SIB agreement. (not included)

28. Appendix E concerns the confidentiality of data and information, and explains where Freedom of Information laws apply. (not included)

29. The independent assessor is responsible for determining whether the external organization achieves the outcomes and the level of payment due. They must be appointed with the agreement of both parties. We assume that the government takes the lead in doing so, but the external organization could also be the lead actor. Our timeframe here may well be ambitious, but we have suggested a quick appointment so that the independent assessor is in place before the cohort date. In some instances, procurement processes may dictate a slower timetable, which could also delay the cohort and commencement of services dates.
25.2. The government agency can only appoint an independent assessor with the consent of the external organization and must follow the process for appointment detailed in Appendix F to this agreement.

25.3. If at any point during this agreement, the government agency and the external organization agree that there should be a new independent assessor, they can appoint a replacement independent assessor through a process they both agree upon.

26. Both parties must comply in a timely manner with any reasonable request for information or data from the independent assessor.

26.1. Where an independent assessor’s request relates to information or data held by another government agency within the same administration, the requirement to release information applies to that agency in the same way it does to the government agency that is party to this agreement.

27. Within six months of appointment, the independent assessor should prepare an assessment plan that should be agreed upon both parties.

The arbiter

28. The government agency shall appoint an arbiter within three months of the agreement.

28.1. The government agency can only appoint an arbiter with the consent of the external organization and must follow the process agreed between the parties and detailed in Appendix G.

28.2. If at any point during this agreement, the government agency and the external organization agree that there should be a new arbiter, they can appoint a replacement arbiter through a process they both agree upon.

30. Appendix F details the appointment process for the independent assessor. (not included)

31. The process for appointing the arbiter is similar to the independent assessor.

The arbiter has a general duty to resolve disputes that may arise between the parties as a means to minimize the risk of litigation.

32. Appendix G details the appointment process for the arbiter. (not included)
29. Where a dispute arises between the parties during the course of this agreement that cannot be resolved directly between the parties, either party can ask the arbiter to resolve the dispute.

29.1. In instances where this agreement describes a process and/or timetable for the resolution of a particular type of dispute, the arbiter should comply with that process.

29.2. In instances where this agreement does not describe a process and/or timetable for the resolution of a particular dispute, the arbiter should devise a process and/or timetable as necessary and agree upon it with both parties.

29.3. The arbiter’s decision on any dispute is final.

30. Both parties must comply in a timely manner with any reasonable request for information or data from the arbiter.

30.1. Where a request relates to information or data held by another government agency within the same administration, that other government agency is required to release the information or data as if it were the government agency under this agreement.

30.2. The arbiter must keep information received from both parties confidential.

Termination for convenience by government

31. The government may terminate the agreement for convenience by giving four months notice in writing.

31.1. If it chooses to do so, it must compensate the external organization, the greater of:

a. The costs that the external organization has incurred up to the date of termination and any reasonable unavoidable costs it will incur after the date of termination, plus an annual interest rate of ___ percent; or

b. Any future outcome payments that the external organization would reasonably have expected under the agreement.

33. There will be instances where government wishes to terminate the arrangement, and this clause allows it to do so out of convenience. It sets out that the government should give four months notice and make a payment to ensure that the external organization is adequately compensated. The interest rate in section 31.1 should be set at a high enough level so that government is discouraged from terminating the arrangement using this clause, and investors receive adequate compensation if the government uses this clause to terminate the agreement. The arbiter has a role to help determine the level of payment. In this instance and others where disputes might arise, there is always a risk that a dispute would result in litigation, in which case a court rather than the arbiter would determine the correct level of compensation.
31.2. In these circumstances, the parties must either:
   31.1.1. Seek to agree on the correct level of compensation due under (a)
or (b) above within six weeks of the termination notice being issued; or
   31.1.2. Refer the issue of the correct level of compensation to the arbiter.
31.3. If they refer the issue of compensation to the arbiter, the arbiter must deter-
mine the correct level of compensation under (a) and (b) above within six weeks of being requested to do so.
31.4. If the parties fail to agree on the correct level of compensation within six weeks of the termination notice being issued, the issue is automatically referred to the arbiter.

Alterations proposed by government

32. The government agency must notify the external organization and propose altera-
tions to the external organization’s practices if the agency reasonably believes that the actions of the external organization are:
   c. Resulting in harm to any person
   d. Imposing or are likely to impose additional costs to government, citizens, or business (except where specified in Appendix D); or
   e. Bringing the government into disrepute
32.1. The external organization must respond to any reasonable request within seven days with a plan of action that lists changes it proposes to make and the timescale for proposed changes.
32.2. If the government agency believes the plan of action will resolve the issues that it believes are resulting in (a) to (c) above, it must respond within seven days consenting to the plan.
32.3. The external organization must implement a plan of action that has received consent as soon as reasonably practicable.

34. There may be instances where government believes that the external organization is not complying with the expectations set out in clause 24 above. This draft clause presents a process for resolving those issues.

35. Appendix D defines instances where increased cost to government is an acceptable result of the SIB agreement. (not included)
33. If the government agency believes that the plan of action is inadequate at addressing 32 (a) to (c) above, it may propose modifications to the plan and make consent subject to the modifications being implemented.

33.1. If the external organization is content to implement the plan with modifications, it must do so as soon as reasonably practicable.

**Disputes arising from proposed alterations and termination procedure**

34. If the external organization believes that the government is acting unreasonably under clauses 32 or 33 above, it may refer the issue to the arbiter.

