Advancing with ESIF financial instruments

The Portuguese Social Innovation Initiative

The Social Impacts Bonds Programme

Using ESF to finance Social Innovation and Social Entrepreneurship

European Commission

European Investment Bank The EU bank

LIST OF ACRONYMS

AA	Audit Authority
BA(s)	Business Angel(s)
BSC	Big Society Capital
CC	Certifying Authority
CF	Cohesion Fund
CPR	Common Procedures Regulation
CSR	Corporate Social Responsability
DG EMPL	Directorate General for Employment, Social Affairs and Inclusion
EAA	Ex-Ante Assessment
EaSI	EU Programme for Employment and Social Innovation
EC	European Commission
ECB	European Central Bank
EFSI	European Fund for Strategic Investments
EGESIF	Expert Group on European Structural and Investment Funds
EPC	Energy Performance Contracts
ERDF	European Regional Development Fund
ESF	European Social Fund
ESIF	European Structural and Investment Funds
EU	European Union
FAQs	Frequently Asked Questions
FoF	Fund of Funds
HR	Human Resources
ICT	Information and Communication Technologies
IMF	International Monetary Fund
JAP	Joint Action Plan
MoU	Memorandum of Understanding
MR%	Market Rate %
MRI	Mission-Related Investments
OECD	Organisation for Economic Co-operation and Development
OP(s)	Operational Programme(s)
PA	Partnership Agreement
PbR	Payment by Results
PPP	Public-Private Partnerships
PRI	Programme(Project)-Related Investments
PSI	Portugal Social Innovation

PSIMS	Portugal Social Innovation Mission Structure
SCO(s)	Simplified Cost Option(s)
SCO-LS	Simplified Cost Option - Lump Sums
SE JV	Social Enterprise Joint-Venture
SEO	Social Economy Organisations
SIB(s)	Social Impact Bond(s)
SIF	Social Innovation Fund
SPV	Special Purpose Vehicle
TA	Technical Assistance
UN	United Nations
VC	Venture Capital

1. SETTING THE SCENE

For the past decades, social innovation has been a transversal priority for European Structural and Investment Funds (ESIF), and in particular for the European Social Fund (ESF). However, with the exception of the 2000-2006 EQUAL initiative[1] up until the current 2014-2020 programming period, there has been a limited number of specific ESF financing instruments directly targeting social innovation and social entrepreneurship projects.

Rather than embedding a social innovation component in all ESF financed projects as intended by the European Commission (EC) in setting it as a transversal priority, practice has transformed this area in a good-to-have residual addition to ESF projects across the European Union (EU) or, as in most cases, a few vague lines on social innovation in project descriptions, as required by EC templates.

An emerging area needs a more direct targeted approach. Especially in a moment, when societal challenges are growing, becoming more significant and complex. Climate change, ageing, the sovereign debt crisis, the refugee crisis, fragmentation and populism are just a few examples that, together with increasing financial constraints in the public sector in most EU Member States, are putting additional pressure on traditional social models and responses.

Perceived as essential components of the new approach needed to effectively address these issues, social innovation and social entrepreneurship are now emerging as global key trends for future policy making across the EU and worldwide.

Simultaneously, there has been increasing interest for impact investing from organised civil society. As a result, new complementary approaches and solutions are starting to be tested and adopted. In fact, the growing interest of EU Member States in Social Finance[2] is also leading to innovative approaches being implemented in several public policy areas, where instruments as payment by results (PbR) schemes, performance contracts or social impact bonds are becoming a reality across Europe.

By creating the Portugal Social Innovation (PSI) initiative in December 2014, Portugal was a pioneer in the use of ESF for financing the full life cycle of social innovation and social entrepreneurship projects, through 4 innovative instruments:

- a capacity-building grant scheme (Capacity-Building for Social Investment);
- a venture philanthropy matching-fund scheme (Partnerships for Impact);
- a Social Impact Bonds (SIBs) Programme;
- a Social Innovation Fund (a financial instrument using ESF for social investment).

Since then, other Member States have also begun to use ESIF for the set-up of similar financing instruments.

1 http://ec.europa.eu/employment_social/equal_consolidated/.
2 The concept of Social Finance includes a wide range of financial instruments focused at generating social impact, while also delivering financial return. In practice, it blends financial and social outcomes, aligning incentives for investments to achieve both.

Developed for the European Commission/DG EMPL and the European Investment Bank (EIB) under the *fi-compass* initiative, the present study focus on the analysis of the PSI experience concerning SIBs, with two main objectives:

- To provide practical guidance to other Member States willing to implement this type of financing mechanism under the ESIF-ESF during the current 2014-2020 programming period;
- To provide lessons learned and recommendations that could be used as evidence-based inputs for supporting the EC in the design of the regulatory framework for the next ESIF programming period, namely concerning innovative ESF financing mechanisms.

The study provides in-depth analysis of the PT SIBs Programme, supported by empirical evidence and experience from PSI's implementation of PbR and Simplified Cost Options – Lump Sums (SCO-LS) mechanisms under the ESF.

2. THE PORTUGAL SOCIAL INNOVATION INITIATIVE

The PSI initiative was created on the 16 December 2014, in a very specific context that aligned the needs, the players and the funding:

- After Ireland and Greece, in May 2011, at the peak of the European sovereign debt crisis, Portugal signed a three year Economic Adjustment Programme with the European Union (EU), the European Central Bank (ECB) and the International Monetary Fund (IMF). Strong austerity measures followed, increasing social needs.
- Those increasing social needs were being met by a combination of diverse deep-rooted traditional players (associations, foundations, cooperatives, mutuals, misericórdias3, etc.) that encompassed the Portuguese Social Economy, as well as by an emerging group of social entrepreneurs and social start-ups.
- Those were also the years when Portugal, as all EU Member States, started the definition of priorities and the negotiation process with the EC of its 2014-2020 ESIF programming cycle. At the time, Portugal was not able to access debt markets, being very dependent on EU funds for all public investment.

As a result, Portugal decided to elect Social Innovation and Social Entrepreneurship as a key priority of its 2014-2020 Partnership Agreement, allocating EUR 150 million ESF with two main goals: to finance social innovation and social entrepreneurship projects; to promote the necessary ecosystem for its future sustainability, creating a social investment market.

To design the PSI initiative and to provide inputs for the negotiation process with the EC, a small working group was created, including ESIF experts/negotiators and experts in social innovation, reporting directly to the Minister coordinating the 2014-2020 Partnership Agreement and Operational Programmes (OPs) negotiation. Being PSI a transversal initiative to all Portugal ESF OPs, it was decided to embed its negotiation with the EC in the negotiation process of its main financing OP – the Social Inclusion and Employment OP, assuring the roll out of the outcome to all other relevant OP. This back-to-back strategy, with ESIF experts being the common element to both the working group and the EC negotiation rounds, led to an agreement in December 2014, after several rounds of relevant PT-EC discussions[4].

Following this agreement, the PSI initiative was created as a Resolution of the Council of Ministers[5], which also created its managing structure – the Portugal Social Innovation Mission Structure (PSIMS), whose three member Executive Board included three elements of the former working group.

3 Misericórdias are a specific type of association created in Portugal under canon law (Catholic Church) since the XV century, with the purpose of satisfying a broad spectrum of social needs. Currently, there are approx. 400 Misericórdias, serving around 165 000 final beneficiaries.
4 With timings matching the closing of PT-EC agreements on PT ESF OPs.
5 Resolution of the Council of Ministers 73-A/2014 (https://dre.pt/application/file/a/65891195(PT)).

Inspired on the UK Big Society Capital (BSC), the PSI initiative was designed as a neutral wholesaler model, equidistant from all players, with three main goals:

- *To promote social innovation and social entrepreneurship in Portugal, as a way to generate new solutions, complementary to mainstream social products and services, for the resolution of key societal problems;*
- *To grow the social investment market, creating financing instruments more adequate to the specific needs of the Social Economy and of social innovation and social entrepreneurship projects;*
- *To improve the skills of all the players in the social innovation and social entrepreneurship system, increasing their level of response/impact and contributing for their sustainability.*

To be able to fulfil those three objectives, PSIMS operational *technical* team was structured into two independent sub-teams:

- A financing team, responsible for all activities related with the end-to-end cycle of ESIF processes (launching calls for applications, application technical and financial analysis, monitoring, payment processing, evaluating, etc.);
- An ecosystem activation team, with members based in each of the eligible geographies, responsible for creating pipeline, as well as for stimulating the ecosystem, mapping and engaging locally with all types of relevant players (implementing entities, social investors, intermediaries, etc.), building networks and communities.

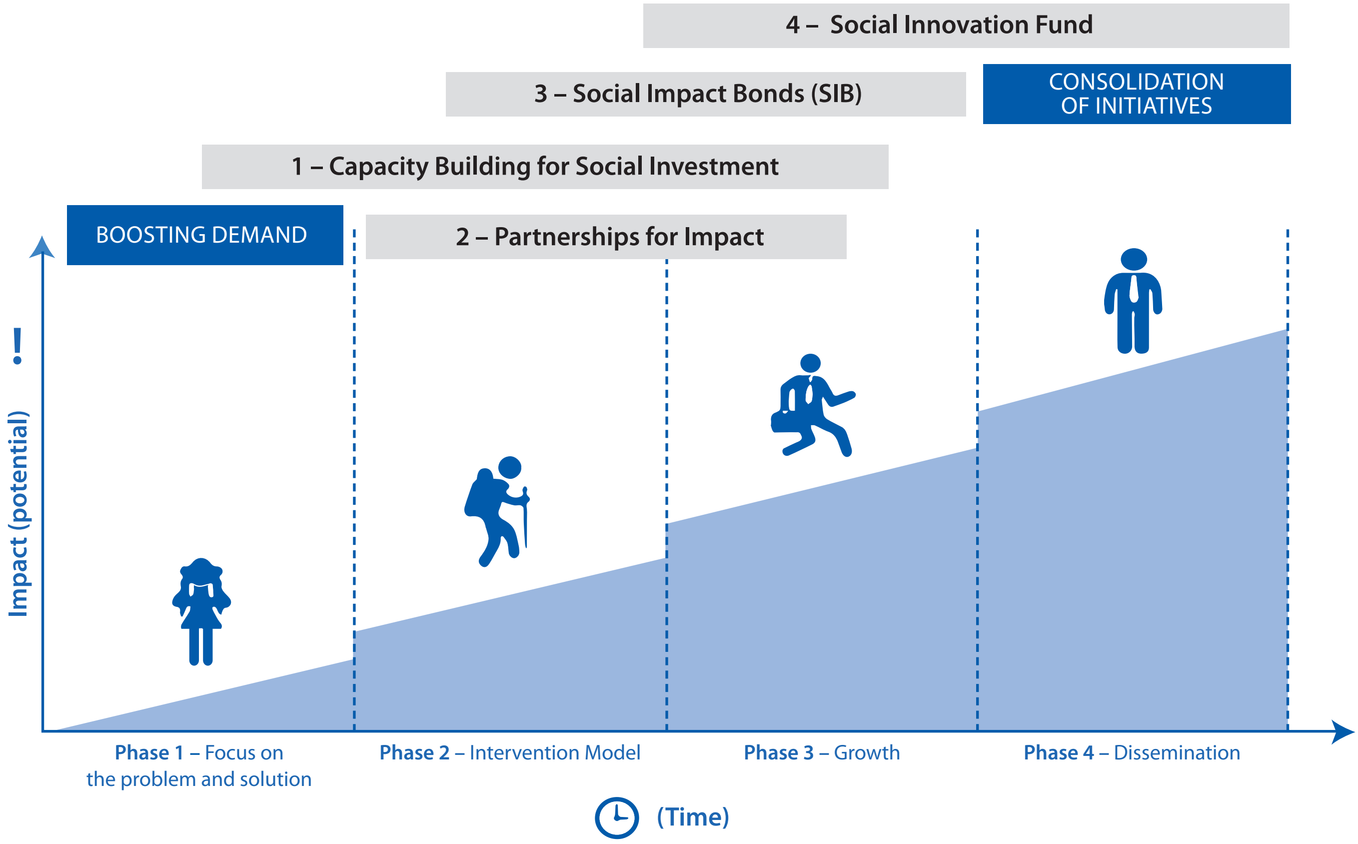
Overall PSIMS activities go beyond financing, but as far as ESIF are concerned, PSIMS acts as an intermediate body for the financing OPs managing authorities:

FINANCING INSTRUMENTS	PT 2014-2020 OPERATIONAL PROGRAMMES			ESIF-ESF Funds
	OP Social Inclusion and Employment	OP Human Capital	Regional OPs*	
1 - Capacity building for Social Investment	✓		✓	EUR 15 million*
2 - Partnerships for Impact	✓	✓	✓	EUR 20 million*
3 - Social Impact Bonds	✓	✓	✓	EUR 20 million*
4 - Social Innovation Fund	✓			EUR 47.5 million*

** ESIF-ESF Funds of Lisbon Regional OP is still being negotiated*

Currently, eligible regions for PSIMS financing instruments are Norte, Centro, Alentejo and Algarve. Projects in the first three regions ("less developed regions") are financed under thematic OPs Social Inclusion and Employment and Human Capital. However, the Portuguese 2014-2020 programming exercise also included ESF funding from all Regional OPs (namely Lisbon and Algarve) to reach total coverage of mainland Portugal. PSIMS started its financing activities in Algarve in June 2018, while negotiations to reach the Lisbon region are still being held.

PSIMS manages four innovative ESF financing instruments, covering the full life cycle of social innovation and social entrepreneurship projects:



Capacity-Building for Social Investment

Capacity-building for Social Investment is an innovative ESF financing instrument that aims to improve the organisational and management competencies of organisations and teams directly involved in social innovation and social entrepreneurship projects, narrowing their skills gap and preparing them to attract and apply social investment. It intends to solve one of the main barriers for impact investing in social innovation or social entrepreneurship projects – the still significant skill gaps and the corresponding lack of investment readiness of most projects.

It is a grant support up to EUR 50 000 (in the form of vouchers) to finance small ***capacity-building plans*** (up to 18 months of duration), *directly* applied to social innovation and social entrepreneurship projects. It funds 100% of eligible costs to beneficiaries (85% ESIF-ESF + 15% Portugal State budget).

To apply for funding, beneficiaries must submit a ***capacity-building plan*** including the following elements:

1. A diagnosis of the project's capacity-building needs, developed by an external entity (to be reimbursed, for all approved applications, up to EUR 5 000 of incurred costs);

2. Maximum five additional capacity-building interventions (incl. training and/or consulting and/or mentoring) that directly address maximum five capacity-building needs identified in the diagnosis. Interventions are to be developed in the following capacity-building domains:
    - Value Creation Model
    - Impact Measurement and Evaluation
    - Strategy, Partnerships and Growth
    - Marketing, Communication and Fund Raising
    - Structure, Governance, Leadership and HR
    - Financial Management, Control and Risk
    - Operations Management and ICT
3. A detailed budget for each of the additional capacity-building interventions;
4. A simple non-binding expression of interest by a social investor (ex. foundation, municipality, etc.), that, in some cases, will be the first contact of projects with potential future investors.

To simplify application processes and to reduce administrative burdens, templates for 1. to 4. are provided *ex-ante* to applicants, as well as detailed application guides and FAQs.

Due to mandatory regulatory requirements[6], ***Capacity-building for Social Investment*** must use a SCO-LS financing model, as follows:

- ✓ Based on a detailed budget, applicants must propose – for each capacity-building intervention – a fixed cost value (lump sum) and an output to be achieved, that will both be contracted with PSIMS upon application approval. Application approval also releases a 15% advance payment of total eligible cost for initial expenditure;
- ✓ Beneficiaries must select their supplier(s) of capacity building services and actively engage with them in the development of the capacity-building interventions and on the co-creation of its outputs;
- ✓ Payment of each capacity-building intervention (the pre-agreed lump sum, no invoices required) is released *only* upon validation by PSIMS of the resulting output;
- ✓ At the end of each intervention, suppliers of capacity-building services are evaluated by the beneficiaries, as well as by output validation success rates. Aggregated results are made publicly available, namely at PSIMS' website.

RESULTS:

The first call for applications for ***Capacity-building for Social Investment*** (OP Social Inclusion and Employment) was closed on the 28 June 2017. The 168 applications received amounted to EUR 7.85 million of financing needs – more than 2.5 times the initial allocated budget. 99 applications were approved, with approx. EUR 3.5 million ESF financing. A second call for applications is expected to be launched still in the first semester of 2018.

6 European Regulations: CPR – Article 67 (1) (c); Regulation (EU) 1304/2013 – Article 14 (3); Portuguese Law: Portaria n.º 60-A/2015 de 2 de março – Article 4(1).

Partnerships for Impact

Partnerships for Impact is an ESF financing instrument that intends to support the early growth of social innovation or social entrepreneurship projects. It is a grant structured as venture philanthropy financing, leveraging other social investments to support high potential and high impact projects. It works as an incentive to address the often fragmented and diffuse approaches to grants by most donors, promoting longer-term and higher-engagement approaches to finance social innovation and social entrepreneurship projects with high social impact, contributing for the growth of the venture philanthropy sector in Portugal.

It is a grant support of at least EUR 50 000[7] to finance, during the first one to three years, projects that intend to further develop proven social innovation concepts – innovative products, platforms or services to help solving societal problems. It matches 70% to 30% the funding provided by social investors (ex. Foundations, Municipalities, Corporate Social Responsibility of private companies, etc.). It funds 100% of eligible cost to beneficiaries (85% ESIF-ESF + 15% Portugal State budget), with no maximum threshold per project.

A Partnership for Impact application is submitted by one or more social innovators (the project implementing entity(ies)) and must include the following 2 elements:

1. A one to three years ***development plan*** for the project, including a proposal of one or more result indicators, with quantified targets, to measure the project's social impact;
2. A letter of commitment from one or more social investors, stating their financial commitment to the project, the type of engagement they will have with the implementing teams during project development (e.g. capacity-building, mentoring) and declaring no control relationship over any of the implementing entities.

To simplify application processes and to reduce administrative burdens, templates for 1. and 2. are provided *ex-ante* to applicants, as well as an application guide.

It is a typical ESIF-ESF grant, reimbursing real costs actually incurred and paid by the beneficiary, with a 15% total eligible cost advance to be paid upon application approval. ESF and social investors' payments are done *pari passu*.

7 EUR 50 000 lower limit set to avoid the need to use ESF mandatory SCO rules in this particular instrument.

RESULTS:

The first call for applications for ***Partnerships for Impact*** (OP Social Inclusion and Employment) was closed on 31 October 2016. 42 applications were approved (35 projects), with approx. EUR 3 million funding from social investors commitments and EUR 7 million from ESF.

Applications ranged from EUR 71 500 to EUR 980 000, most of them proposing 3 years development plans. Most applications were presented by associations. Social investors were diversified, including foundations, companies, municipalities and international investors.

Examples of approved projects *(societal challenge):* SPEAK (*migrants integration*), Colour ADD (*daltonism*), Beating Autism (*autism*), Apps for Good (*several – ICT*), Mozart Pavilion (*integration by music – prison environments*), U.Dream (*children health and wellbeing*), 10 000 lives (*Health – ICT*), CARE (*youths and children sexual violence*), Just a Change (*deprived housing – volunteer urban regeneration*), Pedagogical Villages (*ageing*), EKUI cards (*discrimination – inclusive child alphabetization*), New grape seeds (*civic education of disadvantaged youth in a specific wine region – wine association and companies as investors*), Smiling world (*children oral hygiene*).

A second call for applications for ***Partnerships for Impact*** related to social innovation and social entrepreneurship projects in the fields of Education and Training (under OP Human Capital), with a total indicative budget of EUR 3 million, closed on 16 January 2018. 26 applications were submitted and are now under assessment, representing a potential investment of approx. EUR 3 million from social investors, to be matched by approx. EUR 7 million of ESF financing.

