

The Treasury

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Joint Report: Social Bonds Pilot Procurement: Lessons Learned Review

Date:	23 September 2016	Report No:	T2016/1602 MOH Report No: 20161490
		File Number:	ST-5-4-2-1-1 AD62-14-2016

Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Bill English)	Note the contents of this report. Discuss this report at a briefing with officials (to be arranged).	Friday 7 October 2016
Minister of Health (Hon Dr Jonathan Coleman)	Note the contents of this report. Discuss this report at a briefing with officials (to be arranged).	Friday 7 October 2016

Contact for Telephone Discussion (if required)

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Actions for the Minister's Office Staff (if required)

Return the signed report to Treasury.

Schedule a meeting on this report with officials.

Note any
feedback on
the quality of
the report

Enclosure: **Yes (attached)**

Joint Report: Social Bonds Pilot Procurement: Lessons Learned Review

Executive Summary

In April 2016 Treasury reported to you on our intention to commission a lessons learned review of the social bonds pilot programme (TR2016/496 refers). Treasury engaged Fiona Mules to conduct this.

The main issues identified by the review stemmed mostly from the lack of commercial financial expertise within the pilot team, which led to a heavy focus on process diligence, as well as other issues such as a lack of senior sponsorship and engagement with investors.

To address the issues raised in the review, we have made the following changes to the current pilot programme:

- Roles and responsibilities across agencies have been clarified and agreed in a Memorandum of Understanding – in summary, the Ministry of Health remains the lead agency responsible for the delivery of the pilot programme, and Treasury will provide assurance that commercial advice to the programme is sufficient.
- Clearer delegations within Treasury. Commercial Operations is the Treasury lead on the social bond programme and responsible for ensuring that the commercial advice is adequate. Fiscal and State Sector Management provides policy and vote support.
- The membership of the pilot programme Steering Group has been re-cast to bring on board senior sponsors from the agencies that are involved with the pilot.

With respect to the future of the programme:

- The pilot phase will conclude when negotiations that are in train on bonds 1 and 2 close, regardless of whether these negotiations reach contract.[4]
- This means that there will be a number of milestones between now and the end of the pilot, with reports to Ministers (and potentially Cabinet) depending on how the work and negotiations progress.
- Once the pilot has been concluded we will work together to:
 - Formally capture lessons that can be applied to other forms of payments-for-results or outcomes-based contracting, and
 - Assess the desirability of a further programme of work on social bonds and provide advice to Ministers.

At present we see three key considerations for the future of the programme, if we consider that social bonds are an effective and efficient way for government to improve social outcomes:

- [2]

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Recommended Action

We recommend that you:

- a **note** the contents of Fiona Mules' lessons learned review (provided in full in Annex 2).
- b **note** that the following changes have made to address the issues identified in the review:
 - clearer delegations within Treasury,
 - changes to the membership and governance of the pilot project, and
 - a Memorandum of Understanding between the Ministry of Health and Treasury has been agreed in order to clarify the respective roles and responsibilities.
- c **note** that some of the recommendations from Fiona Mules' review would be best actioned in any future bond procurements beyond the pilot programme, given the advanced stage of the negotiations on bonds 1 and 2.
- d **note** the status of bonds 1 and 2
 - [4]
 -
- e **note** the following key milestones and decision points:

Milestone	When	Reporting
Modelling for bond 2 complete – decision to proceed (or not) on basis of value proposition for the Crown.	[4]	Update report to Ministers on the outcome.

Negotiations concluded, with contract agreed (or not) for bond 1.	[4]	<p>If contract is agreed: Cabinet paper and business case (to draw down funding for outcome-based payments).</p> <p>If contract not agreed: report to Ministers.</p>
Negotiations concluded, with contract agreed (or not) for bond 2 (on the basis that modelling will substantiate that a bond is viable).	[4]	<p>If contract is agreed: Cabinet paper and business case (to draw down funding for outcome-based payments).</p> <p>If contract not agreed: report to Ministers.</p>
Report to Ministers on the lessons learned from the pilot and recommendations for the future of the bond programme.	[4]	Report to Ministers.

f **note** that officials will provide advice to Ministers on the future of the social bonds programme, [2]

g **note** the following clarification of responsibilities between the agencies.

Ministry of Health	Treasury
<p>Delivery of the pilot procurement process.</p> <p>Running a robust and fair process.</p> <p>Leading negotiations and communications on the two bonds currently in train.</p> <p>Managing consultants and expert advice as required.</p> <p>Documenting lessons learned and preparing an evaluation at the conclusion of the pilot.</p> <p>Day-to-day management of the programme, including OIA requests, parliamentary questions and media.</p> <p>Ensuring that Ministers are sent regular updates on the progress of the pilot.</p>	<p>Treasury to provide assurance that commercial advice to the programme is sufficient, through increased level of commercial advice to the programme.</p> <p>Commercial Operations to be the lead contact within Treasury, and part of the negotiating team.</p> <p>Broader policy advice on the future of the social bonds model in New Zealand, as well as emerging policy and vote issues (as they arise).</p>

h **discuss** the contents of this report at a meeting (to be arranged with your offices).

