

# INNOVATIVE FINANCING FOR THE ELIMINATION OF HARMFUL PRACTICES

## IMPACT BONDS AS A TOOL TO ELIMINATE HARMFUL PRACTICES



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### 01 | BACKGROUND

UNICEF undertook scoping exercises to identify promising innovative financing models that support gender equality and the empowerment of girls. These were done in collaboration with the female genital mutilation (FGM) Donor Working Group (DWG)<sup>1</sup> and a global advisory group of experts

from institutions, such as the Wallace Global Fund, World Bank, Swiss Agency for Development and Cooperation, Better Finance, World Bank, UBS Optimus Foundation and the Swedish International Development Cooperation Agency (Sida). In their deliberations, the advisory group identified impact investment bonds as a strategic tool for financing the elimination of harmful practices generally. This note provides an overview of impact bonds and defines how UNICEF could use this tool in advancing the elimination agenda for harmful practices in alignment with UNICEF Child Protection Strategic Plan 2021–2030.

## 02 | INTRODUCTION AND CONTEXT

Impact bonds (IBs) have established themselves as an important source of development finance and, arguably, as the most widely used innovative financing (IF) mechanism (instrument). IBs are a form of outcome contract, where an investor (as a rule a non-public entity) provides upfront financing for the provision of (social) products and/or services and is only paid if the specified outcomes are achieved. The payment is conditional to the success, i.e., the stipulated outcomes being achieved. IBs focus on outcomes and, as a rule, involve a third party to the contract.

IBs have been used in both developing and developed countries, from financing social/community initiatives to raising funds at the national level to contribute to Sustainable Development Goal (SDG)-related national efforts. They are a form of performance agreement where the focus has shifted from the inputs to the definable results (i.e., outcomes). They are also often referred as one of the instruments linked with pay-for-results promoted by some national governments (most notably the United Kingdom) and international financial organizations (such as the World Bank). Although they have been used extensively in international development, they have not been utilized, as such, in financing the achievement of SDG 5.3. One of the major challenges may have been the difficulties in measuring the outcomes.

## 03 | IMPACT BONDS TAXONOMY

IBs have been used for over 20 years, and over time they have diversified. Social impact bonds (SIBs) and Development impact bonds (DIBs) are two major types of impact bond that are currently used while developing financing practice.

### SOCIAL IMPACT BONDS (SIBS)

A SIB is a type of the outcome-based contract where investors are paid by the (national) government, which represents the society (i.e., diverse interested parties). SIBs are a form of pay-for-performance (PfP) contract that have been used primarily in developed countries, especially to finance social interventions and/or regeneration initiatives.

### DEVELOPMENT IMPACT BONDS (DIBS)

A DIB, in contrast, is an outcome-based contract, where the commissioner (payer for the outcomes) is usually an external party, either an international donor (donor government or multilateral development agency) or (international) philanthropic entity.

UNICEF and its partners have an opportunity to work on developing both bonds, with different stakeholders. With regard to SIBs, UNICEF may act as a capacity developer and advocate, working with national governments to build the necessary IF infrastructure and facilitate the SIB development at a national level. UNICEF and partners, as global leaders, would develop DIBs to co-finance its activities, including ending harmful practices. DIB raised finance may in fact be used to co-finance commissioning of SIBs at a national level, creating a unique performance driven development space.

## 04 | IMPACT BOND MECHANISM (SIB/DIB)

IBs are tripartite contracts where the contacting parties are the investor that provided up-front financing for the service (or goods) and the commissioner that pays for the stipulated outcomes. The investor is, as a rule, a private entity that is seeking a return on its investment, whilst contributing to the societal development. As the impact bond payment is directly linked with success (i.e., defined outcomes being achieved), the investors face a certain level of risk and as such would require a commensurate rate of return. Also, international financial institutions may be involved in providing some de-risking services, thus making the impact bond more attractive to more traditional investors. The service provider is usually a domestic entity that works closely with the targeted societal groups to ensure that the outcomes are achieved as stipulated in the contract. The provider manages the contract and has to document the outcomes and present them to other contractual parties. The commissioner sets out the desired outcomes to be achieved and when they can be seen to be (demonstrably) achieved, is expected to make payment to the investor(s).