A third call for applications for all other fields (under OP Social Inclusion and Employment) with a total indicative budget of EUR 7 million, was closed on 30 May 2018. In total 91 applications were submitted, representing a potential investment of approx. EUR 8 million from social investors, to be matched by approx. EUR 18.8 million of ESF financing. In comparison with the total budget allocation, the request for ESF financing was more than 2.5 times the amount available.

Social Impact Bonds (SIBs)

The *PSIMS'* ***Social Impact Bonds Programme*** is an ESF financing instrument that uses an outcome payment mechanism to support innovative projects that address societal problems in specific public policy areas – Employment, Social Protection, Justice, Health and Education.

By acting as the outcome payer, PSIMS uses ESF to remove a key constraint to the adoption of SIBs in Portugal – the current lack of public sector outcome-based commissioning, while proofing the concept and help persuading public sector entities to start shifting from the traditional output-focused approaches towards more outcome-oriented public policies. Additionally, by involving private external parties as initial investors, SIB reduces the financial risk of innovation failure for the public sector, while attracting private funding to the provision of social goods and responses.

It consists of a grant support to pay for *validated* outcomes achieved by specific social innovation projects in an area of public policy. It funds 100% of eligible cost financing to beneficiaries (85% ESIF-ESF + 15% Portugal State budget), upon validation of contracted outcomes, with no maximum threshold per project. Project durations are long, going up to five years between project start and outcome validation and payment.

In the case of the PSIMS' SIBs Programme, any SIB application must be submitted by a consortium of:

- One or more private investors, that finance the project;
- One or more implementing entities, that are responsible for executing the innovative solution;
- One or more public sector entities, that validate the alignment of the project with the relevant public policies, as well as the significance of the proposed outcomes.

The consortium might also hire one or more intermediary entities to manage the project, subjected to a threshold on related expenditure.

The SIB application to be submitted by the consortium must include the following five elements:

1. A Memorandum of Understanding (MoU) signed by all the members of the consortium;
2. A declaration of the relevant public sector entity, agreeing with the relevance of the project and with the proposed outcomes;
3. The SIB's intervention model;
4. The SIB's budget and financing model;
5. The SIB's outcome measurement model.

To simplify application processes and to reduce administrative burdens, templates for 1. to 5. are provided *ex-ante* to applicants, as well as a detailed application guide.

The PSIMS SIBs Programme consists of "delayed" ESIF-ESF grants, with no advance payment. Payment (meaning the reimbursement of real costs actually incurred and paid by the consortium) only takes place after the validation of outcomes.

RESULTS:

Following an extended capacity-building preparatory stage on how to set-up a SIB, the first call for applications for the ***Social Impact Bonds Programme*** (OP Social Inclusion and Employment) was closed on 28 November 2016.

Three applications were approved, with around EUR 1.5 million financing from social investors and projects currently being implemented:

Code Academy (youth unemployment)

Implemented by Code for All and the Social Investment Lab (SIL), the Code Academy created an innovative training model in ICT programming for unemployed young people with a BA degree in any subject, that want to change their professional lives. ASSOP – Association of Shared Services & Outsourcing Platform and the Calouste Gulbenkian Foundation are the investors (around EUR 723 500).

Go Forward (youth unemployment)

Created and implemented by TESE and SIL, Go Forward is a capacity-building project, focusing on self-knowledge, soft skills and networking to ease the entry of young people in the labour market, including a 10 month period of applied mentoring and coaching. It targets young people that are the first in a family to earn a BA degree, with migrant parents or unemployment in the family. The Calouste Gulbenkian Foundation and Deloitte are the investors (around EUR 387 800).

Project Family

Implemented by Movimento de Defesa da Vida and SIL, Project Family is an innovative intensive programme that intends to prevent the entry into the foster care system of children and young people at risk. It works with families identified by the Ministry of Solidarity and Social Security. The Calouste Gulbenkian Foundation and Caixa Económica Montepio Geral are the investors (around EUR 433 300).

A second call for the ***Social Impact Bonds Programme*** in the fields of Education and Training (under OP Human Capital), with a total indicative budget of EUR 5 million, closed on 12 March 2018. 15 applications were received, representing around EUR 5.2 million potential financing from social investors.

A third call for SIB in all other fields (under OP Social Inclusion and Employment) is expected to open still in the first semester of 2018.

Social Innovation Fund

The Social Innovation Fund (SIF) is one of the first ESIF financial instrument in Europe using the ESF for social investment.

SIF intends to improve access to finance for Social Economy organisations (SEO) and social start-ups involved in social innovation and social entrepreneurship projects by addressing the following market failures identified in an independent ex-ante assessment (EEA):

- Weak capital structure, high financing needs and growing demand of SEO, with no spare resources to organisational improvements and innovation;
- No appropriate response from mainstream finance solutions:
  - *Risk:* perception of high risk and no collateral
  - *Return:* high transaction costs for expected below-market returns
  - *Impact:* positive externalities not recognised nor taken into account
- Maturity gap (no availability of longer maturities);
- Lack of intermediaries in social financing and social investment;
- Reduced diversity of available financing options, not adjusted to the specific financing needs of this type of projects;
- High fragmentation and short-term drive of existing philanthropic financing.

The EEA also identified a total financing gap of EUR 433.9 million, split into two distinct segments: investment in SEO innovation (EUR 281.2 million) and investment in social start-ups (high potential – EUR 28.6 million). Additionally, it pointed out the need for the adoption of asymmetric risk/return sharing mechanisms to attract financial system players into this market.

SIF is currently structured as a hybrid model of fund with two financial instruments: a debt financial instrument with a wholesale approach, designed to ease the access to finance for the social economy entities and a retail equity financial instrument to foster the social investment market. On the debt financial instrument, SIF will provide guarantees so financial institutions can provide loans to social economy entities at below the market conditions. On the other hand, the equity financial instrument will co-invest alongside private investors in SMEs that are implementing social innovation projects. Both financial instruments of the SIF will be managed by a 100% public financial entity.

SIF was designed to serve the stages of growth and dissemination of social innovation and social entrepreneurship projects and has two main goals:

- To finance the growth and consolidation of social innovation and social entrepreneurship projects with products more adjusted to their specific needs, like long loan maturities and lower interest rates;
- To promote a social finance ecosystem, by co-investing with social investors allowing a risk mitigation strategy. The co-investors will have call options for the first 6 years that will let them avoid much of the risk carried by an early-stage enterprise.

As Portugal still doesn't have a legal status for social enterprises, SIF will focus on financing the most common legal forms of the entities that are implementing these projects, namely social economy entities and SMEs.

RESULTS:

The **Social Innovation Fund** has been created as an autonomous public investment fund by Decree-Law in the beginning of 2018. It was approved by the Council of Ministers on 15 March and promulgated by the President of the Portuguese Republic on 5 April of the same year.

3. THE PORTUGAL SOCIAL IMPACT BONDS PROGRAMME

3.1. Design stage

What is a Social Impact Bond?

"In financial terms, SIBs are not real bonds but rather future contracts on social outcomes" (OECD, 2015)

A Social Impact Bond (SIB) is a type of outcome payment agreement involving at least three main parties, whose interests are aligned around pre-agreed and measurable social outcomes:

1. a Public Sector commissioner (usually the public sector organisation directly responsible for a specific public policy area), that is willing to pay initial investors a specific amount for a contracted social outcome once it has been achieved.

   In this way, the public sector transfers the financial risk of failure of a SIB to its initial social investors, without reducing the overall level of State welfare services performed;

2. one or more Service Providers (e.g. social enterprises or other social organisations) that develop a social intervention, directly addressing the contracted social outcome.

   Focusing on outcomes, rather than on outputs or the cost of services alone, service providers have the incentives to innovate and collaborate on service provisioning. Longer-term SIBs contracts provide them extra investment for service delivery, as well as the stability and time necessary to gain the trust of service beneficiaries;

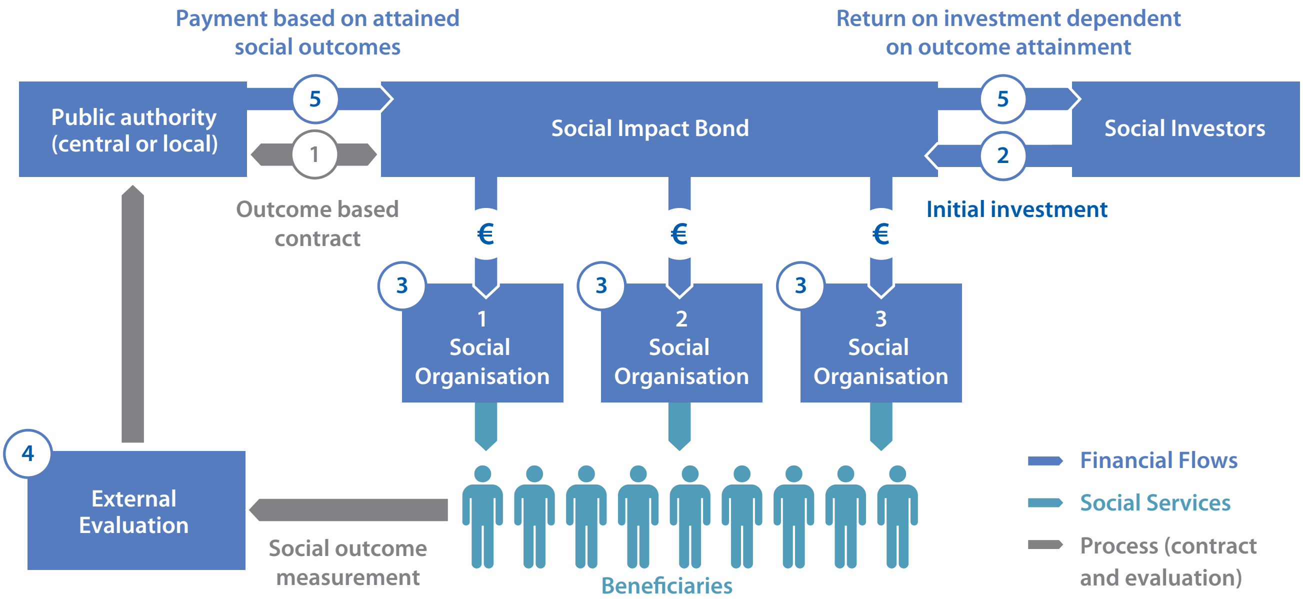
3. one or more Social Investors that are willing to make the initial investment to provide service providers the working capital for that intervention, assuming the financial risk. Social investors are later paid by the public sector organisation if (and only if) the contracted social outcomes are achieved.

   In most SIBs, social and financial returns are aligned, as greater improvements in the contracted social outcome usually imply higher returns for the social investors. As a result, it allows investors to generate blended social and financial returns on investment.

Due to its complex setting, a SIB can also involve intermediaries to aggregate investors, perform due diligences, negotiate and develop required contracts or to manage the SIB throughout its implementation.

Using innovative service provisioning to improve a *measurable* societal problem, SIBs are ultimately directed at a specific target population or cohort, that benefits from the innovative social intervention implemented by the service providers. Focused on outcomes, interventions are usually designed in a flexible innovative way, addressing individual needs rather than following prescribed processes or pre-set inputs/outputs.

Supported by rigorous social impact metrics, SIBs use the measurement of social outcomes as the trigger for payments from the public sector to initial investors. Therefore, impact measurement methodologies and metrics need to be pre-agreed by all SIB stakeholders, and are often performed by external evaluators or rely on sound official statistics and data sets (e.g. unit cost data, that also supports the application of rate card models[8]). Depending on each SIB end goal, outcome setting can focus on potential cost savings, but also on value creation and outcome improvement.



With a strong focus on prevention, SIBs are different from other outcome payment mechanisms only in the combination of outcome-based contracts with non-governmental investment to deliver social services, broadening sources of financing.

SIB benefits:

- *Outcome-focused, leading to improved effectiveness and efficiency of implemented solutions.*
- *Alignment of incentives for all involved stakeholders – blending social with financial returns, while transferring risk away from the public sector; focusing on outcomes and paying for success, allowing delivered services to improve and adapt to performance information and changes in the delivery environment, in a dynamic way.*
- *Easier identification of effective innovations in early intervention stages, facilitating coordination between stakeholders working on overlapping problems or complementary solutions.*
- *Diversifying sources of funding, attracting additional capital to fund welfare projects, and allowing the public sector to achieve more impact within existing budgets.*
- *Increased accountability, supported by more rigorous impact measurement processes, quantitative metrics and verifiable outcomes.*

8 Used in most UK SIBs, rate cards are a demand-driven alternative to more complex ex-post outcome measurement methodologies, where the Public Sector commissioner identifies outcomes of interest and sets a rate representing the max. amount it is willing to pay by end-beneficiary achieving those outcomes, turning SIBs set-up into a bidding process, closer to mainstream outcome-based contracting. An initial approach on advantages/disadvantages of rate cards can be found at: http://pfs.urban.org/pay-success/pfs-perspectives/how-uk-pays-success.

SIB challenges:

- Not all social innovation projects can be a SIB – only measurable projects with quantifiable social outcomes in a specific area of public policy, usually addressing preventive service gaps. The specific nature of each SIB project and its adjustment to individual needs of final beneficiaries might hinder its broader roll out or scaling, if mechanisms for its incorporation into the design of mainstream public policy are not in place.
- SIB contracts are perceived to be complex, with high transaction costs (metrics, baselines, legal arrangements and financial calculations). Additionally, most regulatory frameworks are still not adjusted to the set-up of SIBs or other outcome payment mechanisms. Evolving commissioning and public procurement practices together with engaging into standardisation and simplification efforts might help to promote SIBs adoption, but are still not widespread.
- Lack of existing or widely accepted data sets (namely unit cost data) in most countries to support outcome measurement processes. Also, cross-silo benefits within the public sector are very hard to capture and to attribute to complementary public policy areas (e.g. health and social protection; justice and social inclusion).
- Risks of market distortion, either by pricing risk too high or by risk dumping on SIB investors and service providers, who might in turn avoid the more innovative or riskier projects, or the trickiest societal challenges and target populations, narrowing the potential for SIBs impact.
- Political risk due to long-term contracts and funding structures, which may increase the impact of public budget cycle constraints or even hinder continuity across political cycles.

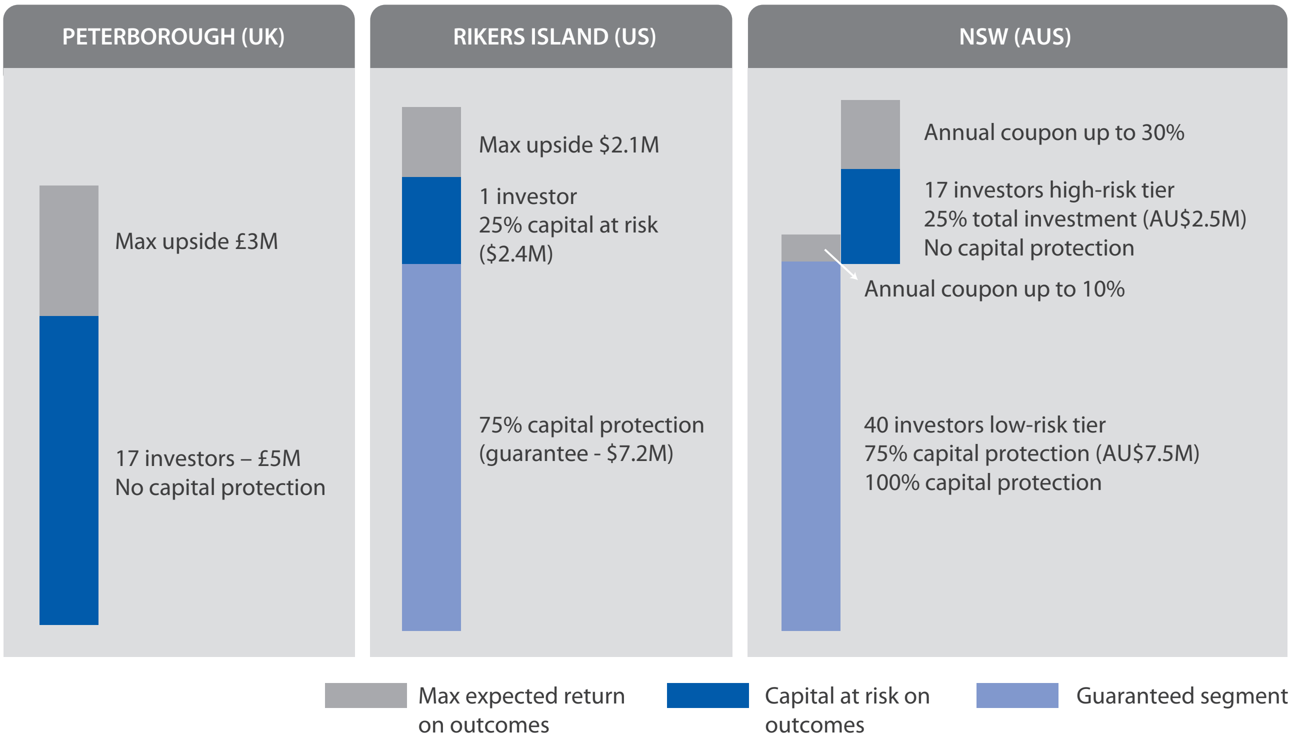
The SIBs mechanism is still in its early stages, with different approaches to SIBs set-up depending on context and regulatory environment. Following the first SIB pilot in Peterborough (UK) in 2010[9], there are currently more than 60 SIBs being implemented worldwide[10], adopting diverse variations of the SIBs model.

First, relevant SIB stakeholders might differ, as different Member States have different governance structures and different levels of accountability and decentralisation. E.g. the exact same SIB might be commissioned by a Central Government Agency in one country or by a Regional body or even a Municipality in others, depending on where lies the direct responsibility for the targeted public policy area.

Additionally, some SIBs focus on a single long-term outcome contract with one single payment, while others adopt multiple outcomes / multiple payments contracts, as a way to recycle and reinvest SIBs outcome payments into the same SIB, reducing the need for higher initial investments.

Finally, from a financial perspective, different approaches to risk and return also lead to significant variations on SIBs financing structures.

9 The UK Government released the final process evaluation report on Peterborough SIB in 2015, available at: https://www.gov.uk/government/publications/social-impact-bond-pilot-at-hmp-peterborough-final-report.
10 http://gsgii.org/wp-content/uploads/2017/06/SIBs-Early-Years_Social-Finance_2016_Final3.pdf.



Source: *Saïd Business School, Oxford University (2017, adapted)*

Financed under ESIF-ESF, the PSIMS Portugal ESF SIB Programme is just another variation to the SIBs model, resulting from the additional need to comply with the EC regulatory requirements. Some of its design decisions are structural, and have to be taken at a very early stage, ideally during the initial programming and negotiation process of ESIF-ESF with the EC. Other key decisions can be taken at a later stage, at national level only.

Design Decision #1: a Financial Instrument or a Grant?

Designing a SIB using ESIF-EFS starts with a choice between the only two financing formats that are compatible with SIBs set-up:

- a financial instrument, with ESIF-ESF being used as initial capital (*pre-financing*), leveraging or even replacing the social investors role in a SIB;
- a "delayed grant"[11], with ESIF-ESF being used to pay for the contracted social outcomes *(social outcome fund)*, replacing the public sector as the outcome payer.