34.1. The arbiter will determine whether the external organization’s actions fall within the scope of clause 32 above.

34.2. If so, the arbiter will determine whether the government’s proposed alterations are reasonable and whether the plan of action is adequate to address the issues raised.

35. If after 21 days of the request being made (under clause 32 above), the government agency concludes that the external organization does not intend or is unable to address the issues it has raised in an effective or timely manner, it can refer the issue to the arbiter.

35.1. The arbiter will determine whether the government agency’s request was reasonable and whether the external organization has sought to resolve the issue in an effective and timely manner.

35.2. If it determines that the request was reasonable, and the external organization did not or was unable to resolve the issues in an effective or timely manner, it can give the government permission to terminate the arrangement.

35.3. If it does so, it must also determine whether there should be a payment to the external organization to compensate it for costs incurred or any future outcome payments that it would have reasonably expected under the agreement.

36. There is a risk of disputes arising between the parties over the expectations of the external organization. The government may ask for alterations that the external organization does not implement. In some cases the external organization may believe that government is acting unreasonably. This section states that the arbiter should help to resolve these disputes. It also allows the arbiter to give the government consent to terminate the agreement if the external organization is not complying with its expectations.
It should determine that a payment should be made in cases where it believes that the external organization acted in good faith throughout the agreement, and there was a high likelihood of it successfully achieving the outcomes.

Emergency action

Where the government agency reasonably believes that the actions of the external organization are resulting or likely to result in significant and immediate harm to the program group, and there is an urgent need to take immediate action to protect citizens, it can take emergency action:

1. In such instances, the government agency may require the external organization to stop actions that it believes are causing harm within two days notice.

2. The external organization may refer the issue to the arbiter, who will make an urgent determination whether the government agency's actions are reasonable.

3. If the government agency takes action under this section, it must also follow the alterations process set out at clause 32 within seven days.

Termination by the external organization

The external organization may terminate this agreement where it reasonably believes:

a. It cannot accomplish the outcomes at reasonable cost
b. It cannot afford to continue to provide services as a result of cash flow constraints; or
c. The government is not cooperating with the external organization as it would expect

In such circumstances, the external organization must give government at least four months notice before discontinuing services to beneficiaries, and it must cooperate with any reasonable requests from government to facilitate a smooth transition to a new service provider or the winding down of services.

There may be situations where the government needs to take urgent action to stop harm to the program group. This clause allows it to take action in those circumstances.

Social Impact Bond arrangements are risky for external organizations. They enter into the arrangements believing they can achieve the outcomes, but they may realize later that they cannot do so, and that they are therefore unlikely to receive payment from government. In such situations the external organization has very strong incentives to walk away from the arrangement.

We believe that it is hard to oblige the external organization to continue to provide services in these situations. If government agencies seek to do so, they may find that the outcome payments have to be significantly greater (as the external organization will want a premium for the risk). In any case, the external organization may have formed a special-purpose vehicle for the arrangement and could easily let that entity fold.

It is better to have an orderly means to allow the external organization to exit the arrangement. In this example we propose the external organization should be required to give four months notice so that government can make alternative arrangements for the continuation of services. If adequate notice is not given, then the external organization has to make a payment to compensate government.

In addition, we believe that if the external organization wishes to exit the arrangement because the government is not cooperating, it should be eligible for compensation to be determined by the arbiter.
37.2. In the case of (c) above, the external organization may seek compensation from government. If it wishes to do so, it should refer the issue to the arbiter.

37.3. The arbiter will determine whether government has not fully cooperated with the external organization in the manner set out in this agreement.

37.4. If it concludes that the government has not fully cooperated, then it must determine a level of payment to the external organization to compensate it for costs incurred or any future payments that it would have reasonably expected under the contract.

37.5. The external organization must either (i) place in escrow a sum of $______ to compensate government in the event that it does not give the government four months notice before discontinuing services, or (ii) purchase insurance that provides compensation to government in this situation.

Publicity

38. The parties are jointly responsible for publicity in relation to the arrangement or any activities carried out under it.

38.1. All publicity efforts or comments to the media by either of the parties must be agreed upon in advance with the other party.

Special provisions\(^{39}\)

39. The external organization is not part of government, and the requirements that apply to government do not apply to it, except where required by statute or where the requirements are necessary in order to protect members of the program group or other persons.

40. Nothing in this agreement supersedes legal obligations on the government agency or the external organization.

39. In addition to the special provisions proposed here, any agreement will need to contain standard provisions that governments include in their agreements with external contractors. These might include, for example, clauses on severability, conflict of interest, and intellectual property. In some cases these standard provisions may need to be revised to ensure that they are consistent with the Social Impact Bond model, where the roles for government and the external organization are somewhat different to other agreements.
Conclusion

The above language for inclusion in a Social Impact Bond agreement is meant to help address common questions about how these unusual arrangements can be structured between government and an external organization. But it is by no means the final word on how these arrangements should function. Social Impact Bonds are still developing in the United States, and as more states and cities explore the concept, new models with their own agreement terms and language will emerge. Because Social Impact Bonds require openness, trust, and ongoing communication between government agencies and an external organization, most agreements will likely contain clauses formalizing the roles, responsibilities, and expectations of both parties—including rules for the orderly termination of an agreement.

Upcoming issue briefs in this series will focus on possible applications of the Social Impact Bond concept, further explore how to measure successful outcomes, and discuss the long-term potential of these innovative new financing tools.

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