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SOCIAL IMPACT BONDS 2.0?

PANDEMIC SHOWS RISKS OF EXTREME EVENTS TO SIB BENEFICIARIES



The first Social Impact Bonds were launched about ten years ago. Much has happened since. Economic and social upheavals followed the 2008 financial crisis. Then came the COVID-19 pandemic.

These events compounded new and increasing social needs including ageing populations, the rise of long-term health conditions such as diabetes, high rates of unemployment for young people, a mental health epidemic, plus loneliness across the generations and homelessness. This transformed landscape makes now a timely moment to think again about Social Impact Bonds and their future development.

This series of briefings on the future of Social Impact Bonds has been produced by the Policy Evaluation and Research Unit at Manchester Metropolitan University and the Price Center for Social Innovation at the University of Southern California. The series editors are Professor Chris Fox and Professor Susan Baines from the Policy Evaluation and Research Unit and Professor Gary Painter from the Price Center for Social Innovation.

PANDEMIC SHOWS RISKS OF EXTREME EVENTS TO SIB BENEFICIARIES

The pandemic reveals a need to build resilience into SIB relationships and the pay for performance contracts that undergird SIBs.

Deborah Burand details how COVID-19 and catastrophic weather events should prompt a rethink of SIB contracts and relationships.

The pandemic and recent catastrophic weather events are focusing attention on what happens when something really bad and very unexpected occurs that can suddenly paralyze some – or even all – of the parties to a Social Impact Bond (SIB). The vexing societal and environmental problems that SIBs and their close cousins, DBs (development impact bonds), attempt to address are hard to fix in the best of times. But this past year has seen scenarios where nearly everything that could go wrong does go horribly wrong.

How do you improve the education of girls if their schools are closed? How do you tackle recidivism if offenders are dying of disease while incarcerated? How do you reduce unemployment or homelessness in cities that are under strict quarantines and when government authorities allow only essential businesses to operate?

Some SIBs and DBs are confronting situations where service providers may be unable to provide contracted services to target beneficiaries. Evaluators may be precluded from measuring impact outcomes. Investors may be reluctant to continue disbursing funds. Even outcome payers

may be facing challenges in meeting their financial obligations.

The contracts that undergird many SIBs commonly provide for contractual governance mechanisms that bring parties back to the negotiation table, should these transactions stumble. For example, SIBs typically allow for the replacement of non-performing parties with substitutes. But what do you do when no service providers or no impact evaluators can perform their tasks because of unforeseen catastrophic events such as a pandemic or extreme weather conditions?

"FORCE MAJEURE" CLAUSES

Chances are you (or your lawyer) will look to see if your SIB contracts include a "force majeure" clause.¹ When a force majeure event occurs – be it an "act of God" or "act of man" – this clause typically excuses or suspends performance obligations of contracting parties for a designated time.

¹ In civil law jurisdictions you may find that force majeure is provided by law. In those jurisdictions, parties do not need to expressly provide for a force majeure clause in their contracts, unless they want to vary the clause's contents from what the law would otherwise provide.

PERU Policy Evaluation & Research Unit

The Policy Evaluation and Research Unit at Manchester Metropolitan University is a multi-disciplinary team of evaluators, economists, sociologists and criminologists. We specialise in evaluating policies, programmes and projects and advising national and local policy-makers on the development of evidence-informed policy. We have a long-standing interest in social investment and Social Impact Bonds. See www.mmuperu.co.uk for details of relevant publications.

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Sol Price Center for Social Innovation

The Sol Price School of Public Policy at the University of Southern California is a leading urban planning, public policy, public administration and health policy and management school. The Sol Price Center for Social Innovation is located within the School and develops ideas and illuminates strategies to improve the quality of life for people in low-income, urban communities.

'It may not be good enough to allow the various parties to a SIB to throw up their hands in despair and take some time off until they can get back to work.'

There is no single standardized form of force majeure clause. Yet, these clauses often take a similar approach to dealing with extraordinary events that are unforeseen and outside of the reasonable control of the contracting parties.