This design choice defines the focus of the entire SIBs programme and has major consequences on later design decisions and implementation. It should therefore be determined by the type of core gap identified – the gap that led to the use of ESIF-ESF budget for SIBs deployment in the first place:

11 In Portugal, as in all other Member States, an "ESIF-ESF grant" can be paid against the fulfillment of certain conditions (e.g. SIBs contracted outcomes) and still be considered a grant (or subsidy). In fact, the current ESIF 2014-2020 regulatory framework further strengthens the alignment of ESIF financial support towards results. Moreover, standard costs mechanisms in the form of lump sums, currently being used by several Member States under ESIF, are already simple output (or outcome) based payments. This element makes an ESIF-ESF grant substantially different from a "no strings attached" donation. In the case of the Portugal SIBs Programme, the grant is approved and contracted in the process of SIBs set-up well before it is paid against outcome validation ("delayed grant").

- Absence of the initial capital necessary for SIBs investment, due to a limited number of existing social investors and/or to a fragmented social investment market, with limited knowledge and experience of traditional investors in this type of blended financial products;
- Absence of public sector commissioners willing to pay for outcomes, as a result of deep-rooted practices focused on standard input/output processes and/or budget constraints that don't allow for experimentation and innovation in welfare services.

However, addressing either of these two gaps might have potential negative consequences in the long-run if not counterweighted at later design stages, with ESIF-ESF increasing the risk of crowding out key SIBs stakeholders, respectively social investors or public sector commissioners, in each of the design options.

Portugal, in 2011-2014, at the peak of the sovereign debt crisis and in a moment of significant public budget cuts, had an easy choice – faced with growing demand and additional pressure on public services and systems, allocating any part of an increasingly scarce public budget to multiyear SIBs contracts, even if pertinent in the long-run, was not an option.

Portugal's decision had two immediate consequences:

- It put the public sector commissioners at the centre of the SIBs design. To assure effective buy-in and active participation (thus minimizing the above-mentioned crowding out risk), PSIMS included the public sector commissioner as a required member of each SIB consortium applying for ESIF-ESF grants[12]. As a result, public sector commissioners acted solely as an element of validation (assuring alignment with public policy goals and the relevance of proposed social outcomes), not being engaged in any financial flows.

  This high involvement of public sector in the early stages of SIBs Programme design and set-up, mediated by PSIMS, was expected, at a later stage, to contribute for the creation of the necessary mechanisms for progressively replacing ESIF-ESF as the SIB outcome payer, as well as for the integration of SIBs innovations into the relevant mainstream public policies.
- It fully aligned SIBs Programme deployment with the results-oriented philosophy of the 2014-2020 ESIF-ESF programming cycle – in theory, the ideal ESIF-ESF SIBs design. However, in practice, EU and Portugal regulatory framework for ESIF-ESF created constraints that hindered an easy and effective deployment of this solution.

  One key constraint was the fact that ESIF-ESF regulation didn´t allow any element of return on outcomes for investors, just cost reimbursement (even if 100% eligible cost reimbursement, as is the case of the SIBs Programme).

There are some potential mechanisms to minimize this "no return" bottleneck, some of them currently being explored by PSIMS:

I. Fiscal incentives for SIBs investors. A tax relief scheme was approved in the 2018 State budget law, making Portugal, together with the UK, the only Member State to allow tax breaks associated with SIBs investment;

II. Financial structures with differentiated multi-tier risk/return approaches, where some more impact-focused philanthropic investors agree to transfer a share of their outcome payments to subsidise returns for other commercial or financial investors;

12 With ESIF-ESF grants acting as outcome payments. Cf footnote 8 on the concept of grants and "delayed grants".

III. A SCO-LS methodology variation (e.g. a smaller simplified Joint Action Plan), with investors returns corresponding to a total or partial appropriation of SIB public sector's cost savings / efficiency gains[13].

It is therefore possible to use ESIF-ESF financing at either the pre-finance or the outcome payment stages of a SIB. It is even possible to use it as pre-SIBs technical assistance (TA) to complement both options, financing awareness, capacity building of relevant stakeholders or other early SIBs preparatory work, thus dropping its set-up costs. In the Portuguese case, this early TA was done directly by PSIMS teams, in the case of awareness and capacity building, and through another PSIMS ESIF-ESF financing instrument (***Capacity-Building for Social Investment***) for customised SIBs preparatory work.

TECHNICAL ASSISTANCE	• **Philanthropic donors** • **ESIF-ESF** • **Other EU Funds (EFSI, EaSI)**
PRE-FINANCING	• **Social Investors (Philanthropic, commercial, financial)** • **ESIF-ESF** *(ALTERNATIVE 1)* • **Other EU Funds** (EFSI, EaSI, namely the EIB/EIF PbR Platform)
IMPLEMENTATION	**Implementing organisations** *(e.g. social enterprises or other social organisations)*
OUTCOME PAYMENT	• **Public Sector** • **ESIF-ESF** *(ALTERNATIVE 2)* • **Other EU Funds (EFSI, EaSI)**

A key question that remains to be answered relates to the possibility of combining ESIF-ESF with other EU level instruments (namely EFSI and EaSI) for financing SIBs deployment. In a context of increasing convergence between ESIF and EFSI funds for 2030, it would be relevant for SIBs adoption to have a clear understanding on how they could effectively be combined, eliminating the risk of misinterpretations regarding double financing. For example, is it possible to combine SIB pre-financing through EIF PbR Platform or through a ESIF financial instrument providing debt or equity financing to SIBs social investors with ESIF "delayed grants" paying for the SIB outcomes?

Furthermore, although critical in the preparatory stage of any SIB, TA (and TA funding) could also support other ancillary activities throughout the SIB life cycle (e.g. ex-post impact measurement), contributing to further reduce one of the key barriers to widespread SIBs adoption: complexity and high transaction costs. It would therefore be relevant to understand how TA ESIF-ESF grants could be awarded across a SIB end-to-end cycle (could they be combined in the same way as grants and financial instruments?[14]).

13 To be discussed in more detail in section 4 of the present document.

14 CPR Article 37 (7) (8) (9) and "Guidance for Member States onCPR_37_7_8_9 Combination of support from a financial instrument with other forms of support" (EGESIF_15_0012-02,10/08/2015).

Design Decision #2: ESF or ERDF?

Another key initial decision when setting up a SIB financed under ESIF is the choice of the fund to use.

Mostly applied as a mechanism to contract and pay for relevant social outcomes, in the current 2014-2020 ESIF regulatory framework, SIBs as all other outcome-based payment mechanisms and social innovation and impact investing instruments[15] would fall directly under ESF related Thematic Objectives 8, 9, 10 and 11 (Articles 3(1) and 9(1) of Regulation (EU) 1304/2013).

However, SIBs – as other outcome payment mechanisms – are implemented across all public policies (Education, Inclusion, Justice, Social Protection, Culture, Health, Employment, Energy, Environment, Agriculture, etc.). Moreover, even when public sector outcome-based commissioning targets social challenges only, most of these challenges are becoming increasingly complex and multifactor. As a result, some might fall outside the traditional ESF scope, namely in more infrastructure-related areas such as climate change, environmental sustainability, social farming, clean energy, social housing, etc. For those types of SIB projects, eligibility of expenditure might become a critical problem, narrowing down the implementation choices and hindering impact.

Depending on the core focus of a SIBs Programme, as well as on the level of additional complexity involved stakeholders are able to accommodate, two alternatives might be considered under the current ESIF 2014-2020 regulatory framework:

- Using ESF only, thus reducing the range and scope of implemented SIBs to non-infrastructure projects and expenditure (article 13(4) of Regulation (EU) 1304/2013)[16], unless using the 10% cross-funding possibility open by article 98 (2) of the CPR;
- Using one of the integrated approaches available in the context of ESIF 2014-2020 programming period (namely Joint Action Plans), which are mostly public sector lead initiatives with complex governance and reporting structures, that in its current design are not totally adjusted to SIBs implementation and might increase even further its transaction costs[17].

More important, regardless of the type of fund used for SIBs deployment (ESF, ERDF, CF), under Article 69(3) of CPR rules on eligibility of expenditure prevent any type of risk remuneration (assumed as falling into the non-eligible "interest on debt" category).

Assessing pros and cons in the 2011-2014 context, Portugal chose to exclusively use ESF and embed the negotiation process with the EC of the PSI initiative in its main financing OP – the Social Inclusion and Employment OP (Thematic Objectives 8 and 9)[18]. At the time the negotiation took place, no cross-funding was possible due to previous Portugal ESF/ERDF allocation decisions, combined with 2014-2020 ESIF ring-fencing rules.

15 Further references on the link between EU priorities, ESIF-ESF and social investment mechanisms (including SIBs) can be found at COM(2013) 83 final - Towards Social Investment for Growth and Cohesion – including implementing the European Social Fund 2014-2020, available at http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52013DC0083&from=EN.

16 In the 2000-2006 period, the EQUAL initiative, focusing on financing cross-cutting social innovation projects, had a broader ESF eligibility regarding infrastructure investments.

17 Section 4 includes an in-depth analysis of a conceptual Joint Action Plans design variation adjusting it to the deployment of SIBs or other outcome payment mechanism under ESIF.

18 Section 2 provides additional details on the creation of the Portugal Social Innovation initiative.

One of the four financing instruments of the PSI initiative, the SIBs Programme was designed as an initial experiment, aiming to improve the capacity-building of relevant stakeholders for the deployment of innovative outcome contracting mechanisms, as well as to promote the creation of the necessary ecosystem and relationships to support the continuity of the SIBs Programme beyond 2020. However, should it continue beyond 2020 under its present design, it will not cover all key relevant intervention areas, potentially reducing pipeline, take-up and impact of the SIBs Programme.

Design Decision #3: Geographic scope

The final decision to be taken at an initial design stage concerns the geographic coverage intended for the ESF SIBs Programme.

In the early stages of a SIBs Programme, nationwide geographic eligibility is not a key concern. A particular SIB deployment is normally structured around the contracting of social outcomes benefiting well-defined target groups (or cohorts), usually circumscribed to a specific geography (e.g. reduce reoffending rates by prisoners released from Her Majesty's Prison (HMP) Peterborough after serving a sentence of less than twelve months, in the case of the first UK SIB). Moreover, in the case of ESF – ultimately financing people, by nature mobile – rules applied to geographic eligibility of expenditures are quite flexible (Article 70(4) of CPR and Article 13(2) of Regulation (EU) 1304/2013).

Therefore, in the initial set-up of a SIBs programme financed under ESIF-ESF, the main challenge regarding geographic scope relates directly to the potential mismatch between the adopted ESIF-ESF spatial governance structure and the public sector spatial organisation, relevant for public policy implementation (and, consequently, for engaging in SIBs or other types of outcome-based contracting mechanisms).

On one hand, for SIBs programmes structured under the "delayed grant" model, with ESIF-ESF acting as an Outcome Fund, SIBs outcome payments might be perceived by involved public stakeholders as a budget transfer between different levels of government, e.g.:

- when *federal* or *regional* OPs are the payers for outcomes in an area of direct central government responsibility;
- and, in reverse, when outcome payments directly associated with a specific federal or regional policy are being decided by a central government transversal OP managing authority.

Depending on local context and on the level of decentralisation of political systems in each Member State, this type of mismatch might distort incentives and hinder the adoption of outcome payment mechanisms such as SIBs, especially in a situation of austerity and/or budget constraints, with different levels of government competing for budget allocation. Ideally, the ESIF-ESF governance structure relevant for outcome payments should be aligned with the public sector governance structure relevant for the launch of that particular SIB or SIBs Programme. The design of a cross-sector SIBs Programme might not solve this mismatch if different areas of public policy have different levels of decentralisation.

The Portugal SIBs Programme is currently financed through transversal multi-regional ESIF-ESF OPs with its managing authority appointed by central government and ultimately responding to multi-sector inter-ministerial commissions. Furthermore, central government public sector entities are directly responsible for the public policies relevant for SIBs deployment (employment, social protection, health, justice, education, etc.). In this framework, the few remaining concerns are operational and result mostly from ESIF national rules and gold-plating.

On the other hand, for SIBs programmes structured under the financial instrument model, with ESIF-ESF acting as a Pre-financing Loan or Guarantee Fund, leveraging or even substituting initial investors for widespread investment in SIBs or other outcome payment mechanisms agnostic to geographic labels, the lack of transversal multi-regional geographic coverage from the EFSI-ESF financing component might result:

- in a fragmented approach, with each Regional OP setting-up its own Outcome Fund, without the necessary critical mass for demand take-up and increasing both the complexity of deal sourcing and transaction costs;
- in a complex joint-structure regarding geographic eligibility with higher transaction costs associated with multi-region reporting requirements, should all financing Regional OPs pool resources in one single vehicle.

Consequently, both models ("delayed grant" and financial instrument) would benefit from a more integrated and centralised approach to geographic coverage – ideally a single multi-region ESIF-ESF financing source, with the possibility of top-up funding coming from other interested public sector entities at a central, regional or local level (e.g. becoming the national matching-fund component of ESIF-ESF support, that might increase over time).

This would also facilitate replication and scaling at a later stage (e.g. beyond 2020), once SIBs or other outcome-based contracting mechanisms had been sufficiently tested.

Design Decision #4: Project duration

Long project durations[19] are a common element of SIBs and other outcome payment mechanisms. In any project, outcomes tend to be achieved (measured and paid) later than inputs or outputs, as consequences of project implementation. In some cases, outcome metrics are defined over an even longer period of time (e.g. six or 12 months after project conclusion), as an instrument to confirm sustainable impact before contracted payments are made.

Especially in the case of ESIF-ESF, where typically project durations tend to be shorter, the deployment of any SIB – and even more a SIBs Programme financing several SIBs over time – might require the adoption of specific rules at national level. According to existing data, SIBs duration often exceeds 5 years and implementation is, in some cases, phased in multiple cohorts over even longer periods of time.

19 In the context of ESIF-ESF, the concept of project duration relates directly to its financing cycle. In general terms, the duration of an ESIF-ESF financed project is the time between two key moments: i) the beginning of project implementation, usually after the approval of the ESIF-ESF financing; ii) and the closure of the financing process, usually associated with the end of project implementation and final payment.

This is not a critical issue for SIBs Programmes or other outcome payment mechanisms financed under an ESIF-ESF financial instrument model (Pre-financing Fund) – project duration until repayment is by definition expected to be long and investments are done upfront or at an early stage of project implementation[20].

However, for SIBs Programmes or other outcome payment mechanisms financed under an ESIF-ESF "delayed grant" model (Outcome Fund), longer than average project durations might become a challenge:

- Both SIBs and any other type of outcome payment mechanisms don't include any advance payment. Payments only occur against the validation of outcomes achieved, after project implementation. In the context of 2014-2020 ESIF-ESF rules, this increases considerably the time span between the approval of an ESIF-ESF financing for a SIB (commitment) and its payment (execution).
- The ESIF-ESF regulatory framework limits to 3 years the timeframe for the use of committed budget, in what is usually known as the "n+3 rule". As a general rule, the EC decommits *"any part of the amount in an operational programme that has not been used for payment (…) by 31 December of the third financial year following the year of budget commitment"* (Article 136(1) of CPR). As a result, to prevent budget loss, additional national ESIF-ESF rules in many Member States further limit project duration to 3 years.
- Closure of all ESIF-ESF 2014-2020 OPs must happen until the 31st of December 2023 (commitment and execution). This means that the timespan available between ESIF-ESF financing approval and project conclusion narrows over time, which puts increasing pressure on SIBs duration, limiting the scope of its outcomes, as well as the adoption of more long-term outcome measurement methodologies.

In the case of the Portugal SIBs Programme, at a regulatory level, SIBs-specific exceptions were introduced to the 2014-2020 national ESF rules, allowing longer project durations (up to 5 years) and precluding the standard 15% initial advance payment upon approval of the ESIF-ESF financing application for each SIB.

Moreover, at an operational level, although not eliminating the problem, a set of mechanisms were adopted for managing risk associated with low execution rates:

- a contained total initial budget dedicated to SIBs deployment (EUR 20 million ESF);
- the promotion of multiple outcomes – multiple payments SIBs structures;
- a proactive effort from PSIMS to assure early take-up, including:
  I. capacity-building of stakeholders;
  II. close cooperation with public sector agencies responsible for relevant public policies (Employment, Social Protection, Education, Justice, Health, etc.);
  III. pipeline creation;
  IV. standardisation and streamlining of processes, templates and requirements;
  V. TA on the development of financing applications;
  VI. close project monitoring.

20 As a general rule applied to financial instruments (articles 65 and 42 of CPR), investments in final recipients must be placed (but not repaid) until the end of the eligibility period – this means 2023 for the 2014-2020 ESIF framework. In some cases (articles 42(1)(c) and 42(3) of CPR), ESIF payments might even take place 10 years beyond 2023, by means of escrow accounts specifically set up for that purpose, for effective disbursement after the eligibility period.

Under the current 2014-2020 ESIF framework, Portugal[21] and EU rules on eligibility period create a significant constraint for an effective deployment of SIBs, affecting TA expenditure at a preparatory stage (prior to ESIF-ESF application), as well as outcome payments at a later stage, should they be made beyond 2023.

This is not a new SIBs-specific problem in the EU context. Nor is it a new challenge for ESIF frameworks. In fact, the problem has often emerged in the past, in relation to long duration operations or financing mechanisms, such as Public-Private Partnerships (PPPs), Energy Performance Contracts (EPC) or financial instruments. Solutions have been tested and internalised in current ESIF rules (e.g. Articles 42 and 64 of the CPR). In the next ESIF programming cycle, these solutions could also be expanded to apply to the specific case of SIBs and other outcome-based contracting mechanisms.

Design Decision #5: Reimbursement of real costs or SCO (lump sums)?[22]

Payment flows and processes are central aspects in the operation of a SIB or any other outcome payment mechanism. Payments are one of the most critical components of outcome contracts, as well as one of its major sources of complexity and transaction costs risks.

When payments are financed under ESIF-ESF – either upfront (financial instrument – Pre-financing Funds) or after outcomes have been achieved ("delayed grants" – Outcome Funds), those risks increase exponentially. This should be a key design concern at implementation stage, as payment arrangements/provisions have the potential to motivate or hold back SIBs deployment and contracting for outcomes.

In the current 2014-2020 ESIF programming period, following[23]:

- growing complaints of excessive bureaucracy and administrative burdens associated to ESIF processes, namely regarding ESF payments, that often disproportionately impacted smaller beneficiaries and more innovative projects;
- the deployment of several SCO pilots in previous programing cycles with positive results, but still low take-up.

The EC decided to include a comprehensive set of SCO[24] as part of the new ESIF-ESF regulation and actively promote them as relevant mechanisms to promote simplification and result-orientation, as an alternative to the mainstream ESIF-ESF payment contracting methodology: the reimbursement of costs actually incurred and paid by the beneficiary (also referred to as "real costs").

21 Portuguese ESF regulation (Article 10(1) of Portaria 60-A/2015) restricts elegibility of expenditure up to 60 days before application submission.

22 The current subsection focus on design options, constraints and its consequences, also presenting the main decisions taken by PSIMS in the implementation of the PT SIBs Programme. Based on the Portuguese practical experience applying both SIBs and SCO-LS, a detailed simulation on how this SCO methodology could be applied to the implementation of SIBs or other outcome payment mechanisms, under ESIF-ESF financing is presented in section 4, together with the identification of the necessary regulatory changes to make it possible.

23 As identified by both the European Commission and the European Court of Auditors (www.ec.europa.eu/social/BlobServlet?docId=16745&langId=en).

24 Articles 67 and 68 of CPR, Article 14(2) (3) (4) of Regulation (EU) 1304/2013 and "Guidance on Simplified Cost Options (SCOs) - flat rate financing, standard scales of unit costs, lump sums" (EGESIF_14-0017) provides additional detailed information on SCO and its application (http://ec.europa.eu/regional_policy/sources/thefunds/fin_inst/pdf/simpl_cost_en.pdf).