Zoe Wyatt
Team Leader, Fiscal and State Sector Management, Treasury

Stephen O'Keefe
Chief Financial Officer, Ministry of Health

Hon Bill English
Minister of Finance

Hon Dr Jonathan Coleman
Minister of Health

Joint Report: Social Bonds Pilot Procurement: Lessons Learned Review

Purpose of Report

1. The purpose of this report is to inform you of the main findings of the lessons learned review on the social bonds pilot programme (commissioned by Treasury) and the actions we have taken in response. We also provide an update on the current state of the pilot programme.
2. In April 2016 Treasury indicated that it would conduct a lessons-learned review of the social bonds pilot programme to date, to inform thinking about the future of the programme. Treasury engaged Fiona Mules to undertake this. The review is in Annex 2. A summary of the review's recommendations and the actions taken in response is below.

Background

Results to date

3. The social bonds procurement pilot was launched in late 2013. As of August 2016, no social bonds have been contracted. In May 2016, parties to the negotiations on bond 1 (Mental Health and Employment), the [1] withdrew from negotiations. The Ministry of Health (MoH) is now engaged in negotiations with alternative parties for this bond. Negotiations on bond 2 (Reducing Youth Reoffending) are at an earlier stage, with data being collected and analysed to ascertain the value proposition.
4. Bond 1 is smaller in size [4] and relatively simple, so the expectation is that contract could be reached [4]. Bond 2 is larger [4] and the financial modelling is more complex, as the outcomes of youth offending could be much later in life for the recipients of the service (for example, a 12 year old receiving the service might then avoid a jail term in their 20s). This makes the modelling more complex as the bond needs to pay out (or not pay out) based on demonstrated results that are more proximate in time to the receipt of the service. [4]

The Lessons Learned Review

5. The main findings of the review were:
 - While the procurement process itself has been well run, a lack of commercial financial expertise within the pilot team has led to a heavy focus on process diligence as opposed to achieving a successful process outcome.
 - A lack of ongoing visible senior sponsorship within agencies for the pilot programme.

- That clearer basic commercial and financial parameters upon which the Crown would be willing to contract would have provided greater certainty and confidence to the market.
- The requirement to undertake a market-led process has added time and complexity to the procurement process, as well as a loss in negotiation power for the Crown.
- Investors should have been better included in all parts of the procurement process in order to understand what potential issues/concerns they might have about things like risk allocation and financial return. There should have been more up-front interaction with the market with respect to the intermediary role.
- That the lack of real-time decision-makers for the Crown at the negotiation table was suboptimal in terms of running a commercial transaction procurement process efficiently and effectively.

6. We accept these findings and Ms Mules' recommendations. We have taken immediate actions in response, as set out in the table below:

Review recommendation	Officials' response
<p>There needs to be commercial advice embedded into the social bonds programme.</p> <p>This is the most critical recommendation and could have helped the programme to have achieved more concrete results, despite a lack of clarity in the policy and commercial parameters.</p>	<p>Treasury will provide assurance that commercial advice to the programme is sufficient, with Commercial Operations to be the lead contact within Treasury and part of the negotiating team.</p> <p>The delegations within Treasury have been made clearer with the Commercial Advice Team becoming the Treasury lead for social bonds, and the Fiscal and State Sector Management Team providing policy and Vote support.</p>
<p>There needs to be a definitive owner of social bonds, with this agency owning the brand and the success. Logically it should be the agency providing the commercial advice resource.</p>	<p>Given that negotiations for bonds 1 and 2 are underway, it would be disruptive to transfer the ownership to Treasury (or elsewhere) at this point. Ownership of social bonds will be considered as part of the post-pilot review.</p> <p>The Social Bonds team at MoH has recently been refreshed, and the Senior Responsible Owner and Sponsor roles formalised following the recent leadership changes.</p>
<p>The commercial parameters on which the Crown is willing to contract should be made clear early in the process.</p>	<p>This recommendation has been incorporated into the discussions with the new parties to bond 1.</p>
<p>Ensure that there is a strong level of senior support for social bonds, and that their high priority is well communicated.</p>	<p>The membership of the Steering Group for the pilot has been re-cast to ensure that members are at an appropriately senior level (Tier 2 or above).</p>

Investors should have been better included in all parts of the procurement process in order to understand what potential issues/concerns they might have about things like risk allocation and financial return.	This approach is being incorporated into current discussion with parties to bonds 1 and 2.
The roles and responsibilities of Treasury and the Ministry of Health should be clarified.	<p>This has occurred and been reflected in a Memorandum of Understanding agreed between Treasury and MoH.</p> <p>Key points of clarification:</p> <ul style="list-style-type: none"> • MoH is responsible for the delivery of the pilot programme. • Treasury will provide assurance that commercial advice to the programme is sufficient and is responsible for broader policy work on social bonds. • An agreed set of principles to guide the working relationship. <p>More detail is included in paragraph 19.</p>

7. There were several other recommendations in Fiona Mules' report that are not able to be actioned in the short term, as they were more relevant to the set up of the process, and so would be better considered at the commissioning of any other social bond procurements. These recommendations are outlined in Annex 1.