Force majeure clauses are not meant to be escape hatches. To the contrary, Rather, force majeure clauses are designed to give the parties a breathing spell until circumstances improve or the parties can work out how to get the wheels back on the bus. This "breathing spell" is time limited; there are built-in mechanisms for parties to agree when the time is up. At this point, the parties may resume operations, renegotiate key terms for continuing performance, or even terminate the transaction.

RISK TO VULNERABLE BENEFICIARIES

However, invoking a "force majeure" clause is not quite as straightforward as it might initially seem, particularly in the case of SIBs. Typically, SIBs are designed expressly to meet the needs of vulnerable populations who are affected by "wicked" problems. Their needs may be urgent. Moreover, as the pandemic has shown, the vulnerability of SIB beneficiaries is often heightened, sometimes disproportionately, in moments of a societal or environmental crisis.

So, it may not be good enough to allow the various parties to a SIB, when faced by unexpected catastrophic events, to throw up their hands in despair and take some time off until circumstances have improved and they can get back to work.

In practice, this means rethinking the elements of a force majeure clause. That involves identifying clearer limits on what types of events can trigger a SIB's force majeure clause; making more inclusive the decision-making process for determining when a force majeure event is triggered; and developing a timeline for excusing performance that takes into account the impact on SIB beneficiaries, as well as on the contracting parties.

Illustrative list of force majeure events those floods that now occur on a regular basis, in this case every two years, in the territory where that DIB is operating.

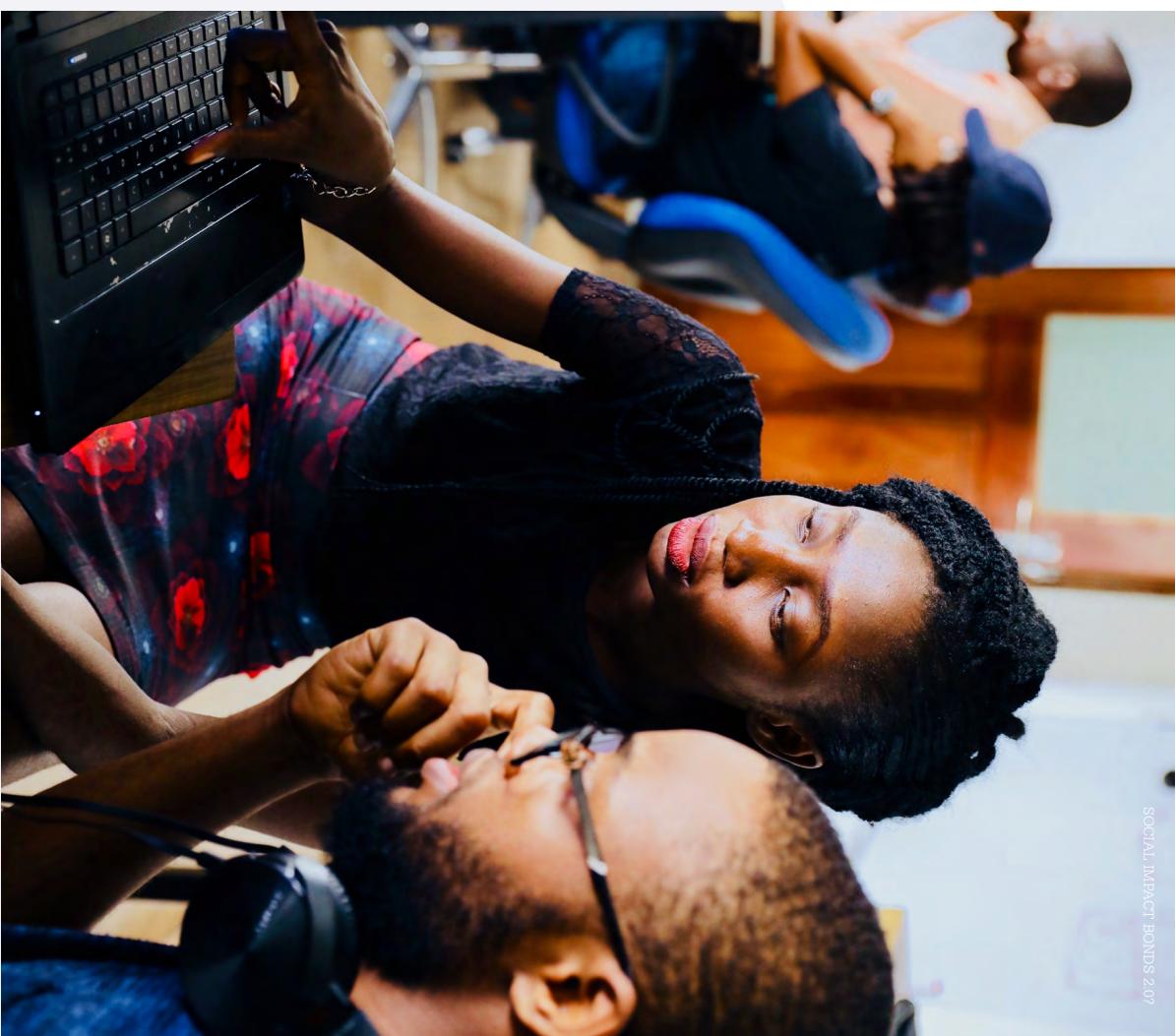
With the pandemic, other changes in force majeure clauses are afoot. Unlike a tsunami, for example, a pandemic's waves can continue to surge and resurge for an extended period. How long should parties' performance be excused during a protracted, and increasingly foreseeable, health crisis? Accordingly, some who are interpreting force majeure clauses are now looking, not to the pandemic as the possible triggering event, but rather to "acts of man" as the triggering event – namely to the regulations imposed by government authorities in response to the pandemic. When these regulatory responses are lifted, so too would the force majeure's breathing spell end.