Real costs reimbursement mechanisms fully match current public sector commissioning methods, focused on (usually highly prescriptive) processes and based on standardised and well-established input/output metrics to support payments. However, their adoption in the context of SIBs or other outcome-based contracts (meaning contracting outcomes, but paying for inputs used to achieve them) distorts the concept of an outcome payment mechanism and its incentive system. Additionally, in both financial instrument and "delayed grant" SIBs ESIF-ESF financing options, it would represent an extra burden on beneficiaries, that not only would have to achieve and demonstrate outcomes to trigger payment, but also would need to provide detailed account of all expenses incurred to be validated and reimbursed by managing authorities (with the value of that reimbursement oddly being the value to be received for achieving the contracted outcome). Again in both options, ESIF-ESF control and audit activities would focus on process and financial compliance, and not on achieved outcomes.

This makes SIBs and other outcome payment mechanisms a preferred field for the application of a specifically well-suited SCO: lump sums. SCO-LS (also referred to as "all-or-nothing lump sums") are a methodology where, supported on a detailed application and following approval, managing authorities and beneficiaries contract a fixed amount to be paid against the validation of a specific output. The exact same mechanism could also easily be applied to contract and pay for outcomes. In fact, all-or-nothing lump sums for each proposed outcome is currently the only methodology that fully aligns ESIF-ESF financial flows with outcome payment mechanisms.

However, lump sums are restricted to amounts up to EUR 100 000 of public contribution (Article 67 (1) (c) of CPR; Article 14(3) of Regulation UE 1304/2013), well below most SIBs outcome values.

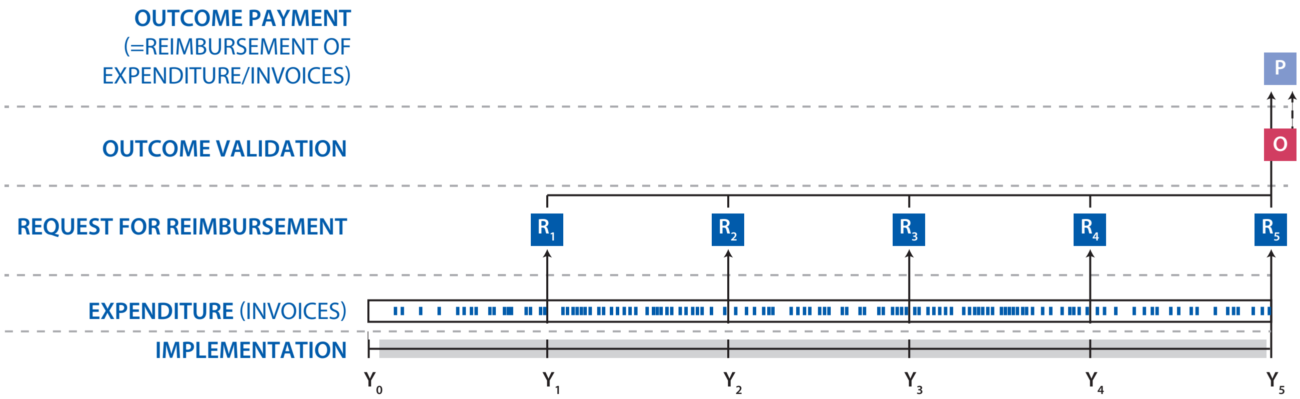
On the other hand, the use of "unit costs" (another alternative SCO methodology where ESIF-ESF OP managing authorities pay unitary costs to beneficiaries, supported by a pre-defined unit cost table), although similar to a SIBs rate card model, was not considered a feasible option in the Portuguese case, as:

- it would require a comprehensive *ex-ante* mapping of all relevant public policies costs *per capita*[25], which is a lengthy and complex process for MS with no prior consolidated SIBs or outcome contracting experience and no unit cost database already in place[26];
- it would reduce transaction costs for projects targeting public policies included on the unit cost table, but not for those targeting other public policies, an unwanted distortion in a very early stage of SIBs deployment;
- it was not viable during the 2011-2014, at the peak of the austerity period, to begin the discussion it entails on the actual cost of public service provisioning, without a solid previous base of evidence.

25 *Per capita* standing, in this case, for each end-beneficiary of a particular public policy.

26 Developing a global unit cost table to be used, under ESIF, for SIBs or other type of outcome-based contracting requires different areas within the public sector to engage in a discussion on the actual cost of public service provisioning. Considering the long time the approval of a SCO unit cost table takes, it is advisable to do it as a joint effort rather than to fragment it per public policy.

So, as a result of 2014-2020 ESIF regulatory constraints on the use of SCO-LS methodology, PSIMS had no option but to adopt real cost reimbursement as its ESIF-ESF payment contracting methodology in the implementation of the SIBs Programme. As expected, PSIMS is currently experiencing all the difficulties described above, while trying to minimise its impact on beneficiaries by issuing detailed guidelines and providing templates, as well as significantly increasing TA to projects in end-to-end ESIF-ESF paying processes[27].



Simultaneously, PSIMS is already testing a SCO-LS model as payment mechanism for another of its programmes financed under ESIF-ESF: Capacity-building for Social Impact, a max. EUR 50 000 grant for which lump sum adoption is a mandatory EU and Portugal regulatory requirement (Article 14(4) of Regulation 1304/2013, combined with Portugal Article 4(1) of Portaria 60-A/2015). In spite of the good-will and commitment from all parties involved, its introduction took more than two years to negotiate with both the EC and Portugal Certifying and Auditing Authorities, raising concerns on SCO time-to-market[28]. However, after this long preparatory stage, it is now well-established, being already perceived as a relevant mechanism for paying for outcomes in the context of ESIF-ESF, and – above all – for the deployment of SIBs or other outcome payment mechanisms under ESIF-ESF financing.

Design Decision #6: Impact measurement

Together with payment procedures, social impact measurement methodologies are the other pre-agreed element critical for the set-up of SIBs or other outcome payment mechanisms, providing the evidence base necessary for validating social outcomes achieved, triggering the correspondent contracted payments.

At the moment of contracting a SIB or any other outcome payment mechanism, the definition of what to measure, when to measure, who should measure and how to measure are key variables to address in the design of impact measurement provisions. Also critical is the identification of the consequences of the impact measurement process[29], as well as of the mechanisms for their enforcement. With investment reimbursement and return at risk, at the initial contracting stage, impact measurement is mostly a negotiation process between stakeholders on relevant metrics, targets and validation methodologies, supported by a comprehensive theoretical and empirical framework, but mostly by existing data. Details must be clear and pre-agreed among all contracting parties, remaining stable until the end of the contract.

27 Most PSIMS' ESIF-ESF financing instruments beneficiaries are first time ESIF users, with no previous experience on any technical aspect of this type of funds. In the particular case of SIBs, with three projects approved (and a max. of 40 projects expected by 2023), it was feasible to implement dedicated TA for each project.

28 It was however the first ESF SCO-LS to be implemented in Portugal and one of the first in the EU, applied to an innovative financing instrument with limited previous track-record.

29 Generally linked to payment (or non-payment) events.

Social impact measurement can be done:

- By a credible external independent evaluator (e.g. an University) agreed by contracting parties.

  When SIBs or other outcome payment mechanisms are financed under ESIF-ESF, TA can work as a neutral equidistant payer, minimizing the risks of capture of external evaluators, especially as these tend to rely on long processes and expensive methodologies (e.g. cross-section or time series estimates, or difference in difference "DID" methods, supported by panel data or control groups in randomised control trials) to assure robust and less disputable outcome validations, while avoiding errors in impact attribution when measuring achieved outcomes in complex cause-effect scenarios.

- Directly by accessing specific public data sets (e.g. by running queries to official statistics), when relevant outcome metrics are already available with the required level of detail (or can be easily developed based on existing data), both for outcome contracting and later data collection.

  In fact, public sector entities in all Member States already possess very detailed and up to date data sets related to the exact same public systems and policies that tend to be targeted by SIBs or other outcome contracting mechanisms (e.g. health, education, social security, etc.).

  Complementarily, at an international level, there are also comprehensive cross-border data sets (e.g. OECD, EUROSTAT) that, in more straightforward cases, could be used to improve comparability and standardisation of impact measurement metrics, broadening the potential for scale and replication of projects.

  Also when using ESIF-ESF financing for the deployment of SIBs programmes or other outcome payment mechanisms, its lists of indicators and metrics[30] could be considered, whenever possible, as inputs for contracting outcome payments. This would mean using the same indicators and metrics for triggering a SIB outcome payment and for ESIF-ESF reporting to OP managing authorities. However, in spite of a substantial evolution of ESIF-ESF indicators and evaluation systems towards result-orientation, combined with an effort from the EC and Member States to improve data collection, most ESF metrics are still input/output related, far from being able to fully support social impact measurement activities for SIBs or other types of outcome payment contracting, and to deliver reliable evidence on outcomes for payment purposes.

  In all previous scenarios, using pre-existing databases at a national and/or international level makes the deployment of SIBs and other outcome payment mechanisms faster and cheaper, but requires the pre-existence of more sophisticated/mature system in place for data collection and analysis. Moreover, when using large comprehensive public databases, issues associated with data access permissions, security, privacy and personal data protection become increasingly critical, holding back data sharing and use.

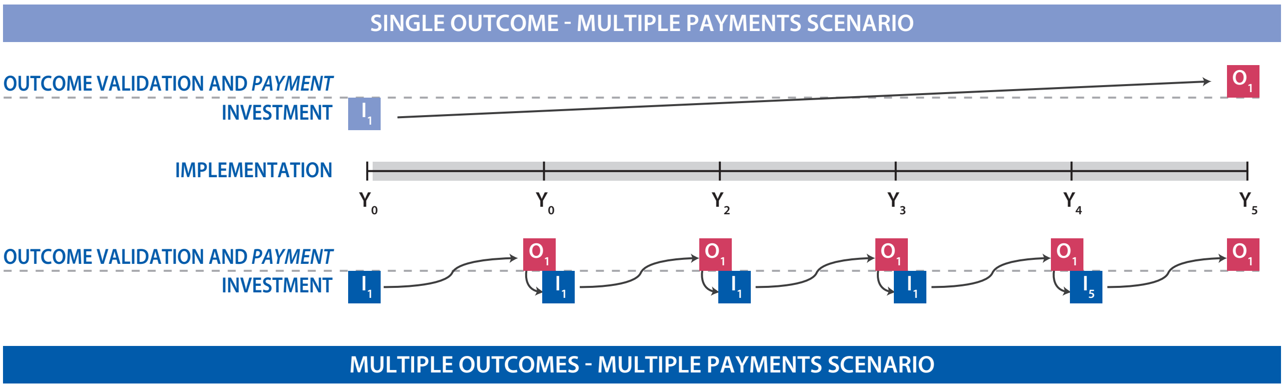
30 Namely in the case of ESF, where a detailed list of alternative indicators and related guidelines on methodologies and data collection are available (https://www.portugal2020.pt/Portal2020/Media/Default/Docs/AVALIACAO/4-ESF_ME_Guidance_Jun2015.pdf).

Based on previous SIBs deployment or practice supporting other types of public sector commissioning for outcomes, some mature markets with additional data and experience on setting metrics and targets for outcome contracting, as the UK, are already aggregating validated unit cost data and starting to use *rate cards*[31] to price and bid directly for social outcomes, speeding up standardisation and initial contracting processes. In time, this could represent a major shift in the model for financing large public systems such as social security or health (e.g. paying for the improvement of patients' wellbeing rather than *per* medical act performed on those patients), slowly transforming SIBs and other types of outcome payment mechanisms in the new standard for public sector commissioning. Therefore, strong involvement and buy-in from the public sector since initial design, testing and set-up stages are key for future take-up and success.

Relying on pre-existent national or international public databases reduces time and transaction costs, facilitating the introduction of multiple outcomes and multiple payments in a SIB or other outcome payment contract. There are numerous options for defining multiple outcomes, which can be parallel (e.g. cohorts) or sequential (e.g. consecutive improvements) or a mix of both, depending on context, type and area of intervention, etc.

Contracting multiple outcomes (which, if all goes well, represent a larger number of smaller "all-or-nothing payments") seem to be an interesting option to reduce risk for both initial investors and public sector commissioners:

- for public sector entities, it means being able to achieve and communicate quick-wins over time;
- for initial investors, it means avoiding to fully commit the total investment upfront and be able to recycle the first payments for outcomes received into the next contracted investments in the project.



However, when financed under ESIF-ESF, this conclusion changes depending on the chosen model:

- in a "delayed grant" model (Outcome Fund), where ESIF-ESF replaces the public sector commissioner in paying for the achieved outcomes, it has an additional positive aspect, speeding up ESIF-ESF execution rates[32]. However, it might become a perverse incentive to over-fragment a project;

31 Cf footnote 6, for a definition of rate cards.
32 This acceleration of execution rates helps to mitigate the issues raised around decommittment and OP closure dates, as referred in the previous sub-section "Design Decision #4 – project duration".

- in a financial instrument model (Pre-financing Fund), where ESIF-ESF leverages or even replaces the initial investors in their upfront investment, contracting multiple outcomes has a negative slowdown effect on ESIF-ESF execution rates. In fact, the more capital is invested initially, the more capital is passed on to social organisations responsible for project implementation, and as a result, under ESIF-ESF current rules, the more is executed. This might lead to over-consolidating a project, reducing incentives for investors or Pre-financing Fund managers to establish any pre-condition on their initial investments on the social organisations implementing the solution.

In the context of the Portugal SIBs Programme, all SIBs approved so far have defined multiple outcomes – multiple payments.

From design decisions to implementation requirements

A mix of choice and constraints, the previous six key design decisions (DD) taken by Portugal when setting up its SIBs Programme using ESF financing, produced a set of initial requirements that structured its implementation and defined the "rules of the game" for beneficiaries:

DD1:

- Using "delayed grants" to pay for the contracted social outcomes, replacing the public sector as the outcome payer, as a direct result of the Portuguese 2011-2014 sovereign debt crisis and public sector budget cuts (**DD1.1**);
- Involving the relevant public sector agencies (the "would-be commissioners") in the contracting process for the deployment of each SIB, to ensure commitment and co-creation (**DD1.2**);
- Using fiscal incentives to attract private investors to the SIBs Programme[33] (**DD1.3**).

DD2:

- Using ESIF-ESF only to finance the SIBs Programme (**DD2.1**);
- No risk remuneration for SIBs investors, as non-eligible under ESIF rules (**DD2.2**).

DD3:

- SIBs Programme financed primarily through transversal multi-regional ESIF-ESF OPs, as a means of aligning governance levels of SIBs-related relevant public policies with those of SIBs Programme ESIF-ESF funding (**DD3.1**).

DD4:

- Defining longer project durations, up to five years (**DD4.1**);
- Eliminating all initial advance payments, ensuring that SIBs payments only occur against the validation of achieved outcomes (**DD4.2**);
- Focusing on standardising and streamlining processes, templates and requirements for both the application and the implementation stages (**DD4.3**).

33 This measure, although identified at an early stage of the PT SIBs Programme design, was first implemented (as part of the 2018 State Budget Law) after the first round of SIBs calls for applications.

DD5:

- Reimbursing to the investors of each SIB the costs actually incurred and paid by the organisations (Service Providers) implementing that particular SIB ("real costs" reimbursement against invoices), as a result of ESIF-ESF regulatory constraints **(DD5.1)**.

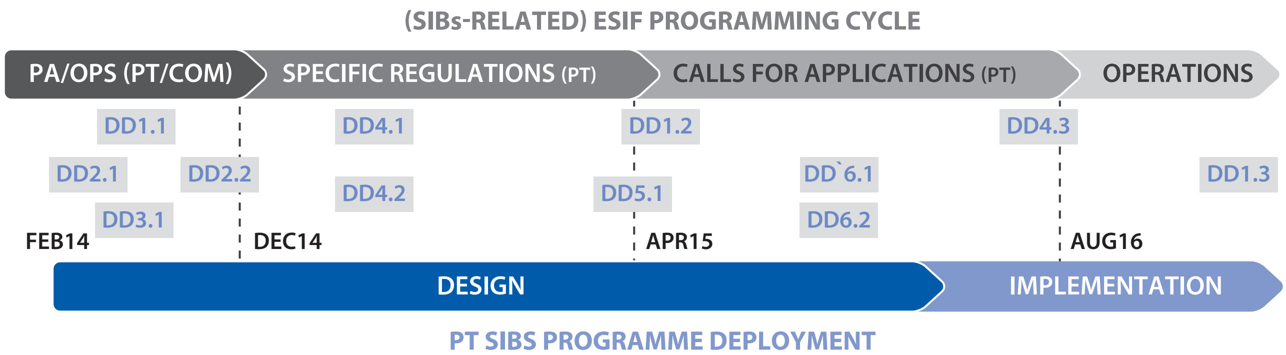
DD6:

- If possible, using pre-existing public databases for measuring impact and validating outcomes, involving relevant public sector agencies in the set-up of metrics and targets, as well as in providing access to key data sets for outcome validation **(DD6.1)**;
- Allowing "multiple outcomes – multiple payments" SIBs structures, reducing risk for investors and improving ESIF-ESF execution rates **(DD6.2)**.

The main stages of the design process

Planning and implementing in the right timeframe is a critical aspect for the set-up of any SIBs Programme, but especially for those using ESIF-ESF financing. Not taken in the right timing, key "SIBs-relevant" ESIF-ESF decisions may hinder the full process of SIBs deployment under ESIF-ESF[34].

The following table presents the main stages of the SIBs Programme design process, identifying – against SIBs-related ESI-ESF timings – the moments when key design decisions were taken.



The resulting SIBs Programme implementation features, processes and roadmaps are presented in detail in the next section from the perspective of the beneficiaries of the SIBs ESIF-ESF support.

34 "When to decide…. (what)?" and "What needs to be in place (when)…?" are the two key questions to answer when developing a SIBs Programme roadmap. They are especially critical when financing it under ESIF-ESF, as they also need to adjust to ESIF timings.

3.2. Implementation Stage

The Portuguese ESF SIBs Programme

The ESIF-ESF based Portuguese SIBs Programme is a financing instrument aiming at supporting innovative solutions in public service provision, with an outcomes oriented approach and a purposeful contribution for cost reduction.

This financing instrument consists of a mechanism of PbR, involving an encompassing partnership (including one or more social investors, one or more public entities with the public competence in the thematic field of the social innovation or social entrepreneurship project and one or more implementing entities of the project). The purpose of this PbR scheme is to obtain concrete social outcomes in a specific field of public policy, such as Employment, Social Protection, Education, Justice or Health.

The two major objectives behind it are:

- To promote higher experimentation and diversification in public services provision, through the validation of new interventions/services or the scaling of existing interventions/services in public policy areas;
- To deepen the knowledge on the costs of social problems and to promote a culture of outcomes based public services provision, thus contributing to the regular improvement of public services performance.

According to the specific regulation of the social inclusion and employment domains[35] of the Portugal2020[36], eligible interventions to financing include new products, service provision, processes or other types of interventions[37], which build on existing good practice when relevant and act in the public policy sphere. The social innovation or social entrepreneurship projects are to be developed under the following terms:

- By organisations of the social economy or other private entities committed to outcomes based services, and with potential high impact in addressing social problems in the social public policy sphere;
- Allow for measurable gains, where the merit is validated by public bodies, which facilitate the implementation of the intervention;
- Supported by social investors, which finance the implementation of the intervention and bear the risk of non-reimbursement of the initial financing in case the intervention fails to deliver the contracted outcomes.

Eligible projects must be fully carried out in one or more eligible regions of Portugal (Norte, Centro, Alentejo and Algarve). As seen in previous sections, the PSI initiative has been implemented at an initial stage in these three regions, imposing a strong restriction on potential demand for these financing instruments. However, the negotiation and the design of the financing instruments, including the SIB's Programme, has anticipated its enlargement to other regions of the continental territory, such as the Algarve and the Lisbon area, allowing for a full coverage of mainland Portugal.