The pilot – expectations and key milestones

8. The pilot will conclude when negotiations on bonds 1 and 2 close, regardless of whether these reach contract. [4]

9. MoH has no plan to extend the pilot beyond bonds 1 and 2.

10. The key milestones and decision points are summarised in the table below:

Milestone	When	Reporting
Modelling for bond 2 complete – decision to proceed (or not) on basis of value proposition for the Crown.	[4]	Update report to Ministers on the outcome.
Negotiations concluded, with contract agreed (or not) for bond 1.	[4]	<p>If contract is agreed: Cabinet paper and business case (to draw down funding for outcome-based payments).</p> <p>If contract not agreed: report to Ministers.</p>

Negotiations concluded, with contract agreed (or not) for bond 2 (on the basis that modelling will substantiate that a bond is viable).	[4]	<p>If contract is agreed: Cabinet paper and business case (to draw down funding for outcome-based payments).</p> <p>If contract not agreed: report to Ministers.</p>
Report to Ministers on the lessons learned from the pilot and recommendations for the future of the bond programme.	[4]	Report to Ministers.

The future of the social bonds programme

11. Our priority is to embed changes to the current pilot programme to support a good outcome for the Crown. Our preference is to refrain from making a judgment about the future of the programme until after the pilot programme has concluded so that we have the complete experience of the pilot to draw on.
12. Once the pilot phase has concluded we will work together to:
 - formally capture lessons that can be applied to other forms of payments-for-results or outcomes-based contracting, and
 - assess the desirability of a further programme of work on social bonds and provide advice to Ministers.
13. We are building up a clearer picture on both of these undertakings as the pilot progresses.
14. Making a decision on the future of the programme will require consideration of the following:
 - Whether social bonds are an effective and efficient way for government to improve social outcomes.
 - Whether the wider objectives for the social bonds programme (trialling innovative approaches in social service delivery, providing a funding option for good ideas, using outcomes based contracting etc) are best addressed via a social bonds programme.
 - The return we could expect from progressing the social bonds model in New Zealand, weighed against the high transaction costs.
 - Whether the pilot has demonstrated that the model either does, or could, work in New Zealand, given the novelty of the instrument and small investment market.
15. At present we see three key considerations for the future of the programme, if it is continued:
 - [2]

- [2]

-

Governance of the programme

- The membership of the Social Bonds Steering Group has also been revised to explicitly include the agencies from the social sector that could potentially inherit the management of the contracts for both pilots. The level of membership has also been elevated to a more senior level.
- The agencies represented in the Steering Group are: Corrections, Ministry of Justice, Ministry of Social Development, Ministry for Vulnerable Children – Oranga Tamariki, Treasury, Police, and the Ministry of Health.
- The Steering Group is charged with providing oversight, guidance and advice to the project team and the Senior Responsible Officer in MoH. They meet as required, regarding any key milestones that might be occurring, and bi-monthly at a minimum.

Roles and responsibilities

- As summarised in the table in paragraph 6, the roles and responsibilities of the agencies have been clarified in a Memorandum of Understanding as follows:

Ministry of Health	Treasury
<p>Delivery of the pilot procurement process.</p> <p>Running a robust and fair process.</p> <p>Leading negotiations and communications on the two bonds currently in train.</p> <p>Managing consultants and expert advice as required.</p> <p>Documenting lessons learned and preparing an evaluation at the conclusion of the pilot.</p> <p>Day-to-day management of the programme, including OIA requests, parliamentary questions and media.</p> <p>Ensuring that Ministers are sent regular updates on the progress of the pilot.</p>	<p>Treasury to provide assurance that commercial advice to the programme is sufficient, through increased level of commercial advice to the programme.</p> <p>Commercial Operations to be the lead contact within Treasury, and to be part of the negotiating team.</p> <p>Broader policy advice on the future of the social bonds model in New Zealand, as well as emerging policy and vote issues (as they arise).</p>

Communications

20. We recommend that consideration be given to proactively releasing Ms Mules' report when the pilot has concluded. Officials will be in touch with your offices to discuss this.

Risks

21. There are still a number of risks in bring the pilots to a conclusion. At this stage the main risks for bond 1 are around the timescale in completing the documentation for the outcome agreement, and concluding the investor arrangements. For bond 2 the risk is identifying a robust outcome agreement that delivers benefits for all parties.

Annex 1 – Recommendations that cannot be actioned in the short-term

For completeness, below is a table of the recommendations from Fiona Mules' report that cannot be actioned in the pilot, but would be taken into consideration for any subsequent social bond procurement.

Recommendation	Reason
Government should lead with the outcome areas in which it has interest in procuring a social bond.	This recommendation is best addressed in a subsequent bond procurement, as the outcome areas have already been chosen. It may be faster and simpler for government to specify the outcome areas of interest in subsequent procurements.
There should be better market building/education with investors and intermediaries.	This recommendation is best addressed in a subsequent bond procurement, as the intermediaries for bonds 1 and 2 are already in place. Investors are not yet in place however.
It would be preferable to procure on a consortium basis, where multiple parties are required to come together under one structure, rather than the 'cobbling together' of respondents.	This recommendation is best addressed in a subsequent bond procurement, since the service providers and intermediaries are already engaged in the negotiations for bonds 1 and 2.
The commercial and financial parameters should have been set up front.	Since the negotiations on bond 1 and 2 are well under way, it is not practical for the Crown to revise these. However, this recommendation was taken into account for the restoration of bond 1, with the initial communications with the other parties being much more specific about the outcomes sought and the financial parameters.
Government should help provide the proof of concept to investors by being willing to invest in social bonds alongside other social investors.	There is no specific funding allocation at present for government to be able to directly invest in social bonds. However, other government investment funds may be interested in taking part as minority investors. Whether government should set up a purpose-built social bonds investment vehicle is a broader policy issue that should be considered prior to the commissioning of another work programme of bonds.