IBs empower effective partnerships where experts from different fields may be brought together. Up-front financing facilitates early interventions, promotes innovation and experimentation, supports involvement of civic sector organizations and other



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societal partners. However, impact bonds are often expensive to launch, although innovative in their nature, they may be structurally rigid (and hamper innovation), require excellent data collection and management, outcomes may be difficult to define and may lead to further 'financialization' of international development finance (i.e., may be perceived merely as a replacement for the traditional overseas development assistance (ODA) flows).

### 05 | APPROACHES TO IMPACT BONDS IN THE CONTEXT OF ENDING FGM AND CHILD MARRIAGE

Impact bonds (SIBs and DIBs) financing for the elimination of FGM and child marriage may be approached at global and national levels.

#### GLOBAL LEVEL

At the global level, the most efficient approach would be to **use the existing DIB infrastructure**, where the larger DIB issue would, in part, be used to finance ending FGM and child marriage programmes/projects and where a fraction of development outcomes may be focused on eliminating FGM and child marriage. Global SDG bonds may also be explored, since eliminating FGM and child marriage are targeted by SDG 5.3, and as such should be eligible to be covered by such a financial instruments.

Another approach would be to **issue a global DIB** targeting the elimination of FGM and child marriage where the issuer(s) will be an international agency (such as UNICEF) ideally in collaboration with an international

philanthropic organization, and/or international or regional development bank. A banking partner may serve as a co-commissioner or provide de-risking services, thus making the impact bond more interesting to the market.

#### NATIONAL LEVEL

At a national level, employing the proposed government engagement framework, national governments may consider **issuance of an SIB** where some desired outcomes would be linked with eliminating FGM and child marriage. The SIB may be structured as an SIB or be labelled as an SDG impact bond. National governments in larger countries which face serious problems with FGM and child marriage, may consider the issuance of a separate SIB that would exclusively target ending FGM and child marriage. This single outcome targeting may be particularly attractive to large federal and quasi-federal countries where the national government and states' (federal units') governments are strongly committed to ending harmful practices (FGM and child marriage).

#### WHAT UNICEF WILL REQUIRE TO SET UP A GLOBAL DIB

Impact bonds, like all the other IF mechanisms, require the following:

- Thorough capacity development
- Ongoing support for the issuer in terms of developing a project, pricing the outcomes, awarding and managing the outcome-based contract and selecting and managing the implementing partner
- Developing capacities to collect and manage data, use data to understand and support outcome reporting, and so on.



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## 06 | STEPS IN DEVELOPING IMPACT BONDS

Developing impact bonds is usually an onerous process which requires significant time and resource commitment. It usually encompasses the following steps:

**STEP 1: Conceptualizing.** In the conceptualization phase, ideas are challenged and the development of a 'bankable project' is initiated so that there is a mini-market for good projects (internally). During this stage, the concepts are developed, and not the full project/programme proposals.

**STEP 2: Deciding.** Through internal competition the proposal/concept that is most likely to attract the interest of potential investors is put forward for further development. SWOT analysis of each and every proposal is usually undertaken.

**STEP 3: Designing.** The project that has been supported will be the fully developed in a way that the potential investors would find attractive. Having a clear definition of outcomes is a key issue to be tackled in this phase. Also, proving (usually based on the past performance) the capacity to monitor and manage the project is another key element.

**STEP 4: Contracting.** Contracting is seen as a process of entering into a formal legal relationship by all the major parties (investor and

commissioner) with rights and duties of the contract/agreement parties being clearly agreed. Often there may be a special purpose vehicle (SPV) developed to release the payment to the service provider.

**STEP 5: Procuring.** When the contract is in place a service provider has to be chosen (for SIBs).

**STEP 6: Implementing.** The service provider implements the project, focusing on the agreed outcomes.

**STEP 7: Monitoring and Reporting.** Monitoring and reporting systems are the key for the realization of the contract and payment of the investor; hence, regular data collection has to be established and impact assessment established.

**STEP 7: Closing.** Impact bonds are time-limited and the contract has to be brought to a close with payment made to the Investor as per the contract, based on the outcomes and impact.

## 07 | CONCLUSION

IBs take time to develop, may vary in maturity to suit the needs of issuer and ultimately may not be a one-size fits all solution, but rather a tailor-made IF solution for committed and effective public sector partners and complimentary financing streams to the traditional development finance sources for ending FGM and child marriage.