35 DL 97-A/2015.
36 Partnership agreement between the Portuguese Government and the EC for the programming period 2014-2020.
37 To be submitted with the application in the *SIB's intervention model*.

Budget and co-financing

The budget earmarked for the SIBs financing instrument under the present programming period is EUR 20 million.

The SIBs *delayed grant* covers up to 100% of the total eligible costs of the project (85% ESFI-ESF + 15% Portugal State Budget). The consortium must guarantee the upfront financing of the estimated costs covered by their own resources.

The minimum demand for public financing per project is EUR 50 000, with no maximum threshold.

Main rules for application

The Portuguese SIBs model aims at contracting outcomes resulting from specific interventions, whilst contributing to higher innovation and efficiency in the provision of services in fields that traditionally lie in the public acting sphere, through a mechanism of payments by results.

Outcomes metrics

The contracted outcomes and respective targets are aligned with priority themes of public policy, under the thematic domains referred to in the previous subsections, according to the following reasoning:

Given the scarce national experience in contracting outcomes, the first calls do not indicate specific policy targets to be achieved in each thematic domain. Rather, the option is to identify the relevant thematic domains, the priority policy objectives/social problems and examples of outcome metrics for each policy objective identified.

Further, the calls do not close applications to the identified policy objectives. A valid application is an application, which presents a relevant intervention for a given social problem in any of those thematic domains. This is a flexibility element of the process in order to allow each stakeholder to mature its role in the setting up of a SIB once a call is launched.

For each contracted outcome, the application must indicate:

- The indicator for measuring the outcome;
- A quantified target;
- The deadline to meet the target, under the total duration of the project;
- The sources of evidence, which will allow for the validation of the targets in the agreed deadline, and for the respective payment decision.

For multiple outcomes, the information on the deadline must be detailed per outcome, indicating both the starting date, which will coincide with the activities developed to attain the specific outcome, the finishing date of those activities, and the final date to be considered as the date in which the target is met. This final date corresponds to the reference date for validation of the evidence of attainment of each outcome contracted[38].

Because of the additional layer of complexity, resulting from the validation of the contracting outcome, the maximum duration of the entire project is five years. This extension of the standard duration of ESIF-ESF projects (one to three years) is a key element of the design of the financing instrument, as shown in previous sections.

Monitoring and validation

Beneficiaries are responsible for transmitting all quantitative monitoring data (evidence) on each expected outcomes, according to the approved calendar of contracted outcomes. Therefore, they must foresee the necessary funding for monitoring and reporting.

At the submission of the application, the Consortium must also identify the main sources of information for outcome validation. Whenever administrative data is available, it should be used as the main source of evidence for the validation of outcomes.

The coordinator of the consortium (lead applicant), as the representative of the consortium, is responsible for the collection and consolidation of the elements of evidence for the validation of each contracted outcome, as well as for its submission to the managing authority/Intermediate Body.

Under the Portuguese SIB's Programme, PSIMS acts as the Intermediate Body for the managing authority. Therefore, it is responsible for the analysis of the evidence presented and for the validation of the contracted outcomes.

Main rules for project execution

Cash advance

In Portugal, most ESIF-ESF projects run in real costs are entitled to a 15% cash advance of the total approved budget for the project. However, since outcomes payments only occur upon the validation of contracted outcomes, the specific regulation came to introduce an exception clause to make the SIB Programme design fit standard ESIF-ESF regulation. Therefore, under this financing instrument there is no upfront payment of the standard 15% of total financing needs of the project.

Requests for payments (financing and balance)

Payments are made according to the initially contracted calendar for outcomes delivery[39]. The assessment of requests for payments requires the examination of the eligibility of the expenditures submitted, the reasonability of the expenditures presented, and the evidence reported for outcome validation, as contracted in the Grant Agreement.

38 This information is presented with the application in the *SIB's outcome measurement model* template.
39 Article 243, Portaria N.º 97-A/2015.

Requests must include:

- the corresponding list of expenditures, reporting to the period of implementation of the intervention;
- the evidence of attainment (quantitative monitoring data) of the respective outcome.

For projects with multiple outcomes, the beneficiaries must submit a request for payment for each outcome attained.

Payments and outcomes

The reimbursement of incurred expenditures in the context of a given outcome, will only take place upon the achievement/validation of the contracted outcome.

The validation of an outcome is subject to the attainment of 100% of the contracted target, and respective calendar, of the Grant Agreement. Otherwise, all expenditure incurred will be at the consortium risk and non-eligible for financing.

Any expenditure incurred up to 60 days before the signature of the Grant Agreement is eligible for financing, if it succeeds to comply with the above validation terms.

Stakeholders, roles and interactions

Social Innovation has been the central driving force for the launching of the PSIM initiative. At the time, the initiative was the public response to a wide national motivation to support innovation in the social area thus contributing to create the enabling environment to produce systemic change across sectors.

Taking a framework supported in an ecosystem approach and the notion of a social investment market, PSIM initiative was able to anchor its work in a more detailed understanding of the interactions and resources between different actors involved in social innovation, and to direct its role to support the changes that help to build this field further.

To do this there has been a strong effort to strengthen the infrastructure to social innovation across the four financing instruments, covering the domains of capacity building of implementing entities, philanthropic and investment practices of private actors, public sector practices and cross-sector dialogue.

This framework was based on the identification of four major categories of players:

a. social investors;
b. public sector bodies;
c. implementing entities;
d. intermediaries.

Social Investors

Social investors[40] comprise entities from the private sector, the public sector and the social economy, both with commercial or philanthropic objectives that contribute with financial resources to the development of an impact generating social innovation project. These *funders* are interested in integrating social innovation within their grant making or investment approaches. They can also be seen from the perspective of the *asset owners*. In this case, social investors are organisations that own or manage capital that can be used in impact investing.

Public Sector bodies/entities

Public Sector bodies[41] include government departments and public agencies with a remit in relation to a key area of public policy (i.e., an area of social need) covered by the intervention of the project that have an interest in testing an innovative intervention model.

Implementing entities

Implementing entities[42] are key practitioners from the social economy or the private sector. They are either working within specific sub-sectors more open to social innovation practices (traditional social economy entities) or already active in social innovation (social entrepreneurs).

Intermediaries

Intermediaries are organisations that help implementing entities with support and guidance in order to make them more ready to develop impacting social innovation projects, and to make them grow. They can also act as facilitators of capital between entities looking for funding and social investors. Finally, they can be key organisations with expertise in social innovation and resources that might generate greater social benefit or who have an interest in innovation and a key area of social policy (including academia).

The Consortium

Eligible beneficiaries to the SIBs Programme are legal entities established and registered in Portugal, including public, for profit and non-profit private entities.

The applications must be submitted by a consortium[43] of at least three applicants – a social investor, a public sector body, and an implementing entity[44], resulting in a group of several applicants to be engaged in the signing of a "multi-beneficiary agreement".

Consortium applications consist in the concerted involvement of several entities in the implementation of a given project. They perceive one another as partners to pursue this common objective, taking advantage of generated synergies in the development of the project's actions.

40 Article 2, Portaria N.º 97-A/2015.
41 Article 239, Portaria N.º 97-A/2015.
42 Article 240, Portaria N.º 97-A/2015.
43 N.º (s) 1 and 2 of article 242.º, Portaria N.º 97-A.
44 Portaria N.º 97-A, article 240º.

For the purpose of the application, the consortium is responsible for the designation of one of the applicant entities as the lead-applicant, the "coordinator". All other applicants are co-applicants. For simplification and decreased transaction costs, the role of coordinator is assigned to one of the social investors or to an investment sub-consortium specifically created for the project. The coordinator is responsible for managing the contractual relation with the managing authority/Intermediate Body[45], and for intermediating the relations between co-beneficiaries.

The contractual relations between the different entities of the Consortium are autonomous and of the sole responsibility of the Consortium itself. All applicants agree in writing upon appropriate internal arrangements, consistent with the provisions of the grant agreement, for the implementation of the interventions[46].

Financial flows, information flows, interplay between one another

Under the SIB model, social investors guarantee the financing and contribute to the success of the intervention. They are willing to advance the initial investment necessary to the implementation of the intervention. They are also committed to bear the risk associated to the failure in achieving contracted outcomes.

Social investors or consortia specifically created by multiple social investors, cannot be simultaneously implementing entities of the project, nor can there exist a control relation from these on the entities responsible for the implementation of the intervention.

Because a SIB aims at involving social economy entities and other private actors in the public policy sphere, public sector bodies cannot be social investors nor implementing entities.

One of PSIMS' motivation behind the development of a SIB model is to stimulate PbR schemes, in opposition to a payment by services model. Since ESIF-ESF is replacing the outcome payer with the expectation that the learning process will allow public policy bodies to adhere to PbR schemes on their own in the future, under this SIB model public sector bodies take part in the consortium, but they are not involved in any sort of financial flows from or to the project.

In this SIB model, public sector bodies are committed to facilitate the implementation of the intervention and to attest the alignment of the intervention with their policy priorities. Their role is also crucial in the process of setting the proposed outcomes and identifying the relevant sources of information for the validation of the targets set.

The SIB model predicts that implementing entities have the means to implement upfront the innovative intervention generating social impact and the guarantee of financing from social investors to cover the costs related to the implementation of the intervention.

45 Portaria N.º 97-A, article 242.º.

46 The written agreement is submitted together with the electronic application form as the upload document *Memorandum of Understanding of the SIB consortium (template provided)*.

Further, another central aspect of the PSIMS' SIB model is the understanding that all activities related to management control and to the monitoring of outcomes are part of the intervention, and should integrate the cost of outcomes. For this reason, intermediaries as PSIMS perceives them are also implementing entities in a SIB.

Mapping of end-to-end process flow

Application

The procedure to submit proposals starts by accessing *Balcão2020*[47], the electronic platform for applicants to introduce, edit, validate and submit applications, and for beneficiaries to request for payments and modifications of the initial project.

Prior to the submission of the application, all applicants must register and authenticate in *Balcão2020*. The authentication creates a reserved area for each beneficiary, whilst providing access to a variety of functions. This is entirely independent from the nature of the operations and the region or the OP the applicants are applying to. Beneficiaries are understood as all entities involved in the contracting with the managing authority of SIB projects.

This reserved area includes a series of capitalising data of the beneficiaries, supporting applications presented to Portugal 2020.

Applications must be submitted using the electronic submission system available in *Balcão do Portugal 2020*.

The application form is composed of several elements. It follows the following structure:

- Identification > coordinating entity;
- Identification > human resources;
- Project > characterisation;
- Project > partner entities;
- Project > thematic priorities;
- Project > monitoring;
- Activities > list of activities (corresponding to the outcomes in the case of the SIBs);
- Activities > chronogram;
- Costs;
- Outcomes to be contracted;
- Synthesis;
- Uploading documents.

Following the completion of all the different elements of the application form, the coordinating entity should guarantee that all elements are valid and that all faults are corrected, in order to be able to submit the application. Before submitting, it should accept the terms and conditions presented and guarantee that all co-applicants have validated the information in the form. The application will only be valid when all applicants follow this procedure.

47 https://balcao.portugal2020.pt/Balcao2020.idp/RequestLoginAndPassword.aspx.

Selection process

Applications to each call are evaluated as follows:

1. PSIMS' financing team starts by evaluating all applications according to the eligibility criteria presented in the call. Applicants assume this type of criteria on a declarative basis. It includes for instance the validation of the legal existence of each organisation or the commitment that they possess all the technical, physical and financial means and the human resources necessary to development of the intervention.

2. The application is subject to an evaluation of merit based on the matrix of analysis supported on the selection criteria approved by the monitoring committee of the OP. This matrix of analysis includes the following aspects:

MATRIX OF ANALYSIS	
1	Alignment with the public policy priorities
2	Reasoning for the efficacy and efficiency of the intervention
3	Credibility and commitment of the consortium partners
4	Feasibility of the intervention model and consistency of the model to validate the proposed outcomes
5	Relevance of the social outcomes and the social gain to the costs of the intervention
6	Contribution to the objectives of the policy of equal opportunities and gender equality
7	Degree of validation of contracted outcomes in other projects under his responsibility

   Each criteria is evaluated qualitatively with four different levels: inexistent, low, medium and high, to which is attributed a quantitative value to obtain the final classification of merit of the application.

3. Additionally, there is also an evaluation of the relative merit of applications. It consists of the comparison of the merit obtained by the application with the merit of all other applications in the same stage of the decision process. The applications are ordered and evaluated for financing taking into account the amount of funding available for the call.

4. The managing authority notifies the applicants of the decision in 60 days counting from the closing date of the call.

5. In the case of a successful application, the multi-beneficiary agreement must be submitted either electronically or by postal mail in no more than 10 working days.

Information requirements

Similarly, to simplified costs procedures, an application to a SIB represents a high burden of upfront paper load. It includes the application form, but also five other demanding documents. The nature of each is relatively diverse as some represent a legal safety for all actors involved in the project, while others require and in-depth description of the project and several of its components.

The application comprises the application electronic form and five other required documents:

1. The Memorandum of Understanding (MoU) of the SIB Consortium;
2. The Declaration of the relevant public sector body;
3. The SIB's intervention model;
4. The SIB's outcome measurement model;
5. The SIB's budget and financing model.

These documents must be uploaded together with the application, following the templates made available[48].

The Memorandum of Understanding (MoU) of the SIB Consortium

The document includes all relevant information on coordination and the definition of roles of the different entities involved in the SIB Consortium. It quantifies the amount of investment per social investor, the commitment with all outcomes agreed upon by all parts involved and the maximum amount of expenditure to be reimbursed in case the outcomes are validated. It also identifies the coordinator of the consortium and is signed by all parts of the Consortium.

The Declaration of the relevant public sector body

This document consists of a Declaration from the public body responsible for the public policy area in which the project impacts, validating the relevance of the project and the acknowledgement of its value added. It confirms that the outcomes set out by the project are aligned with the priorities of that public policy field, thus justifying the financing of its implementation.

The SIB's intervention model

The document serves the purpose of presenting a detailed description of the social problem addressed by the intervention, including the explanation of the vulnerability of the intervention end-beneficiaries and their respective characterising features. The vulnerability condition of final recipients must relate to specific social problems, under the thematic domains of public social intervention - health, social protection, education, justice and employment. It summarises the expected impact of the SIB on those recipients and describes in detail the intervention model to be applied to achieve that expected impact.

The SIB's outcome measurement model

This document sets out all the outcomes to be contracted under the SIB in a structured way, as well as the several characterising elements of each outcome, including the target, its calculation method and the source of evidence to be used for its validation.

The SIB's budget and financing model

The document includes the financial quantification (cost) of each outcome, with detailed information on the various categories of expenditure included in the total cost of the outcome. The budgetary proposal must be presented per outcome. The total amount of the SIB corresponds to the sum of all the outcome's costs detailed.

48 http://inovacaosocial.portugal2020.pt/index.php/programas-definanciamento/titulos-de-impacto-social/.

Support to final beneficiaries

Despite the unquestionable role of the ESF in Portugal in the last decades, knowledge on how to access it was still underdeveloped for most of the entities of the ecosystem the PSI initiative was addressing. Further, even in the few cases where there was previous ex!!perience with ESF, the innovative features of these new financing instruments, SIBs in particular, required an additional effort to make technical support available to potential applicants.

Apart from the information available through the application platform, there is also information available in the portal of the Portugal 2020[49] and the PSIM website[50] applicants can access:

a. Other pieces of relevant information, namely the legal framework;
b. Technical support and support to the clarification of less clear issues, especially during the periods under which the call is running;
c. Other focal points in order to obtain additional information.

Since the launch of PSI initiative in December 2014, there have been several actions aiming at promoting knowledge and support to the development of a SIB and of a valid application to the financing instrument:

- A **call for Expression of Interest** to identify social innovation projects interested in getting to know more about concepts and design of a standard SIB, while collecting a first impression of the size of potential demand. The call was open for two months. There were 180 applications, of which 40 presented elements to explore a potential fit into a SIB;
- Based on the most vulnerable aspects (on average) of the applications, PSIMS designed and offered three 1.5 day **technical sessions**, to improve the capacity to draft the intervention model and its theory of change, to define project outcomes and measurement methods, and to set up an estimated budget and the pricing of each outcome;
- These three technical sessions took place in the three less developed regions (Norte, Centro and Alentejo), following a regional rather than a national approach. The goal was to guarantee the **proximity to regional and local implementation entities**, potential applicants to the financing instrument;
- This proximity approach is continuously reinforced by **PSIMS' ecosystem activation team**, a dedicated team with members in each of the regions and with whom potential applicants have the opportunity to interact, ask for support, and access to networks and communities (intra-regional and national);
- In parallel, **technical support to projects** has been available on a regular basis supported by the PSIMS' financing team. This team is responsible for all activities related to application processes and provided direct written answers to specific questions on application procedures to all information requests received at PSIMS;
- Following the first call in Autumn 2016, PSIMS launched a **Consultation Process (by means of an on-line survey)** to ask the full network of entities who made contact with the team, through any of the previous channels, for contributions to improve and simplify application procedures in future calls. Feedback was significantly participated with approximately 40% replies, covering all types of stakeholders involved. The survey inquired on six major topics: (i) readiness to get involved in a SIB, (ii) readiness to submit an application under the ESIF-ESF, (iii) the relevance of the PSIM's technical support, (iv) the quality of the support materials made available, (v) the difficulty in setting up a consortium, and (vi) the efficacy of

49 https://www.portugal2020.pt.
50 https://www.inovacaosocial.portugal2020.pt.

PSIM's dissemination and community building efforts. The identification of more complex procedures and the collection of suggestions were crucial tools to inform subsequent calls, and respective rules;

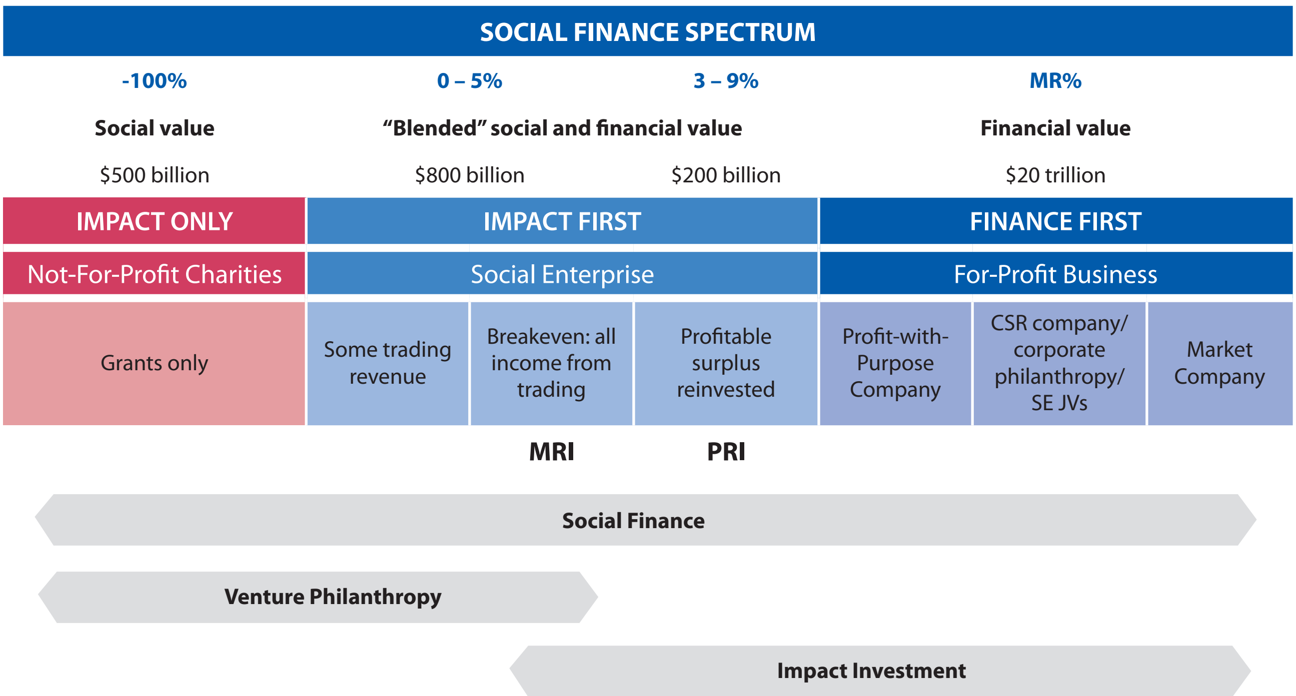
- Finally, as some of the feedback highlighted the need for more regular interaction and support of each single project, PSIMS' decided to shift its support to a **1:1 Approach** at a later stage. It allowed the reinforcement of the support to specific elements where projects identified more difficulties and activating networks of actors interested in taking part in consortiums. This proved to be a more successful tool to uphold interest along the whole process of setting up a project, and thus a more effective way of building more mature pipeline.