Lessons Learned from the Social Bond Pilot Procurement Process

Review undertaken for The Treasury

Report completed 16 September 2016

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1. Background to the Social Bond Pilot Programme

1.1 History

1. The idea for the launch of a social bond pilot programme arose from a 'Dragon's Den'-style initiative run by The Treasury's Better Public Services team in 2012. At that time, the social bond concept was being trialled in various international jurisdictions as a new initiative in procuring improved social outcomes. The Ministry of Health (MoH) took ownership of the launch of the pilot programme in early 2013 (volunteered by the then Group Manager Policy, due to her significant interest in and enthusiasm for the concept).
2. KPMG was engaged to conduct a feasibility study (including market soundings) and produce a business case for MoH. A paper was presented to Cabinet in September 2013 seeking approval to proceed with the social bond pilot programme on the basis of the shortlisted outcomes areas/populations deemed suitable for a pilot within the business case. Cabinet approved the launch of the pilot programme, but directed MoH to instead undertake a "market-led" programme, which would seek participants' ideas in relation to the outcomes sought and the populations targeted for intervention.
3. [4]
4. In approving the launch, Cabinet confirmed the objectives of the pilot programme were to:
 - a) Test the concept in the New Zealand context to see whether social bonds could be an effective and efficient way for government to reduce social problems;
 - b) Develop the conditions needed in New Zealand to use social bonds more widely in the future, including growing the investor market and building capabilities of government agencies and service providers;
 - c) Learn lessons that could be applied to other forms of payments-for-results or outcomes-based contracting in the social sector, including the kinds of social issues, service providers and funding vehicles to which these models could be applied; and
 - d) Enable government to make more informed decisions on whether to use payments-for-results and outcomes-based contracting more widely in the future, and if so, how.

There were no specific objectives set in relation to government achieving a net positive social or financial return on investment for the social bonds themselves.

1.2 Procurement Process

5. The procurement process run by MoH, following Cabinet's approval to launch the pilot programme, comprised the following steps (in brief):
 - a) November 2013 - market education events held to prepare the market for the release of the respective Requests for Registrations of Interest;
 - b) December 2013 - public Request for Registrations of Interest from service providers issued, whereby service providers were to propose their service, target outcomes and target population;
 - c) April 2014 - public Request for Registrations of Interest from intermediaries issued (i.e. the party(ies) proposed to be responsible for managing the service provider(s), managing the investor(s) and managing the contract with government);
 - d) November 2014 - matchmaking event held for shortlisted service providers (12) and shortlisted intermediaries (4) to get together and determine if a suitable partnership could be formed;
 - e) December 2014 - education event held for shortlisted service providers and shortlisted intermediaries to prepare them for the release of the Request for Solution Outline;
 - f) December 2014 - Request for Solution Outline issued to the shortlisted service providers and shortlisted intermediaries, with the parties required to respond in partnership; and
 - g) April 2015 - four potential pilots selected for a more detailed solution design phase (an interactive process with MoH). This phase incorporates another two 'gates' which the potential pilots must move through as they are developed, which cover evaluation of the deliverability of the proposal and its alignment with the pilot programme objectives (gate 2), and Ministerial approval to proceed to the next phase (gate 3).
6. The time period attributed to the detailed solution design phase was expected to differ for each potential pilot due to their varying stages of development and complexity of structures/solutions. Following completion of the detailed solution design phase for each potential pilot (and gate 3 approval), it was expected that the parties would progress to the contract negotiation phase and then the pilot establishment phase.
7. Upon commencing the detailed solution design phase, two potential pilots were identified as having the earliest potential to launch, with the remaining two expected to have relatively longer solution design phases due to their complexity. Of the two 'prioritised' potential pilots, one was identified as being simpler in structure (with fewer parties involved and better data availability) and thereby potentially simpler to contract, and so that pilot was proposed for "fast-tracking". Fast-tracking this potential pilot meant that the development of the remaining three potential pilots would be slowed down until this pilot was contracted. This would enable the lessons learned from contracting the first pilot to be applied to the subsequent pilots as they were further developed.

8. Ministers approved the fast-tracking of the first potential pilot in May 2015. Following this approval, a “joint development” phase was commenced, which included development (and negotiation) of the commercial parameters of the deal, i.e. risk allocation, performance standards, payment mechanism structure, etc. This phase continued through to May 2016, at which point in time the parties behind this pilot withdrew from the pilot programme [4]
9. MoH has since developed a Pilot 1 Restoration Plan which involves offering a social bond targeting similar outcomes areas/populations [4]
10. The current status of the remaining three shortlisted potential pilots are as follows:
 - a) Pilot 2 - has passed the gate 3 approval and has entered into the “joint development” phase, including development of the commercial parameters of the deal; and
 - b) Pilots 3 and 4 - have been placed on hold until Pilots 1 and 2 have been contracted. MoH considers there is significant further feasibility work to be undertaken in relation to these two potential pilots.