But contractual provisions, like force majeure clauses, can only go so far. The dangers that catastrophic events, like pandemics and extreme weather events, pose to SIB beneficiaries may not have been fully recognized in early SIB contracts. A breathing spell that excuses the performance of service providers for an extended period of time can have terrible, even deadly, consequences for SIB beneficiaries.

BUILDING "RESILIENCE" INTO SIB RELATIONSHIPS

In the end, much of this is a discussion about how to anticipate, allocate, and manage risk. The pandemic has revealed the need to build still more resilience into SIB relationships. Vulnerable beneficiaries of SIBs should not be too readily abandoned when the going gets unexpectedly tough – even when it is through no fault of any party.

More specifically, SIB relationships should align parties' behaviours to protect the very populations that are to benefit from the SIB. This would involve engaging in more granular conversations upfront with different parties about whether they have the capacities to plan for catastrophic, exogenous events. Do they have contingency planning in place? Can they lay off some of these risks to third parties – such as insurers?



SIBs are often marketed as a way to tackle wicked problems endured by some of our most vulnerable citizens. We should make sure that, when an unusual act of God or man strikes, the risk of the SIB's demise is not dumped on its most vulnerable party – the would-be beneficiary.

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Additional Resources:

Deborah Burand, "Contracting (Incompletely) for Success: Designing Pay for Success Contracts for Social Impact Bonds (SIBs)," 28 Cornell J.L. & Pub. Pol'y 1 (2019) (available at <https://www.jstor.org/stable/10.7208/cornelljlp.28.1.1>)

Ranajoy Basu, "Force Majeure and Development Impact Bonds," (McDermott, Will & Emery, January 11, 2021) (available at <https://www.jdsupra.com/article/news/force-majeure-and-development-impact-533166/>)

The author(s) developed this paper with a collaborative writer, Jack O'Sullivan, from Think O'Sullivan Ltd
www.think-osullivan.com / jack@think-osullivan.com

The Policy Evaluation and Research Unit
www.mmuperu.co.uk
✉ @mmupolicyeval

Sol Price Center for Social Innovation
<https://socialinnovation.usc.edu>
✉ @USCPriceCSI