4. SIMULATION: PBR AND SCO-LS APPLIED TO SIBS

4.1. The ideal concept for a SIBs Programme

Ideally, regardless of ESIF financing, any SIBs Programme being deployed should have:

- A broad and diverse pool of investors willing to commit the initial capital for SIBs implementation, ideally investing under structured Pre-financing Funds to achieve the necessary critical mass and continuity of investment over the medium/long-term.
- In order to attract the number of investors and the level of investment required for sustainable SIBs deployment over time, solutions for mitigating and for rewarding risks should be in place, improving the attractiveness of investing in a SIB *vis-a-vis* other investment alternatives[51]. Different types of investors have different profiles for risk-return-impact requirements, broadening the range of possible SIBs financing structures.



Source: *Saïd Business School, Oxford University (2017)*

- A broad and diverse pool of organisations implementing innovative solutions that are more effective and/or efficient than traditional public policy responses in dealing with complex societal problems, as well as more adjusted to the needs of end-beneficiaries.

51 Risk-return is becoming increasingly relevant even in the case of traditional philanthropic investors (e.g. Foundations). For these players, potential expected returns represent not only additional budget for reinvestment, but also an alternative to invest endowment capital that is more aligned with its mission. For example on April 2017, the Ford Foundation announced that it would be using $1 billion from its $12 billion endowment over the next 10 years for mission-related investing (MRI) - https://www.nytimes.com/2017/04/13/business/ford-foundation-mission-investment.html.

With major differences across Member States regarding the structure of the Social Economy sector and its legal framework[52], SIBs initial investment should not discriminate potential investees on the basis of their institutional format, but rather on the significance and results of their work. This approach would broaden the pool of *relevant* investees and create a level playing field across the EU for the implementation of social impact solutions, relevant not only for SIBs but also for other impact investment decisions.

- A committed group of public sector commissioners from different SIBs-relevant public policy areas to be engaged in the implementation of each SIB depending on its scope and willing to contract and to pay for outcomes, ideally under structured Outcome Funds.

  Depending on government structures, namely on where the responsibility for SIBs-related public policy implementation lays in each Member State, central, federal/regional or local government organisations must be actively involved, to assure continuity, effective scaling and mainstreaming of successful SIBs. Additionally, as a consequence of its positive externalities across levels of government and sectors, SIBs Outcome Funds should ideally be set-up as joint pools of public financial resources, combining funding from all relevant sectors and levels of government. Cost savings and/or the additional valuation of outcomes achieved should support the provisioning of contracted returns (risk premium) for initial investors in each SIB.

- Reliable and detailed public data sets in SIBs-related public policy areas, to be used to support both outcome contracting and, at a later stage, outcome measurement and validation to trigger SIBs payments.

  Depending on public sector commissioners' objectives, data availability and level of maturity towards outcome-based contracting, outcome measurement activities of a SIB or other outcome payment mechanism can be supported either on standard rate cards[53], or on case-by-case approaches pre-agreed between contracting parties. Even for Member States adopting rate cards as the standard for outcome contracting, case-by-case approaches might still be needed for public policies falling outside its scope.

  Additionally, depending on SIBs Programme design features and especially on public data availability and reliability, external independent evaluators (e.g. Universities) might also be involved in outcome measurement to assure a credible neutral validation, not only of the outcomes achieved, but also of attribution[54] – which is critical evidence for scaling and mainstreaming.

52 One of the best examples of these differences and related institutional distortions lays in the legal definition of social enterprises in different Member States, ranging from non-existent to heavily detailed.
53 Rate cards match desired outcome metrics with max. prices to be paid for its achievement (Cf footnote 6).
54 Attribution refers to the extent to which changes in outcomes of interest can be attributed to a particular intervention and not by other external unrelated factors.

4.2. The use of ESIF

Applied to the ideal concept for a SIBs Programme presented in the previous subsection (4.1.), the exercise now put forward for discussion assumes ESIF as its main source of financing.

The initial stage of this exercise starts by assuming what would be the ideal use of ESIF to finance a SIBs Programme, *based on the Portuguese experience* and regardless of any constraints imposed by the current 2014-2020 ESIF regulatory framework. As a result, it adds an unrestrained architecture of ESIF financial flows to the SIBs concept presented in the previous subsection. The second and final stage of the exercise, presented in the next subsection (4.3.), identifies all the regulatory constraints in place that prevent the set-up of this ideal "SIBs under ESIF financing" concept, putting forward tangible suggestions on how EU legislators could overcome it, already taking into consideration also the relevant changes regarding SCO included in the new Omnibus Regulation proposals, currently under final discussion[55].

To finance SIBs Programmes (or other outcome payment mechanisms), ESIF funds can be applied:

1. as non-reimbursable TA support (grants) to all types of SIBs stakeholders, financing initial capacity-building and awareness, as well as preparatory work necessary for SIBs set-up, reducing transaction costs and complexity.
2. as a financial instrument, ideally structured as a Pre-financing Fund, co-investing directly in each SIB alongside other social investors or even in combination with other non-ESIF financial instruments such as EFSI EIF PbR Platform, lowering the perceived risk of outcome contracting and contributing to attract additional investors and capital[56].
3. as a mechanism to pay for achieved outcomes (in the form of "delayed grants"[57]), ideally under structured Outcome Funds, combining ESIF budget with public sector budget from central, federal/regional and local government, depending on SIBs scope and on each Member State government structure.

   Following outcome validation, each payment would be made under a lump sum, using a small variation of this 2014-2020 ESIF SCO methodology (SCO-LS SIBs), better adjusted to outcome payment mechanisms:

   i) one pre-contracted lump sum paid per *validated* outcome, with no fixed EUR 100 000 threshold;
   ii) achieved efficiency gains (either through cost savings or outcome top-up valuation) used for paying investors returns included in the lump sum value[58];
   iii) no constraints on project duration – outcome payments expected to occur beyond the end of the ESIF framework eligibility period made through an escrow account or similar mechanism.

55 For the purpose of this analysis, Omnibus Regulation proposals refer to its December consolidated 15th version.
56 Although less aligned with the underlying design of SIBs or other outcome payment mechanisms, other products of financial instruments such as debt (e.g. providing loans to the organisations responsible for implementing the contracted solutions) and guarantee (e.g. protecting part of the capital invested in each SIB from non-payment events) might also be considered – but always complemented by strict additional provisions to avoid distortions due to unintended risk transfer.
57 ESIF grants contracted as part of the initial SIBs set-up, with no advance payment and payment(s) made at a later stage against outcome(s) validation.
58 With these risk premium payments to investors – even if subjected to a pre-determined cap – also allowed to be included in the calculation of each lump sum.

4. as additional TA (grants) to be used for financing additional technical work throughout a SIB's life cycle, namely independent impact measurement activities (e.g. development of unit costs databases, outcome validation by independent experts, etc.).

Depending on Member States' preferences on SIBs Programmes design structure, TA financial flows one and four (grants) might represent either stand-alone complementary applications or cost components of a single SIB application.

ESIF financial flows two (financial instrument co-investment) and three ("delayed grants"/lump sums payments) should be mutually exclusive, in order to avoid double financing[59].

The underlying concept of Joint Action Plans (JAP)[60] might provide an appropriate base for the set-up and implementation of ESIF financed Outcome Funds under a SIBs Programme or other outcome payment mechanisms, but not in its current format.

4.3. Constraints and suggestions for improvement

Constraints under the current ESIF regulatory framework

As the first SIBs Programme in the EU to be deployed using ESIF-ESF, the Portugal SIBs Programme has had the EC/DG EMPL full attention and close cooperation, since its starting point, early 2014, during PA/OPs negotiations.

Later, despite several challenges, Portugal has managed to set up and implement a SIBs Programme under the current 2014-2020 ESIF-ESF regulatory framework. Therefore, it is indeed possible to implement SIBs using ESIF. However, not without several constraints from the current ESIF-ESF rules, which have significantly distorted some key aspects of the SIBs Programme design and implementation processes, as mentioned in previous sections of the present study.

As a result, using the Portuguese experience as a starting point, it is possible to identify, for all the four points presented in the previous section (4.2), the main regulatory barriers hindering an effective SIBs deployment under ESIF.

Constraints to Technical Assistance (Grants) – Points 1. and 4.

The combination between TA grants and either Pre-financing Funds (financial instruments) or Outcome Funds ("delayed grants") lacks regulatory certainty and clear rules.

Explicit rules on potential combination only exist in the case of financial instrument (Article 37 (7) (8) (9) of CPR and EGESIF_15_0012-02 *"Guidance for Member States on CPR_37_7_8_9 Combination of support from a financial instrument with other forms of support"*). Therefore, in the particular case of SIBs, if early stage SIBs TA grants were to be combined with the financial instrument at pre-financing stage in a single operation, then financial instruments provisions would also apply to

59 The only potential exception being guarantees, that will only be triggered and paid to investors when lump sum payments for outcomes don't take place.
60 EC "Guidance on Joint Action Plans" (EGESIF_14-0038-01). Suggestions on how current JAP provisions could be improved to better align with SIBs or other outcome-based structures are presented in the next subsection.

TA grants (Articles 37(7) of CPR). However, this combination had to be previously foreseen in the context of the financial instrument EAA and TA grants could not be directly paid to final recipients (Articles 37(2)(a)(e) of CPR and EGESIF_15_0012-02).

Moreover, later stage TA linked with actual SIBs deployment (e.g. to fund SIBs management or impact measurement activities) would in most cases be part of any Outcome Funds / "delayed grants" application, so not falling under these rules.

As a result, different rules would apply to equivalent TA, supporting the same beneficiaries for the same purpose (SIBs implementation), merely on the basis of being granted in different moments. This dual approach would generate distortions and additional administrative burdens, in particular for later stage TA.

Additionally:

- in the case of early stage SIBs TA grants, national gold-plating might also restrict deadlines for eligibility of expenditure[61], making it harder to use for extended SIBs awareness, capacity building and preparatory works operations;
- in the case of later stage SIBs TA grants, if combined with Outcome Funds in a single operation under a SCO-LS methodology, the usual outsourcing of TA activities would make it fall under yet another differentiated cost calculation approach - "real costs" (article 67(4) of the CPR), resulting in additional transaction costs[62].

Constraints to SIBs Pre-Financing Financial Instrument – Point 2.

2014-2020 ESIF provisions are still not fully adjusted to allow the effective use of financial instruments to pre-finance SIBs:

- The mandatory EEA process is excessively burdensome and long (paragraph 2 and 3 of article 37(3) of CPR). Moreover, some of its requirements (namely (d) and (f) of article 37(2) of CPR) are not directly applicable to the EU SIBs context – an emerging transversal area, with no SIBs-related ESIF financial instrument in place yet, developing interventions in a broad spectrum of public policy areas.
- In this regard, it is reasonable to assume that:

    i. especially in less mature Member States SIBs contexts, the EEA exercise – carried out at a very early stage of the process – will not cover all relevant SIBs cases for the entire seven-year framework;

    ii. market failures, gaps and risks/risk perceptions are expected to differ between areas of intervention, or even from SIB to SIB;

    iii. achieving critical mass and economies of scale is fundamental for the success of any financial instrument.

  Therefore, one of the main issues when setting-up a SIBs pre-financing financial instrument would be how to approach, under the current ESIF rules, the trade-off between customisation vs. standardisation of the financial products being offered. This is particularly critical in an emerging EU SIBs context, that is simultaneously very diverse, but also very susceptible to high transaction costs. Always assuming EEA as the basis for designing a SIBs pre-financing financial instrument, detailed requirements should however be flexible

61 Up to 60 days before application submission in the Portuguese case, according to Article 10(1) of Portaria 60-A/2015.
62 In fact, per definition technical assistance implies contracting with third parties, which makes related expenditure ineligible to integrate a lump sum (article 67 (4) of CPR).

enough to accommodate this type of structural non-strictly financial decisions, which are hard to fully predict at an early EAA stage.

- The current ESIF regulatory framework concerning financial instruments does not explicitly foresee the most suitable format for SIBs pre-financing: a co-investment model to support either SIBs Pre-financing Funds or to directly co-investing in SIBs.

  Not being a standard debt, equity or guarantee financial instrument, this type of hybrid financial instrument rather shares some features of PPP investments. In fact, SIBs pre-financing are investments on specific PbR contracts rather than on specific entities. As a result, the tailor-made investment mechanisms required to pre-finance each SIB are not fully aligned with the current ESIF financial instrument rules, without exponentially increasing its already high transaction costs, e.g. by the creation of special purpose vehicles (SPVs).

Finally, it is relevant to point out that several ESIF financial instrument requirements applied to Member States, namely related to EAA, procurement and state aid, would apply differently or not be fully applicable to an ESIF (or to a non-ESIF) SIBs pre-financing financial instruments, were it to be managed directly by the EC or by the EIB Group.

Constraints to SIBs Outcome Payment Mechanism ("delayed grant" under SCO-LS) – Point 3.

Lessons learned from "*Capacity-Building for Social Investment*"[63] made possible the identification of the main regulatory constraints that didn't allow its SCO-LS methodology to be adopted also in the case of the Portugal SIBs Programme.

Its application[64] to a SIBs Programme or any other outcome payment mechanism collides specifically with the following ESIF regulatory aspects:

- The EUR 100 000 max. threshold established in Article 67(1)(c) of the CPR and Article 14(3) of Regulation EU 1304/2013 – too low for average outcome payments, in the case of SIBs or other outcome-based contracting;
- The fact that paying returns to reward investors for risk-taking is not considered eligible expenditure under Article 69(3) of the CPR (i.e. assuming that the investors' risk remuneration falls into the non-eligible category "*interest on debt*"). As a result, it is also not clear that this particular type of performance-linked expenditure might integrate SCO-LS outcome payments under SIBs financing, even if against public sector efficiency gains;
- Depending on the design of the SIBs Programme, and especially on the design of its application for ESIF financing, the provision established in Article 67(4) of the CPR might apply either to the whole operation or to some of its components, making the adoption of SCOs impossible in the first case[65], or very burdensome in the later, due to the need to combine "real costs" with SCOs methodologies under a single operation. In both cases, it creates additional transaction costs, hindering the deployment of a SIBs programme under ESIF financing[66].

63 Portugal Social Innovation´s ESIF-ESF grants scheme for improving the management and organization competences of social innovation and social entrepreneurship project teams.
64 Replicating the "1 outcome validated = 1 ESIF lump sum payment" approach already validated with the EC, where multiple lump sums payments in a single operation where not only possible under the adopted methodology, but constituted per se certifiable and auditable expenditure.
65 For example in SIBs structures where investors alone are the applicants to the SIBs Outcome Fund/ESIF financing, and then procure and contract the SIBs intervention with selected service providers (social organisations, etc.).
66 Cf "*Design Decision #5: Reimbursement of real costs or SCO (lump sums)?*" in Section 3.1., for further details.

- The obligation of total independence between lump sums integrating the same operation, which might work e.g. in the case of a SIB structured in cohorts, but would create a major constraint e.g. in SIBs structured in sequential or composite outcomes (Portugal ESF rules – gold-plating).
- The misalignment between the longer durations of standard SIBs or other outcome-based contracts and the three-years average duration of ESF projects in most Member States. Moreover, even in cases where longer ESF project durations are defined specifically to allow outcome payments as "delayed grants" at a later stage (as it was the case in the Portugal SIBs Programme):

    i) these payment flows might still collide with the n+3 rule for decommitment (Article 136(1) of the CPR);
    ii) in order for *all* these payments to be made before 2014-2020 OPs closure (Article 65(2) of the CPR), project durations will still get increasingly shorter as the ESIF programming cycle evolves, leaving very little time for implementing longer projects or projects starting at a later stage.

- The methodologies underpinning SCOs calculations set out in Article 67(5) of the CPR are not fully adjusted to the deployment of SIBs or any other type of outcome payment mechanisms:

    i) Output and not outcome based;
    ii) Based on historical data, methodologies and practices already applied for similar operations, thus creating barriers to new approaches or to variations/ adjustments to standard methodologies;
    iii) Requiring comprehensive knowledge on existing SCOs methodologies across the EU and the different Member States, that still doesn't exist in most Member States or even at EU level[67].

    Moreover, specifically in the case of SIBs and other outcome payment mechanisms, the level of detail, definition and verification necessary for setting up a methodology for ESIF SCOs calculations, even before the set-up of either of these PbR mechanisms, represent a significant duplication of efforts, especially if not converged. It should not even be necessary, when, embedded in a PbR mechanism, there is a strong involvement of the relevant public sector commissioners (i.e. the entities responsible for the targeted public policies) in the definition of contracted outcomes and in its validation. This type of involvement, that is a usual PbR feature, should *per se* be considered a robust guarantee of methodological soundness and security.

    Depending on PbR design, this involvement of the public sector can happen in three different moments:

    i) Well before the set-up of each SIB and its application for ESIF financing. This more long-term standardised approach is normally supported by the use of rate cards, more common in Member States, where PbR mechanisms are more mature and its adoption more widespread;
    ii) In the moment of the set-up of each SIB, as part of its contract negotiation and ESIF financing application, when each outcome to be achieved is defined (or its definition is formally validated) by the public sector entity responsible for the targeted policy, and its final version integrates already the SIBs contract and financing application;

67 Commission Delegated Acts adopting SCO under Article 14(1) of Regulation EU 1304/2013 don't provide enough information neither on rational nor on process to be used as benchmark for other Member States or regions. Moreover, although increasing, these Delegated Acts are still scarce, most of them related to standard scales of unit costs associated with mainstream policies, making them very Member State specific to be replicated directly in other cases. Also, most SCO in place were still defined, at Member State level, under the standard CPR (Articles 67-68) provisions.

iii) During the evaluation of the ESIF financing application, when the public sector validates (or not) the outcomes proposed in the SIBs financing application.

The last two more customised SIB-by-SIB approaches require those clear detailed rules (but not the final outcome metrics) to be set and communicated *ex-ante* to all interested parties, e.g. on the terms and conditions of the call for applications for ESIF financing. Both approaches are more common in Member States with less mature PbR mechanisms or in cases when the public sector (e.g. for political reasons) doesn't want to publicly expose prices/values for public policies outcomes[68].

So, though it might be desirable, in the medium/long-run, to progress towards a standard rate card approach supporting competitive tendering processes across the EU for SIBs or other outcome payment mechanisms, the implementation of PbR is still in a very early stage in most Member States, where other more customised approaches might still be necessary.

As a result, although a new SCOs methodology more adjusted to PbR mechanisms financed under ESIF is essential (e.g. by means of a dedicated Commission Delegated Act), its content must be well balanced – the implementation of a prescriptive "one size fits all" ex-ante methodology at this early stage might backlash, hindering the future adoption of SIBs or other outcome payment mechanisms by Member State.