2. Review Findings

2.1 Procurement Process

11. The procurement process itself has been well run. In particular I note that:
- The process has followed a logical progression of procurement phasing, i.e. market sounding/building → ROI → shortlist → RFP → interactive process for proposal development → shortlist → negotiation.
 - The documentation provided to participants was of a good standard, with appropriate explanations of objectives and process; clear and consistent messaging; and opportunities for questions and feedback from participants.
 - The evaluation approaches and criteria applied to shortlisting procedures were appropriate for the task at hand and the nature of the project.
 - Measurement and analysis tools have been developed for assessing the financial impacts of improved social and economic outcomes that can be applied to any future social bond programme as well to wider government initiatives in this area.
 - The importance of ethical, fair and equitable treatment across participants was well understood and obvious in its implementation (as evidenced by the 'clean' probity audit reports).
 - Delegated authorities/approval rights were recognised and adhered to.
 - Formal process checks and balances were included along the way in terms of the timing and nature of approvals sought; the involvement of other agencies in the process to provide oversight; and the inclusion of gates/off-ramps to ensure objectives were still being met.
12. Further, MoH has indicated that debriefs undertaken with parties not shortlisted for subsequent phases of the procurement process did not raise any concerns in relation to the procurement process.

2.2 Issues Identified

2.2.1 Intermediary market building/education

13. The market uptake in response to the service provider Request for Registrations of Interest indicates that the opportunity was widely communicated and reasonably well understood by service providers, with 41 Registrations of Interest received. The market uptake in response to the intermediary Request for Registrations of Interest was significantly lower with 13 Registrations of Interest received. This may be a result of the smaller market for parties willing and able to take on this role, or this may indicate a lack of understanding on the market's part in terms of the role and its responsibilities. It is likely a combination of the two.

14. MoH also seemed to struggle with its understanding of who could/would play the intermediary role and what its purpose was in the New Zealand context (as compared with other larger, more developed markets). MoH took the approach whereby the Request for Registrations of Interest was open to parties proposing to take on only one of the management aspects of the role (i.e. service provider management or investor management). While this flexibility may facilitate greater market participation and enable the market to come up with its own structures without government being heavily prescriptive, it can also lead to piecemeal responses and a subsequent “cobbling together” of parties to ensure that all roles/responsibilities required within the social bond construct are covered.
15. Greater interaction with the market upfront in relation to the intermediary role in order to understand who the likely participants were, how they would structure themselves and what their concerns/positions would be in the context of the social bond construct may have assisted both the level of uptake and the consistency of responses across participants in terms of the responsibilities proposed to be taken on.

2.2.2 Interaction with investors

16. An obvious omission from the market building/education phase was any targeted interaction with potential investors. MoH was entirely, and deliberately, reliant on intermediaries performing this function. Given their importance in the mix, it is imperative to understand first-hand what potential issues/concerns that investors may have in terms of the social bond construct and what positions they are likely to take in relation to risk allocation, financial return, etc. This information should be understood upfront, to the degree possible, in order to determine the likely viability of the programme and the consistency with government’s expectations. This issue has been further exacerbated by not having investors involved in any subsequent part of the procurement process, including the development of solutions and commercial and financial parameters of the deals.
17. It is unwise to only interact with intermediaries on this basis and expect them to second-guess what investors’ issues/positions might be (having not yet sourced investors to complete the structure), which was the position taken by MoH. There is a significant risk of disconnect between what intermediaries think investors will sign up to and the reality of investors’ positions once they understand the deal. For this reason, investors must be ‘market tested’ upfront and involved in all discussions along the way in relation to a potential pilot, i.e. they must be sourced and actively ‘at the table’ when discussions commence in order to give any certainty to government that the pilot will get off the ground. Having buy-in from service providers and intermediaries is not the appropriate measure of success in relation to the social bond pilot procurement process, rather having a ‘banked’ contract ready for implementation will indicate a successful procurement process.

2.2.3 Procurement team skills and expertise

18. The team leading the social bond pilot programme is comprised of individuals from the procurement unit of MoH. While very capable in terms of running a 'by-the-book' procurement process, this team does not have, nor purports to have, any experience in undertaking commercial transactions. The difference between running a regular government procurement process and undertaking a commercial transaction (especially in a new market) is significant. The social bond pilot programme falls very much into the latter category.
19. The MoH team require significant commercial support to understand and deal with the dynamics of running a commercial transaction process. This support has been provided by Treasury to varying degrees over the course of the process. It is fair to say that the commercial support from Treasury has not been consistent or to the level required in order to ensure the enduring success of the programme¹.
20. A lack of clarity in the establishment phase of the programme led to different perceptions as to whether or not the programme was being jointly run by MoH and Treasury. In reality, it has not been jointly run. Treasury did provide some commercial expertise (via a resource in the policy team) to the programme until this resource left Treasury in December 2015. After this, Treasury provided mainly Vote and policy expertise, with commercial expertise being made available to MoH when requested (via a resource in the commercial operations team). Treasury's assumption in the latter stages was that the commercial advisor to the programme (PwC) was providing the required level of commercial support, whereas in fact this was not the case, with PwC's mandate only extending to feasibility analysis and financial/economic modelling of proposals. There was clearly miscommunication between MoH and Treasury in terms of what each party's expectations were of the other in relation to the procurement process.
21. Not having commercial transaction expertise embedded in the programme on an ongoing basis has led to a heavy focus on process diligence as opposed to achieving a successful process outcome. This is not to say that a well-run, fair and robust process is not an absolute requirement, but rather the two need to be given equal priority. The MoH team have worked to their process diligence strengths, which is to be expected given the amount of interest in the pilot from media and other observers, and recent publicised probity issues with another project.
22. The lack of commercial transaction expertise within the team has contributed to the following issues:
 - Not fully engaging with the market upfront to ensure the market's understanding of the commercial nature and structure of the deal;
 - Not understanding the importance of engaging with investors (who ultimately make or break the deal) directly as opposed to leaving this to intermediaries;

