

Discussion Topic – Smart Impact Bond Workshop

Impact Bonds Challenges and a Smart Blockchain Response

Given the recent growth in support for (Social Impact Bonds) SIBs as an innovative financing mechanism, there are a number of technical challenges which, if not addressed in the medium term, may result in the asset class not reaching the heights dreamed by its evangelists within the impact investment community.

One area which needs to be addressed is that of research quality. If SIBs are going to see the broad-level market adoption, which many believe is necessary to address society's global inequality challenges, then access to critically informed research is going to be paramount. This research will need to be thorough and be of a sufficiently robust standard that SIB designers (stakeholders) will be able to establish reasonable success outcomes based on objectively verified empirical evidence. The research phase is often where the theory of execution and reality diverge resulting in poorly designed impact bonds, and thereby increasing the risk of programme failure. Thankfully this is one area where blockchain and the Web 3.0 standards will be able to support increased access to rich data through structured and compliant processes.

Another challenge in the impact bond environment is that the biggest proponents of the model are the intermediaries and funders who often take a substantive role in service design and delivery. The risk of this scenario is that these stakeholders run the risk of creating impact bonds engineered with a primary focus on reducing investment risk and increasing pay-out probability versus ensuring that design is ultimately optimised to create the highest social and financial return on investment possible for public entities and governments. This is a natural tension, however in its current state, intermediaries and funders appear to have a disproportionate amount of influence on impact bond design.

The area of opportunity for smart impact bonds application is that traditional impact bonds designers are often limited to targeting only scalable projects to support the cost of the in-depth technical expertise required. Smart impact bonds will provide the opportunity for smaller projects to receive funding which were previously overlooked. As more projects come on stream there will be the opportunity for dramatic intermediary cost reductions and a greater percentage of capital concentrated on service delivery. This is one of the most significant challenges which impact bonds are currently burdened by is managing the success factor expectations between investors and government. The tension between these two types of actors will also be another area where the Smart Impact Bonds framework could significantly improve overall party incentive alignment.

Whilst there are a number of headwinds facing SIBs, there is a significant opportunity for Smart Impact Bonds to further improve a compelling rational alternative to the more traditional approach of impact and social investment. Hope continues to spring.