Beyond ESIF rules, the way those rules are implemented can also be a major source of constraints to the set-up and use of SCOs.

Again based on the Portuguese experience, supporting a new type of ESIF-ESF operation ("Capacity-Building for Social Impact") on SCO-LS proved to be a lengthier and more complex process than first expected. From 2015 to 2016, it took almost 1.5 years for the definitive methodology to be approved and put into practice, even with a strong commitment from all Portugal entities involved and above all with the decisive support of DG EMPL F1/F4. This was mainly due to the combination of two main factors:

1. Lack of legal certainty

   Additional EC guidance on how to apply the regulatory framework provisions on SCOs[69] – although clear, detailed and presenting several relevant examples – did not cover all key aspects for designing and setting up SCOs adapted to specific Member State contexts and operations. Specific TA and access to detailed information on best practices and existing SCO examples in Member States were not easily available.

   Consequently, with limited historical data and no previous experience in the use of SCOs[70], fundamental issues started to emerge very early in the design stage, slowing or even bringing the process of lump sum adoption to a standstill.

68 Health is just an example of a public policy area where public disclosure of unit costs might be particularly sensitive.
69 "Guidance on Simplified Cost Options (SCOs) – Flat rate financing, Standard scales of unit costs, Lump sums" (EGESIF_14-0017).
70 "Capacity-Building for Social Impact", a new type of ESF operation, was also the first ESIF financing instrument to use a SCO-LS methodology in Portugal.

2. Conservative approach at Member State level, from Certifying and Audit Authorities (CA/AA)

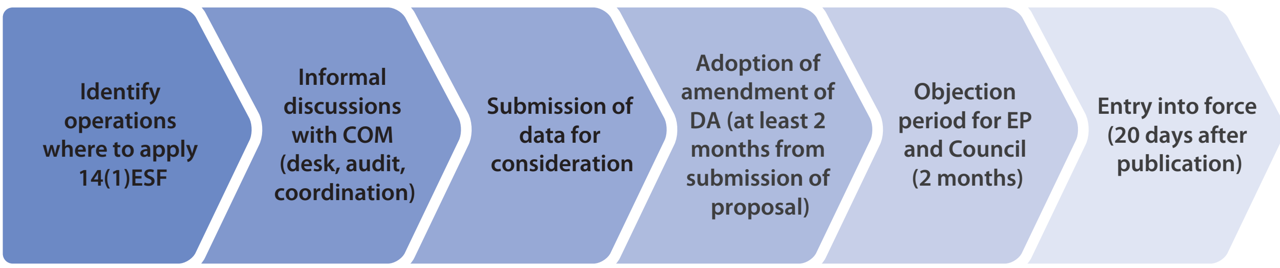
   The adoption of SCOs represents a major shift on certification and auditing processes. Foremost it represents a major shift on mindsets and attitudes towards operations – from validation of administrative processes and invoices to validation of outcomes. It also represents a major shift in the required skills and competences of CA/AA, with little time and reduced incentives to adjust to a new paradigm. For CA/AA, SCOs are perceived as promoting absence of control and additional risk, not fitting the current certification and audit mechanisms.

   Therefore, understandably, CA/AA tend to impose several additional requirements and caveats to SCOs design and implementation, thus making it very detailed and more burdensome (in some aspects even for beneficiaries – the opposite of what was initially intended by the use of SCOs).

   Furthermore, at this stage it is still not fully guaranteed that CA/AA won't require additional information from beneficiaries (e.g. invoices), namely for processing due payments and as part of audit trails, disregarding the fundamentals of SCOs and its simplification goals. This is mainly a result of the fact that current audit methodologies did not evolve enough to fully integrate a broader use of SCOs (e.g. error rate calculation is not adjusted to this new reality, namely in what concerns lump sums, which might create distortions and hinder SCOs adoption)[71].

As an alternative, Article 14(1) of Regulation EU 1304/2013 was used in some Member States to improve legal certainty, reducing the scope of *ad-hoc* financial audit, while providing assurance on methodology.

PROCESS OF ARTICLE 14(1) ESF



Source: *EC, joint EC/Portugal ESF working sessions on SCOs, November 2015*

However, it was still too lengthy (min. five to six months), complex and too rigid once implemented to promote a broader adoption by most Member States. Moreover, it entailed pre-existing support data, thus leaving out new operations[72]. In the case of SIBs, and especially in less mature Member State contexts, this would exponentially increase the constraints associated with the application of SCO-LS or even standard scales of unit costs (rate cards) methodologies.

71 For a single operation including several lump sums, as it is the case of "Capacity-Building for Social Impact" and would be the case of a SIBs operation with multiple payments, each lump sum would represent per se an operation for auditing purposes, thus multiplying exponentially the number of operations, and accordingly the probability of error. This adds to the fact that in lump sum ("all or nothing") methodologies there are no partial errors – an operation is either 100% compliant or 100% non-compliant.

72 So far, NL was the only Member State using this mechanism for establishing a SCO-LS methodology for TA operations (totally unrelated with PbR approaches).

Constraints to the use of Joint Action Plans (JAP) for SIBs deployment

"JAP enables Member States to implement parts of one or more programmes using a results-oriented approach towards a predefined goal. Its focus on results is ensured because it has coherent intervention logic and makes use of SCOs. Selected output and result indicators are linked with corresponding unit costs or lump sums, and this makes it possible to make payments based on achievement levels."

in EGESIF_14-0038-01 – "GUIDANCE ON JOINT ACTION PLANS"

Upon agreement between one Member State and the EC, a JAP allocates a specific ESIF budget, potentially multi-fund, across OPs and priority axis for the implementation of a project or group of projects, using SCOs methodologies (standard scales of unit costs or lump sums, not subjected to the EUR 100 000 threshold) to pay for achieved results. Audit activities of a JAP only verify that the conditions for payment that were previously approved have been fulfilled. In theory, this would be the best option to implement an Outcome Fund under ESIF for SIBs or any other outcome payment mechanism financing, as it fully aligns ESIF financing structure and financial flows with PbR approaches, being applicable to exclusively procured projects.

In practice, however, it is not a fully suitable approach for SIBs deployment due to the following regulatory constraints:

- A limited duration aligned with standard ESIF rules, meaning that the results (outcomes) of a JAP can only trigger payments between JAP´s approval date and 31 December 2023 (Article 105(2) of the CPR);
- The fact that only public sector entities (i.e. a managing authority or other designated public law body) might submit a proposal for a JAP (Articles 104(1) and 105(1) of the CPR).
- In a scenario where "1 JAP = 1 SIB", it wouldn't be compatible with a key design feature of any SIBs Programme, in which (usually private) investors are the main beneficiaries of an Outcome Fund.
- In a scenario where "1 JAP = 1 Outcome Fund", it creates a new layer of complexity in its governance model, with additional levels of approval decisions and reporting. In this later case, the Outcome Fund would have to be public and financed through JAP, and then select projects to finance;
- A complex governance model with a structured steering committee, meeting at least twice a year and reporting to the managing authority, that in turn informs the relevant monitoring committees on progress of the JAP (Article 108(1)(2) of the CPR);
- A minimum JAP budget of EUR 10 million or 20% of the public support of financing ESIF OP(s), whichever is lower (Article 104(2) of the CPR). Although appropriate for a "1 JAP = 1 Outcome Fund" approach, this threshold would be too high for a "1 JAP = 1 SIB" approach;
- Detailed JAP content is closed upon the EC's approval decision (Articles 106 and 107(3) of the CPR), with future financial consequences and lengthy amendment or revision procedures (three months, according to Article 108(3) of the CPR). As a result, a JAP Member State/EC document will define in advance all SIBs projects to implement, as well as all its outcome metrics and milestones.
- Following a "1 JAP = 1 Outcome Fund" approach, this full detailed lock-in of projects, outcomes, milestones and methodologies should only happen when contracting each SIB, not upfront in the set-up of a far-reaching financing Outcome Fund[73]. It would be too rigid.

73 This is true not only for lump sums, but also for standard scales of unit costs / rate cards, for the reasons discussed in section 3.1. "Design Decision #5: Reimbursement of real costs or SCO (lump sums)?".

- On the contrary, this particular provision is quite well adjusted to a "1 JAP = 1 SIB" approach. However, due to the remaining characteristics of a JAP structure, described above, the transaction costs would be intolerable for SIBs-by-SIBs contracting. It would be too bureaucratic and too slow, besides diverging significantly from average SIBs budgets and governance models.

2014-2020 ESIF REGULATORY FRAMEWORK MAIN CONSTRAINTS	
1. / 4. **Technical Assistance** (GRANTS)	1. Asymmetric rules for TA support combined with FI vs. SCOs-LS *(Article 37(7)(8)(9) of the CPR)* 2. SCOs/LS can't be used for TA support, even if in a single operation with other SCOs-LS *(Article 67(4) of the CPR)*
2. **SIBs Pre-Financing** (FINANCIAL INSTRUMENT)	1. EAA requirements not adjusted to EU SIBs/PbR contexts *(Article 37(2)(d)(f) of the CPR)* 2. FI design and implementation rules not fully adjusted to SIBs Pre-financing *(Articles 37 and 38 of the CPR)*
3. **Outcome Payment Mechanism** ("DELAYED GRANT" under SCOs/LS)	1. € 100 000 max. threshold for SCOs-LS *(Article 67(1)(c) of the CPR and Article 14(3) of Regulation (EU) 304/2013)* 2. Regulatory uncertainty of the possibility of financing investors returns in an ESIF-financed SIBs operation *(Article 69(3) of the CPR)* 3. SCOs-LS can't be used for exclusively procured operations or operation components *(Article 67(4) of the CPR)* 4. SIBs/PbR average project durations not compatible with: 4a. n+3 rule *(Article 136(1) of the CPR)* 4b. OPS closing dates for eligibility of expenditure *(Article 65(2) of the CPR)* 5. Methodologies for SCOs calculations not adjusted to EU SIBs/PbR contexts *(Article 67(5) of the CPR)*
JOINT ACTION PLAN (JAP)	1. Incompatible duration (=3.4a/b) *(Article 105(2) of the CPR)* 2. Public sector as only beneficiary *(Articles 104(1) and 105{1) of the CPR)* 3. Complex Governance Model *(Article 108(1)(2) of the CPR)* 4. Minimum budget of € 10 000 000 or 20% of the public support budget of financing OP(s) too high for a "1 JAP = 1 SIB" scenario *(Article 104(2) of the CPR)* 5. Prescriptive JAP content with full ex-ante lock-in of projects and outcomes not compatible with a "1 JAP = 1 Outcome Fund" scenario *(Articles 106 and 107(3) of the CPR)* 6. Lengthy amendment or revision procedures, not adjusted to a "1 JAP = 1 SIB" scenario *(Article 108(3) of the CPR)*

Taking into account the new Omnibus rules regarding SCO and JAP

The new Omnibus Regulation is currently under final discussions and is expected to be adopted until the end of the first semester 2018, with retroactive effects for several of its provisions. Even if not fully stabilised, its present version puts forward some relevant changes, also to many of the ESIF CPR provisions that represent significant constraints to the use of ESIF financing for the deployment of SIBs or other outcome payment mechanisms.

Consequently, even if the new Omnibus Regulation falls outside the scope of the present study and it is still too soon for an exhaustive analysis of its final content, its expected impact on the implementation of a SIBs Programme under ESIF is too relevant to ignore. Therefore, assuming all the necessary caveats and based on available information, the current subsection presents a preliminary analysis (experts' opinion) focusing on providing initial inputs on how the Omnibus provisions regarding SCOs would affect an ESIF financed SIBs Programme.

We make a positive assessment of the proposed new rules – overall, it is a step in the right direction, incorporating past experience. The current version of the Omnibus Regulation considerably improves SIBs-relevant provisions, eliminating several of the constraints identified in the previous sections. Nevertheless, a few key barriers to an effective SIBs deployment still remain to be solved.

Analysis of changes in SCOs provisions

Compared with the current CPR rules (Regulation EU 1303/2013), the proposed Omnibus Regulation:

- Eliminates the EUR 100 000 threshold for the application of SCO-LS, removing one of the main barriers to the use of lump sums for SIBs outcome payments (either directly or through a SIBs Outcome Fund);
- Creates a new SCOs methodology with payments directly linked to the "*achievement of objectives of programmes*", rather than to incurred costs. Although apparently not directly targeting the deployment of SIBs or any other outcome payment mechanisms (at least at this stage), it opens the possibility of using a dedicated more adjusted SCO alternative for its implementation. This new methodology will be further regulated by the Commission Delegated Act to be adopted shortly, where the necessary adjustments could be made. However, as discussed in previous sections, if not well adjusted to this emerging reality (e.g. if too rigid or too prescriptive), these new provisions might hinder the take up of SIBs under ESIF financing;
- Defines, by default, that the EC might adopt Delegated Acts for detailing ***all*** SCOs methodologies. Before this proposal, only flat rate financing and methodologies under 14(1) of Regulation EU 1304/2013 could be targeted by the Commission Delegated Act. Although this is a positive development, it might grow into over regulation without added value in terms of simplification, legal certainty and further SCOs adoption by Member States. Targeted TA, combined with the sharing of information on adopted methodologies and best practices across Member States, might be as useful and less prescriptive, either as an alternative or a complement;
- Focus audit activities for all SCOs, including for this new methodology, solely on the verification that the conditions for reimbursement have been fulfilled, fully aligning audit procedures with the deployment of SIBs and other payment for outcomes mechanisms;
- Allows this new methodology of SCO to be applied even for operations being fully implemented through public procurement procedures. Additionally, if in the implementation of an ESIF financed operation, the public procurement component is restricted to certain categories of costs, all SCOs can still apply to part or to the whole of that operation. These two provisions, while allowing a flexible choice of SCO methodology to apply, also eliminate the need for applying different methodologies to the same operation, as identified in previous sections (e.g. the combination of "delayed grants" lump sums and "real costs" TA in a single operation). As a result, in the case of SIBs, these provisions will contribute for greater simplification, as well as for reducing transaction costs;

- Creates the possibility of also using expert judgments as the basis for a "fair, equitable and verifiable calculation method" for SCOs. This is a major progress for the application of SCOs to innovative operations with limited track-record and data availability, as is the case of SIBs or other outcome payment mechanisms in emerging Member State contexts. However, so far, this provision is only explicitly applied to more traditional SCOs (standard scales of unit costs, flat rates and lump sums). No reference is made to its application in the context of the new more SIBs-adjusted SCO methodology created by the Omnibus Regulation[74].

The following positive SCOs changes do not directly affect a SIB and other outcome payment contract under ESIF financing, unless in the highly unlikely event they are very small operations under EUR 100 000:

- A mandatory requirement for the use of SCOs for ERDF and ESF operations under EUR 100 000 of public support, that are not exclusively procured or subjected to State aid provisions other than *de minimis* rules. Except for operations below EUR 50 000, for which SCO are always mandatory[75], this provision has a 12 months transition period, that can still be extended if dully justified and notified by a managing authority to the EC;
- A greater simplification of methodological procedures and *ex-ante* controls for operations up to EUR 100 000 of public support, as SCOs application might be supported by draft budgets established on a case-by-case basis, to be agreed *ex-ante* by the relevant managing authoritiy[76].
- More flexibility and greater simplification in the design and implementation of the different types of flat rate financing, also creating two additional options:
    - i) A flat rate of up to 20% of direct costs (excluding staff costs) to calculate direct staff costs;
    - i) A flat rate of up to 40% of direct staff costs to calculate all other remaining costs, directly applicable with no requirements for Member States to perform any additional calculations to determine the applicable rate.

Nevertheless, despite these positive changes to SCO design and application brought forward by the new Omnibus Regulation, the following critical constraints to its use for the deployment of a SIBs Programme or other outcome payment mechanism under ESIF financing are still present:

- RETURN: No reference to the possibility of a risk premium to be paid to SIBs investors;
- DURATION: No possibility of outcome payments beyond 2023;
- AUDIT AND CONTROL: potential mismatch between financial instruments/SCO audit and control procedures.

Analysis of changes in JAP framework

The new Omnibus Regulation represents also a positive evolution in the JAP regulatory framework towards a more friendly option for SIBs deployment, including:

- A drop in the minimum mandatory JAP budget, from EUR 10 million to EUR 5 million, and from 20% to 5% of public support of financing ESIF OPs, allowing for smaller JAPs and consequently reducing a barrier to adoption, but still being too high for a "1 JAP = 1 SIB" approach;
- The end of specific references to JAP duration and end dates. Although a welcome change, it might not translate into more flexibility, as standard CPR rules on duration and end dates are still applicable (also to JAP);

74 Although it could be expected that this provision might also be included, at a later stage, in the future Commission Delegated Act regulating this new SCO methodology.
75 This already happens in the current ESIF regulatory framework for operations financed under the ESF.
76 With no historical data available, this was the mechanism used for the calculation of lump sums in the case of "Capacity-Building for Social Impact".

- A lighter, less detailed and prescriptive structure for JAP proposals, including more generic requirements, namely regarding the need for alignment between JAP and financing OPs on objectives, milestones, targets for outputs and results and indicators. It prioritises the focus on JAP specific content rather than on its financing OPs, increasing flexibility for a more customised JAP design and implementation;
- No need for presenting an indicative schedule of payments to the beneficiary linked to milestones and targets.

However, this change is not sufficient for JAP to be considered as an option for the deployment of SIBs or other outcome payment mechanisms, as:

- JAP beneficiaries are still exclusively public, removing the possibility of including social investors, which are relevant stakeholders for SIBs deployment, making a "1 JAP = 1 SIB" approach not viable;
- JAP governance model hasn't changed, and is still too complex, with significant mismatches with SIBs design;
- The JAP requirement for a detailed *ex-ante* content, presenting up front definitive projects, outcomes, milestones and methodologies still holds, making a "1 JAP = 1 Outcome Fund" approach not viable.

		EVALUATION	
		2014-2020	OMNIBUS
1. / 4. **Technical Assistance** (GRANTS)	1. TA Combination with financial instrument vs. SCOs-LS		=
	2. Use of SCOs-LS for TA support		+
2. **SIBs Pre-Financing** (FINANCIAL INSTRUMENT)	1. EAA requirements		=
	2. FI design and implementation rules		=
3. **Outcome Payment Mechanism** ("DELAYED GRANT» under SCOs/LS)	1. € 100 000 max. threshold for SCOs-LS		+
	2. Investors returns		=
	3. SCOs use in procured projects		+
	4. Duration:		
	4a. n+3 rule		=
	4b. OPs closing dates		=
	5. Methodologies for SCOs calculations		+
JOINT ACTION PLAN (JAP)	1. Duration (=3.4a/b)		+
	2. Beneficiaries		=
	3. Governance Model		=
	4. Minimum budget		+
	5. JAP content		+
	6. Amendment and revision procedures		=

Adjusted ■■■■ Non Adjusted

Suggestions for improvement

The analysis performed supports the following set of practical suggestions for further regulatory improvement, identifying possible solutions for the remaining constraints affecting the design and implementation of SIBs Programmes and other outcome payment mechanisms under ESIF financing. Together with the previous sections of this report, it intends to provide "food for thought" for a possible EC Delegated Act addressing this theme.