¹ I note that this inconsistency in the provision of commercial support is not in and of itself responsible for the failure of the first social bond negotiation. The failed negotiation pertains more so to the lack of clear commercial parameters being set upfront to guide both MoH and participants in the process.

- A reluctance to engage with participants during the course of the process in a continuous, direct and open manner to ensure all expectations continue to be aligned (in the nature required in commercial transactions);
- Not understanding the respective parties' (government and bidder) responsibilities in undertaking a commercial transaction and therefore what is needed from a resourcing and budget point of view;
- Not understanding the motives and drivers of all parties to the deal and how that will manifest itself in the joint development/negotiation phase;
- Not having prior knowledge of the important aspects of a deal that need to be considered upfront by government;
- Not having prior knowledge of how to guide the process/discussions to quickly determine whether or not the desired outcomes can be achieved; and
- Not providing confidence to participants in government's ability to do a commercial deal (once in joint development/negotiation phase).

2.2.4 Senior sponsor support

23. While staff and structural changes within Treasury have not helped the situation noted above, the lack of visible senior sponsor support for the social bond pilot programme within Treasury has exacerbated the problem. There has been no clear communication within Treasury as to its role in the programme (current or ongoing), or the priority/importance of this programme vis-à-vis other initiatives.
24. [2]
- Again, there has been no clear communication within MoH as to the priority/importance of this programme vis-à-vis other initiatives, nor strong and consistent support for the project team to ensure its success.
25. This issue arises because there is no clear ownership of either the social bond programme or the individual bonds/contracts. Leading the procurement of such an initiative is not a business-as-usual task for MoH and it will not be the holder of any of the potential pilot contracts. Essentially, this is an unusual, one-off, non-core piece of work for MoH and is being treated as such. MoH understands that its role is only to test the market and prove the concept, and thereafter the programme will be transferred to another entity.
26. [2]
- The approach being taken at the moment is to see whether there is any merit in the programme based on the success of the pilots. Unfortunately, this leaves the pilot programme without an overarching sponsor or advocate across government truly focussed on ensuring its preliminary success.
27. [2]

28. Stronger cross-agency support and involvement would also facilitate valuable cross-agency sharing of similar experiences and initiatives occurring in this space. For example, despite the second potential pilot involving reducing reoffending, the MoH team were not aware that the joint Department of Corrections/Treasury procurement team wrapped a social bond relating to this outcome into the Wiri prison PPP in 2011. There were valuable learnings to be shared here in terms of the payment mechanism, performance standards, measurement metrics, etc, that were 'banked', which have not been shared, thus leading to a doubling up of this thinking and time included within the process that could otherwise have been saved.

2.2.5 Market-led process

29. The Cabinet requirement to undertake a market-led process has added significant time and complexity to the procurement process. As a result of not focussing the Request for Registrations of Interest for service providers on pre-determined outcomes areas, MoH had to evaluate 41 service and outcome proposals, of varying quality and relevance, on a fair and equitable basis. Only 12 of which were deemed suitable for further consideration for the pilot programme.
30. The selection of disparate outcomes areas for the potential pilots has also resulted in the need to source data for feasibility testing and impact assessment of proposals from scratch from a range of sources across government (i.e. no pre-work could be undertaken to expedite the process).
31. Also due to the disparate nature of the outcomes areas contained within the proposals, participants are essentially participating in a non-competitive process, where the terms and conditions of the deal are second order to the good idea. This leads to a loss in negotiation power for government given that no proposals directly compete against each other to be considered the most attractive to government.
32. A market-led process also has more potential to lead to intellectual property ownership disputes. Some of the ideas presented by participants will not necessarily be unique in the market, but may be considered to be so within a procurement process where no solution parameters have been set. Given the sensitivity to government procurement processes being challenged by disgruntled participants, following a 'bring us your ideas' approach knowing that there is little genuine intellectual property likely to be brought to the table in terms of outcomes areas (as opposed to service provision) creates an unnecessary risk.