			SUGGESTIONS
1. / 4. **Technical Assistance** (GRANTS)	1. TA Combination with financial instrument vs. SCOs-LS	=	• Although the asymmetry remains, with the new SOCs-LS rules, it became less relevant. Common rules for all SIBs or PbR-related TA, regardless of type of financing structure would be ideal
	2. Use of SCOs-LS for TA support	+	
2. **SIBs Pre-Financing** (FINANCIAL INSTRUMENT)	1. EAA requirements	=	• COM financial instrument Guidance note detailing the format of application of Article 37(2)(3) requirements to SIBs (more flexible)
	2. financial instrument design and implementation rules	=	• D.Act provisions on using financial instrument for SIBs pre-financing and on its combination with other EU instruments for the same purpose
3. **Outcome Payment Mechanism** ("DELAYED GRANT" under SCOs/LS)	1. € 100 000 max. threshold for SCOs-LS	+	
	2. Investors returns	=	• D.Act provision interpreting Article 69(3) of CPR, allowing performance-linked expenditure (if directly linked with efficiency gains and/or improved outcomes) to be included in SCO-LS outcome payments
	3. SCOs use in procured projects	+	
	4. Duration: 4a. n+3 rule 4b. OPs closing dates	=	• D.Act provision allowing the set-up of SIBs/PbR escrow accounts for outcome payments falling: i) after n+3; ii) after OPs closing dates; replicating already existing ESIF rules for Financial instrument and PPP equity (Articles 42 and 64 of the CPR)
	5. Methodologies for SCOs calculations	+	• D.Act provision setting a specific SCOs methodology applicable to outcome payments of SIBs/PbR operations, with the following key mandatory features: i) use of lump sum or standard tables of unit costs (rate cards); ii) requirement of ex-ante definition and publication of clear rules on processes and methodologies to select projects to finance, to define outcomes to contract, and requirements to pay for those outcomes; iii) requirement of active involvement of public sector commissioners, ex-ante in the definition and contracting of outcomes, ex-post in its validation.
JOINT ACTION PLAN (JAP)	1. Duration (=3.4a/b)	+	• In the scenario "1 JAP = 1 Outcome Fund" (the most feasible for using JAP for SIBs/PbR deployment), constraints one and five can be addressed as presented in points 3.4a/b and three to five above. • All other would need specific new provisions or provision changes that may prove unfeasible: i) expand the beneficiaries to include private law entities; ii) simplify governance rules, shifting responsibility to beneficiaries; iii) simplify and reduce deadlines for revision and amendments.
	2. Beneficiaries	=	
	3. Governance Model	=	
	4. Minimum budget	+	
	5. JAP content	+	
	6. Amendment and revision procedures	=	

Adjusted — Non Adjusted

These suggestions would increase the alignment of the current (post-Omnibus) ESIF rules with the ideal regulatory framework for SIBs/PbR deployment under ESIF financing, as they would support:

- a standardised design of all different components of a SIBs Programme or other outcome payment mechanisms, while allowing a flexible modular approach to its fine-tuning and to its use, based on the specific design and implementation set-ups decisions taken by each Member State or region – e.g. a SIBs Programme might rely on a Pre-Financing Fund to attract investors *or* on "delayed grants" Outcome Funds to pay for outcomes using SCO-LS, whereas a traditional outcome payment mechanism launched by a public sector commissioner[77] with no private investors involved would only use the Outcome Fund component;
- the use of TA grants ("early stage" and "ongoing") in different moments, by all stakeholders involved in the process, either as flexible stand-alone support or combined with other types of support. Material produced would be made publicly available to all interested stakeholders (in an adapted generic format to protect specific / confidential information)[78], lowering information asymmetries and barriers to entry;
- in the case of SIBs, more adjusted pre-financing financial instruments. To avoid long set-up times due to the necessary EEA activities, the use of *non-ESIF* EU level instruments might be considered as a solution to attain critical mass and EU coverage[79]. In any case, investors should always be given the chance of investing directly in individual SIBs rather than exclusively through Pre-Financing Funds;
- the set-up of an Outcome Fund ("delayed grants", paying validated outcomes using SCO-LS), that might combine ESIF financing with national/regional/local budgets, the later representing top-up financing from public sector commissioners (organisations responsible for the targeted public policy) or public sector investors (other public entities interested in the contracted outcomes[80]). The active participation of public sector organisations, as well as the contribution of Member State public sector money for outcome payment, should be encouraged, not only as a key element for outcome definition and validation, but also as a way to internalise PbR practices and to mainstream successful projects[81]. This Outcome Fund might benefit from the use of an adjusted JAP-type structure, with no ex-ante lock-in of projects to be financed and outcomes to be contracted, but rather with fixed detailed and clear rules on processes and methodologies to select SIBs/PbR projects to finance, to define outcomes to contract and requirements to pay for those outcomes. As part of these rules, it should also be included a description of the model to be adopted, including contract/application requirements, as well as the expected roles and responsibilities of all relevant stakeholders profiles, namely public sector commissioners. The JAP beneficiary would be a managing authority or ideally a transversal Intermediate Body, that would be responsible for the launch of calls (transversal or specific), for the selection of SIBs or PbR projects to finance, for promoting the ecosystem and knowledge sharing.
- The possibility of using ESIF to support the risk premium necessary to attract SIBs investors, even if subjected to a cap. This could be achieved through a clarification of the relevant rules, namely Article 69(3) of the CPR, or by a new EC provision specifically addressing this issue. Under the current rules, other potential *ESIF-funded* alternatives, such as using a financial instrument-grant combination, might prove unfeasible not only due to the associated increase in transaction costs, but mainly due to regulatory uncertainty on its

77 "Public authority" in the next figure includes public sector commissioners, as well as other public entities interested in investing in a public Outcome Fund.

78 In the case of TA applications (or application components), those materials might be the SCO-LS outcomes to contract.

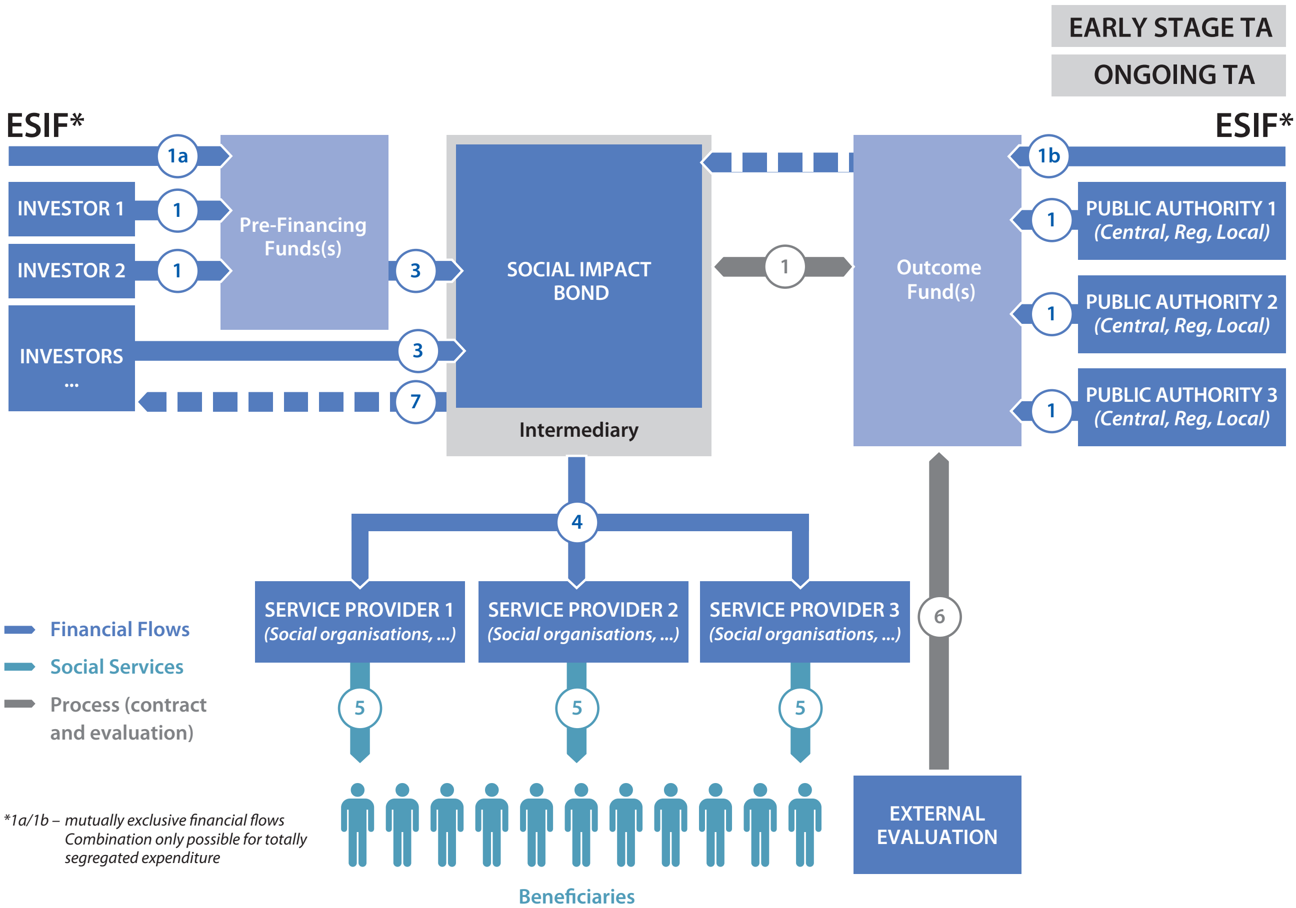
79 Potentially combined with ESIF-financed Outcome Funds at Member State or regional level.

80 E.g. a municipality that might benefit from positive spillover effects from a SIB where the public sector commissioner responsible for the targeted public policy is a Central Government agency.

81 This was exactly what happened in the case of the Peterborough SIB.

application in a SIBs context. In fact, should the "*combined grants*" component supporting risk premium be payed directly to final beneficiaries (in this case, to SIBs investors), it would always imply the use of two separate operations and a total segregation of *eligible* expenditure items[82]. In turn, this segregation might prove challenging should SIBs outcome payments are later made *to those same beneficiaries* through "delayed grants" SCO-LS[83], and not by reimbursing the real costs actually incurred and paid. Transforming SCO-LS outcome payments back in real cost payments might also not be a good solution in the case of SIBs ESIF financing, as explained in detail in previous section 3.1. and 3.2. Finally, in this case, it wouldn't still be certain that these "real costs" risk premium payments might be considered eligible expenditure under Article 69(3) – coming back to the initial need for clarification of this particular provision.

- the set-up of an escrow account mechanism similar to a financial instrument and PPP equity (respectively Articles 42 and 64 of the CPR) to support outcome payments beyond n+3 or OPs closing dates.



82 Under EC "*Guidance for Member States on CPR_37_7_8_9 Combination of support from a financial instrument with other forms of support*" (EGESIF_15_0012-02), in the case of a combination of support within a financial instrument operation (single operation), "*The other forms of support* (including technical support, interest rate subsidies, and guarantee fee subsidies) *are provided either by the fund manager or, in the case of financial instruments implemented pursuant to Article 38(4)(c), by the managing authority. The support is for the benefit of final recipients but it is not directly paid to the final recipient.*" – Page 3.

83 It is not possible to identify eligible expenditure for segregation purposes in SCO-LS payments. Additionally, a SCO-LS payment may also include efficiency gains, thus partially financing the same as the "combined grant" supporting risk premium payments to investors.

5. OTHER RECOMMENDATIONS AND LESSONS LEARNED

... on setting-up a dedicated initiative to support social innovation

For other Member States

- Social innovation is not an easy theme, as it is usually assumed as "too innovative" and "nice to have" after covering all other priorities. Therefore, it is fundamental to have strong political support at the highest level to move the agenda forward.
- It is important to maintain a dedicated agenda topic on social innovation since an early stage of design and negotiation of ESIF programming cycles, ideally supported by the work and inputs of a dedicated technical team, including both ESIF and social innovation experts.
- Rather than embedding a social innovation component in all ESIF financed projects as a transversal priority, the best way to attain critical mass and generate effective impact is setting aside a dedicated ESIF budget specifically for financing social innovation projects (even if just a small amount for a proof-of-concept).
- Covering different sectors (Education, Health, Social Protection, Environment, etc.) and levels of intervention (national, regional, local), it is very important to plan and structure well in advance the alignment of Social innovation with PA/OPs structure concerning type of fund, geographic areas covered, governance, in order to minimise future constraints.
- Social innovation projects tend to have different financing needs as they evolve, so it is essential to finance the different stages of the life cycle of social innovation, as an integrated approach to effectively address all relevant needs and to build future project pipeline. Adjust the type of financing structures to the characteristics of each stage.
- Capacity building of social innovation projects, teams and stakeholders is one of the main gaps that seldom gets forgotten, when designing an initiative to finance social innovation. It is the most important dimension to include in any programme. It has an important multiplier effect, helping to internalise new knowledge and know-how throughout the funded organisations. But as the entry point of newcomers to social innovation and/or to ESIF financing, it is also the most vulnerable area to the negative impact of high transaction costs.
- Financing social innovation alone won't work, if not complemented by a strong focus on developing its ecosystem, building networks and engaging with all relevant stakeholders (implementing entities, social investors, intermediaries, evaluators, public sector organisations, etc.).

For the European Commission

- Technical assistance to Member States on ESIF applied to social innovation financing might help, as well as the timely sharing of best practices.
- Internal EC experts (e.g. DG EMPL F1) with a sound knowledge of social innovation practices and ESIF financing options throughout the EU, could be involved in on demand support to the EC Desks or even to MS in ESIF negotiation process with a social innovation component.

... on designing a SIBs Programme under ESIF financing

For other Member States

- The choice of ESIF financing structure to use (financial instrument or grant) should be aligned with the main SIBs financing gap in each Member State: initial capital/investors or payment for outcomes/public sector. However, in both cases, if not counterweight, there is always the risk that ESIF financing crowds out the participant stakeholders. So, whenever possible ESIF should not totally replace those stakeholders – supporting or co-investing along with investors, in the case of a financial instrument; promoting an active involvement of public sector commissioners and assuring public top-up budget in SIBs contracting and validation, since an early stage.
- Should SIBs performance payments be considered ESIF ineligible expenditure, there are some potential mechanisms, at Member State level, to help minimise this constraint: i) fiscal incentives for SIBs investors, ii) the use of hybrid SIBs investment models, where impact-driven philanthropic investors may be willing to forego part of their outcome payments to support return payments to other investors.
- The choice of ESI Fund (ERDF, ESF, CF, etc.) is a critical decision when setting-up a SIBs Programme. This seven-years decision needs to take into consideration the pipeline of existing and potential future SIBs projects. The adoption of a JAP (relevant for more mature Member State SIBs contexts) or of the 10% cross-funding possibility open by article 98(2) of the CPR (with a more limited scope, but more flexible) are the two alternatives to overcome this constraint, with different timings for implementation (anytime vs. PA/OP negotiations).
- To avoid the risk of unwanted budget transfer between levels of government, when deploying a SIBs Programme, alignment between ESIF spatial governance structure (thematic vs. regional OPs) and public sector spatial organisation relevant for public policy implementation is key. Establishing an ESIF Outcomes Fund with top-up financing from different sectors and levels of government may also be a good strategy to overcome this problem, as long as managed by a neutral consensual stakeholder.
- In the case of SIBs, rather than through standardisation followed by replication, scale is better achieved through the integration of innovative solutions successfully tested in a SIB into public policy, assuring its mainstreaming.
- When compared to most other ESIF operations, SIBs are usually longer duration projects, with no advance payment. So, besides integrating these two features in the design of applicable ESIF Member State specific regulations, reducing constraints to SIBs implementation by stakeholders might also help (e.g. through tailored TA, standardisation and streamlining of processes, templates, requirements, etc.).
- Specially in the case of SIBs, payment arrangement/provision tend to be an area of conflict between involved stakeholders, so rules on outcome contracting and validation need to be very clear and detailed. SCOs (namely lump sums or standard scales of unit costs) tend to be the best outcome payment option for SIBs deployment, but they are lengthy methodologies to design, especially when there is no previous track-record or available data. Ideally, a balance should be found between flexibility and accuracy. Moreover, the ex-ante availability of relevant datasets and the level of maturity of the SIBs context in that particular Member State may determine the methodology to adopt – unit costs / rate cards are usually used in more mature environments where detailed unit costs databases are already in place; lump sums for emerging environments that still need the definition and contracting of outcomes to be made on a SIB-by-SIB basis.
- For a SIB impact measurement and outcome validation activities, whenever possible relying on pre-existing public databases reduces time and transaction costs. The involvement of public sector agencies in SIBs design since its early stages is also important

for the identification and access to relevant public data – a key element for the definition of outcomes to contract in a SIB, as well as for its effective validation at a later stage. In cases impact measurement and outcome validation is performed by external evaluators, TA can work as a neutral equidistant payer, minimising the risk of capture by any of the SIB contracting parties.

- Contracting multiple outcomes is an interesting option to reduce risk for both SIBs investors and public sector commissioners. For public sector entities, it means being able to achieve and communicate quick-wins over time. For investors, it means avoiding to fully commit the total investment upfront and to be able to recycle the first payments for outcomes received into the next contracted investments in the project.

For the European Commission

(lessons learned and recommendations are presented in detail in Section 4 - subsection 4.4)

… on implementing an ESIF-financed SIBs Programme

For other Member States

- Considering setting-up a specific priority OP axis for social innovation, earmarking a specific budget for SIBs financing might be the best solution for effectively implementing a SIBs Programme.
- Setting an indicative value for a SIB but no maximum threshold is critical to allow/promote critical mass, as well as diversity. As gaps are addressed and the market grows, SIBs will tend to have higher values.
- There should be no co-financing requirements to SIBs applicants. A SIBs "delayed grant" for outcome payments should be totally financed by ESIF and Member State Budgets.
- In less mature markets, initial calls for SIBs applications should be broadly defined in terms of addressable public policy areas. This flexibility will not only optimize the number of applications in a first call, but will also allow potential SIBs to have the necessary time to adjust to this new model.
- Extended project duration from the traditional 12-36 months of most ESIF financed operations is a central feature for implementing a SIB, together with no cash advance (advance payment).
- Ideally, Member States should set-up a dedicated structure (Intermediate Body) responsible for creating SIBs pipeline and for monitoring/supporting SIBs implementation. Promoting the development of a strong and diverse network of intermediaries, that might work as process facilitators and aggregators, will also improve the success rates of a SIBs Programme.
- Identifying, raising awareness and supporting potential SIBs parties in building a SIB application is essential for building a strong SIBs pipeline. Pre-application support and capacity building to potential SIBs participants is key, as well as identifying and creating relationships since a very early stage of the implementation process with public sector stakeholders – namely the public agencies that will be supporting the validation of outcomes.
- To avoid conflicts of interest and self-financing through SIBs, social investors should not be implementing entities in the same SIB. Also, there can be no relation of control between the investor and the implementing entity.
- Templates, models, application guides and FAQs notes should be provided in advance to potential SIBs counterparts, in order to simplify application processes and to reduce administrative burdens, together with helplines and 1:1 technical support.

For the European Commission

(lessons learned and recommendations are presented in detail in Section 4 - subsection 4.4)

Additional lessons learned and recommendations

- Supporting SIBs measurement activities across the EU, a systematic effort for the creation of two complementary types of unit cost databases with different objectives, should start both at:
- Member State level, with more detailed and specific information from ministerial data sets, only available at a locally at Member State level. Relevant for outcome contracting and, at a later stage, for data collection / outcome validation;
- an international level, with broader and more generic cross border data sets compiled from multilateral organisations (EC/EUROSTAT, OECD, UN, World Bank, etc.). Relevant for comparability and cross boarder scaling/replication.
- An EU-wide TA approach might be relevant to attain critical mass and avoid fragmentation/ duplication, as SIBs contexts are evolving in the different Member States and increasingly more sophisticated requirements for 1:1 technical support are starting to emerge.
- A knowledge sharing platform supporting Member State-to-Member State interactions, as well as working as a repository of templates and other relevant information (examples of contracts, due diligence reports, etc.) for the different steps of SIBs deployment might also be useful to reduce barriers and asymmetries in access to relevant information.

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