2.2.6 Commercial/financial parameters

33. While remaining silent in the procurement documentation on issues such as risk allocation and payment mechanisms/caps enables government flexibility to consider innovative approaches and structures that the market may come up with, this can also lead to parties being unaware of the commercial nature of the deal that government is anticipating. This often leads to parties participating in a process who have no real ability or appetite to enter into a commercial payment-by-results deal. The end result is that parties may drop out of the process, after significant time and effort has been spent on both sides, or that negotiations become protracted (and even ultimately unsuccessful) due to a complete mismatch in expectations.
34. It is imperative that the market is given an idea upfront of the general basis on which government is prepared to do a deal. That is not to say that government has to understand to the full degree, or pre-empt, where the deal may land, or preclude other approaches/structures being proposed by participants, but rather provide some general parameters within which an acceptable solution may be found. This helps not only to guide participants but also the procurement process itself.
35. When considering whether or not to enter into a commercial transaction procurement process, the market values certainty and confidence. It is important that it is clear to the market that government knows what it is doing, what it wants to achieve and how. The market can then determine on that basis whether or not the parties are aligned before expending time and effort on what can be a lengthy process. This is true even with projects of a catalyst nature, such as the social bond pilot programme. Government must show that it has done some thinking upfront and is confident of a successful outcome on that basis, as opposed to just letting a process run without any definitive parameters and seeing what happens in the end.

2.2.7 Real-time decision-making

36. Having decision-makers at the table provides confidence to participants that the right people are in the room, as well as enables the process to move swiftly. In this instance, there were no decision-makers at the table. The team leading the procurement process had no delegated authority to make real-time decisions in order to expedite the process. Further, there was uncertainty within the team as to what their actual mandate was, with a view that they had essentially been given the message “don’t say yes or no to anything, just report back”, which led to a continuous cycle of checking and approvals even at basic levels.
37. Given the team’s lack of commercial skills and expertise (discussed in sub-section 0 above) this was likely the right approach in this instance, however in terms of running a commercial transaction procurement process efficiently and effectively, this approach is suboptimal. Again, the themes of giving the market confidence in the process, knowing what it is government wants to achieve (from a commercial and financial, as well as a social and economic outcomes perspective) and having a team with the right skills and expertise at the forefront come to bear here.

3. Recommendations Moving Forward

3.1 Measures of Success

38. It is not possible to say definitively at this point whether or not the social bond pilot programme has been a success, or whether or not the pilot objectives have been achieved, given that there have been no social bond contracts let at the time of this report. The issues identified in section 2.2 of this report have contributed to varying degrees to this current outcome.
39. It is certainly possible to say however that lessons have been learned through the progression of the pilot programme to date that can be applied to a subsequent programme should government wish to proceed further with the initiative. The first lesson being to set more specific objectives upfront that pertain to the social bonds themselves and getting successful contracts away. This will ensure that the team leading the procurement focusses appropriately on the desired outcomes of the process as opposed to the mechanics.
40. On the basis of the objectives set for the pilot programme (listed in section 1.1 of this report), it will be easy for government to claim that the social bond pilot programme has been a success without actually securing any contracts for social bonds, given the emphasis on “testing” and “learning”. When participants’ efforts cost them real time and money, government should be aspiring to achieve more specific and tangible outcomes than this from the outset. In reality, the pilot programme cannot be deemed to be successful until social bond contracts have been signed and are in implementation phase.

3.2 Ownership of Programme

41. In order for any future social bond programme to be successful, it must have a definitive owner. It is important that one agency owns the programme ‘brand’, and is responsible for the integrity of the model and the application of the procurement process within that brand. The market values consistency of approach.
42. The market also values having the appropriate expertise in the room to provide confidence that government is taking the programme seriously, knows what it wants and can get a deal done. As discussed in sub-section 0 above, having commercial transaction expertise embedded in the procurement team for social bonds is an absolute requirement. This will also enable real-time decision-making in order to expedite the process.
43. The agency owning the brand and protecting the integrity of the model does not have to be the direct benefactor of any of the social bonds, nor does it have to be the delivery agency. It just has to provide knowledge, guidance and absolute support to agencies looking to undertake a social bond both in their early deliberations and throughout any subsequent procurement process. On this basis, it is logical that the owner of the brand is also the agency providing the commercial transaction expertise to delivery agencies.

3.3 Process Recommendations

3.3.1 Government-led outcomes areas

44. The way in which any future social bond programme is taken to market must be simplified and more focussed in order to be more efficient and progress more swiftly. Government is best placed to determine its priority outcomes areas/populations in order to generate the greatest social and economic impacts. Within this context, government also needs to consider the relative ease with which data can be sourced (or is even available) to support the process and agency ownership of the social bond contract can be determined. It is much more difficult to run an efficient and effective process when multiple agencies have various responsibilities within individual outcome areas, as opposed to a single point of accountability.
45. Once priority outcomes areas/populations have been identified and prioritised as above, these can be presented to the market and participants can then compete within these areas on a service provision basis, i.e. the way in which they propose to provide services to achieve the desired outcomes will be the point of differentiation. This enables a more like-for-like assessment of proposals, while still seeking innovative approaches to achieving outcomes.
46. Selecting the outcomes areas that will be presented to the market also enables government to source the requisite data pertaining to outcome impacts in advance, so as to speed up the feasibility and impact assessment process (and feedback to participants) once proposals have been received. Front-ending the savings/benefits data analysis will also enable government to set financial parameters upfront in terms of the level of payment expected to be made for a certain level of results over and above counterfactual, giving participants certainty as to what they are aiming for and for what return.

3.3.2 Greater market building/education: intermediaries and investors

47. It is important prior to taking a new programme to market that the market is rigorously tested to ascertain both the appetite and the capability of all parties needed within the structure to ensure a successful outcome. A decision cannot be made to proceed without a reasonable view as to whether all positions within the structure can be appropriately filled. This process also gives potential participants the opportunity to build their awareness and understanding of the proposition to them, government's objectives and requirements, and the roles and responsibilities of the various parties expected to participate.
48. Prior to any future social bond programme being launched, a significant market testing and building exercise needs to be undertaken in relation to potential intermediaries and investors to ensure that there is sufficient understanding, interest and expertise to get deals done.

3.3.3 Consortia respondents

49. Selecting parties within a process on an individual basis is sometimes required in situations where there has been no prior market formation. It is preferable however to procure on a consortium basis where multiple parties are required to come together under one structure/contract. This enables parties to undertake their own due diligence on each other and determine if they have cultural/value alignment and similar expectations as to outcome.

50. Any future social bond programme would benefit from enabling/facilitating the formation of full consortia prior to commencing the formal procurement process. This may circumvent, to some extent, any misalignment/mismatch of expectations between parties occurring during the procurement process. Procuring on a consortium basis also serves to speed up the process (given the absence of multi-party discussions within a single bond proposal), and ensure a more complete and cohesive proposal response, thus providing government with more confidence in relation to the overall deliverability of the proposal.

3.3.4 Communication of programme prioritisation

51. Clear communication from Ministers to senior executives, and from senior executives to their teams, is required in relation to the requisite level of support to be provided for any future social bond programme vis-à-vis other initiatives. All agencies and individuals involved, or expected to be involved, are busy and have competing priorities. In order for a process to move forward efficiently and effectively, people need to make time to contribute as and when required.

3.3.5 Commercial/financial parameters set upfront

52. As discussed previously, the market values certainty. Further, it is pointless having participants involved in a process if they do not have the capability or the appetite ultimately required to do a deal. Setting general commercial and financial parameters upfront, such as risk allocation and payment mechanisms/caps, will serve all parties better. Only those prepared to work within those parameters will participate, which ultimately saves some participants a reasonable amount of time and money and also shores up the likely success of the process.
53. That is not to say that government should be definitive or prescriptive to the point of not being open to other (not diametrically opposed) positions from participants, rather government should have a clear view of what success looks like from its perspective in this regard and the general basis on which it is prepared to do a deal.
54. In time, government should also look to standardise (and publish) social bond contractual documentation to the extent possible (general terms and conditions as opposed to bond-specific issues) to expedite the negotiation process and create an open and transparent process with the market.

3.4 Wider Considerations

55. It is important to recognise that an investment in a social bond competes with other social and financial investment opportunities in the market. If the deal is too risky (i.e. likely outcomes are too difficult to assess) for the expected return or too complicated/difficult to understand (as compared with competing opportunities), then investors will be difficult to source. As a matter of course, social bonds only really attract investors with a dual social and financial investment philosophy, albeit they still compete with other available investment opportunities within this context.

56. Social bonds have been successfully contracted overseas due to a proportion of the investment funding being provided by government via a social finance/investment fund. Governments establish social finance funds to invest alongside other social investors in instruments such as social bonds. This spreading of risk facilitates deals getting done. However government has not completely passed responsibility for the achievement of outcomes over to third party investors to manage (which is the real purpose of the social bond concept).
57. Private investors are typically attractive to government because they are considered to bring enhanced due diligence and a direct (and active) focus on performance in order to achieve financial results. Government is not considered to bring those things to the table (hence the focus overseas on co-investment). If government was to bring those things to the table, then there would be no real requirement for third party investment. Government could be the sole benefactor of the financial impacts derived from the achievement of outcomes (in addition to the social and economic impacts).
58. The question is whether or not government can or is willing to bring the benefits associated with third party investment to bear itself. The ultimate purpose of social bonds is to generate better social outcomes through innovative service provision. A valid question to ask is whether there is a simpler way to achieve this than through the addition of a convoluted financial structure. Overseas jurisdictions have settled on a 'half-way house' through the establishment of social finance funds (which employ specialist commercial/investment skill sets), which co-invest alongside other social/philanthropic investors in social bonds (among other things).
59. It may be that this is a structure to consider if the social bond pilot programme proves to be unsuccessful in securing appropriate commercial and financial terms and conditions for government, or if investor appetite is not sufficient to support third-party funded bonds of an adequate size. The social, economic and (net) financial impacts derived from successful performance under the bonds have to be of sufficient size to warrant the government's ongoing investment in the programme (each procurement process costs time and money). Thus, the breadth of service provision on which a bond's success is relying has to be of sufficient size also. It is possible that when social bonds are scaled up in the New Zealand market to the point where they really make a difference, social investors are not willing to put as much capital at risk as is required under a fully third-party funded bond, or there may not be sufficient social investor capacity in the New Zealand market to fund a fully scaled social bond programme.
60. Alternatively, government may just consider whether better contracting processes for service provision (i.e. scalable, flexible and payments-by-results based) targeting government's priority outcomes areas/populations could go a reasonable way towards achieving the desired outcomes.