Leveraging philanthropy

Impact at scale for the world's most vulnerable with the DIB Fund

UBS Optimus Foundation, November 2020

Why are we using blended finance within the new DIB fund? In a word: results.

Philanthropists are giving more than ever before. But we still lack enough funding to achieve the UN sustainable development goals (SDGs) by 2030.

We've seen the benefits of results-based funding in the development impact bonds (DIBs) we've led as social investor. What we need now is funding at scale.

The DIB Fund will use blended finance – philanthropic and commercial capital – to invest 100 million US dollars to improve healthcare, education and livelihoods globally. We think it has the potential to set a paradigm for truly impactful development funding.

The world's most pressing problems can't be solved by the philanthropic capital currently in play. How can we use it to catalyze more investment?

Persistent hardship for the most vulnerable
Over 810 women die every single day from preventable issues and complications in pregnancy and childbirth.[1] Over a quarter billion children were out of school even before the COVID-19 pandemic.[2] And more than half of children over the age of 10 can't read.[3] Poor education leads to a crisis of employment. There are 68 million young people out of work. Among those young people who are working, a full 126 million – about 30 percent – are extremely or moderately poor.[4]

The most vulnerable people in our global society continue to suffer from these privations. And the COVID-19 pandemic has only made it worse. Now, more than ever, it's critical that we find effective, scalable solutions to these global problems.

The cost of solutions
The world's most pressing social and environmental problems are encapsulated by the United Nations Sustainable Development Goals (UN SDGs). The 17 SDGs lay out a blueprint of what peace and prosperity look like globally. And it isn't merely about relieving poverty. The SDGs call for sustainable solutions that improve health and education, provide clean water and sanitation, reduce inequalities and spur economic growth.

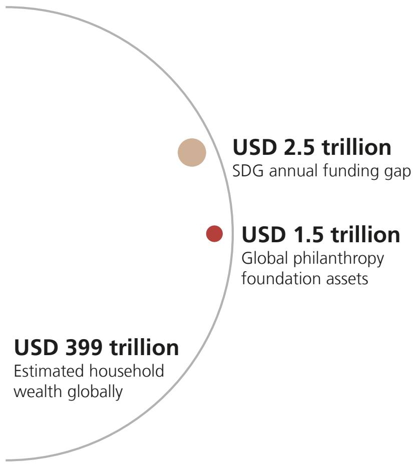
What's that going to cost? The UN estimated in 2019 that to reach the SDGs by 2030 we need 2.5 trillion US dollars more per year. No doubt the COVID-19 pandemic will probably make this shortfall even worse. So there's a need for capital to invest in providing long-term, sustainable solutions.

Can we just give more?
Global philanthropy's total current asset base – all the money in foundations and donor-advised funds around the world – is about 1.5 trillion US dollars.[5] We're living through a boom time in philanthropy, as more and more entrepreneurs are successful and pledging to give away very large proportions of their wealth. At UBS Optimus Foundation we see as much as 90 percent bestowed philanthropically. Through the Bill and Melinda Gates Giving Pledge, over 1.2 trillion US dollars has been pledged to be given away from 200 of the wealthiest families worldwide during their lifetimes or in their wills.

So philanthropy is growing. But it probably will only grow to around 5 trillion US dollars in the next 10 to 15 years. Clearly that's not enough to fill the funding gap of 2.5 trillion US dollars annually or the over 25 trillion needed to reach the goals by 2030.

We know philanthropists care deeply about these issues and have been working diligently to address them. Interventions with proven impact are making progress toward the SDGs. But philanthropy on its own cannot solve these problems. To be successful we need to use philanthropic capital as a catalyst to increase private sector investment in sustainable development.

A gap in funding[6]



1 WHO, Maternal Mortality, September 19, 2019. https://www.who.int/news-room/fact-sheets/detail/maternal-mortality
2 UNESCO Institute for Statistics, "New Methodology Shows that 258 Million Children, Adolescents and Youth are out of School," *Fact Sheet no. 56,* September 2019. http://uis.unesco.org/sites/default/files/documents/new-methodology-shows-258-million-children-adolescents-and-youth-are-out-school.pdf
3 World Bank, Ending Learning Poverty: What Will It Take?, World Bank, 2019. http://documents.worldbank.org/curated/en/395151571251399043/pdf/Ending-Learning-Poverty-What-Will-It-Take.pdf
4 International Labour Office, *Global Employment Trends for Youth 2020: Technology and the future of jobs,* March 9, 2020. https://www.ilo.org/wcmsp5/groups/public/---dgreports/---dcomm/---publ/documents/publication/wcms_737657.pdf
5 Paula Johnson, Global Philanthropy Report, Harvard Kennedy School, 2018. https://cpl.hks.harvard.edu/publications/global-philanthropy-report-perspectives-global-foundation-sector
6 UN SDG Group, Unlocking SDG Financing: Findings from Early Adopters, 2018. https://unsdg.un.org/resources/unlocking-sdg-financing-findings-early-adopters; Johnson, Global Philanthropy Report; Credit Suisse, Global Wealth Report 2020, October 2020. https://www.credit-suisse.com/media/assets/corporate/docs/about-us/research/publications/global-wealth-report-2020-en.pdf

Private investment and government spending aren't closing the gap. What's wrong with the current focus?

Bridging the gap
One way to close this annual funding gap of 2.5 trillion US dollars is to look at private capital. There's over 399 trillion US dollars of household wealth worldwide.[7] So, enough private wealth exists to potentially bridge that gap. Blended finance, using catalytic capital from public or philanthropic sources to increase private sector investment in sustainable development, is one promising route. But why not just rely on current investment strategies?

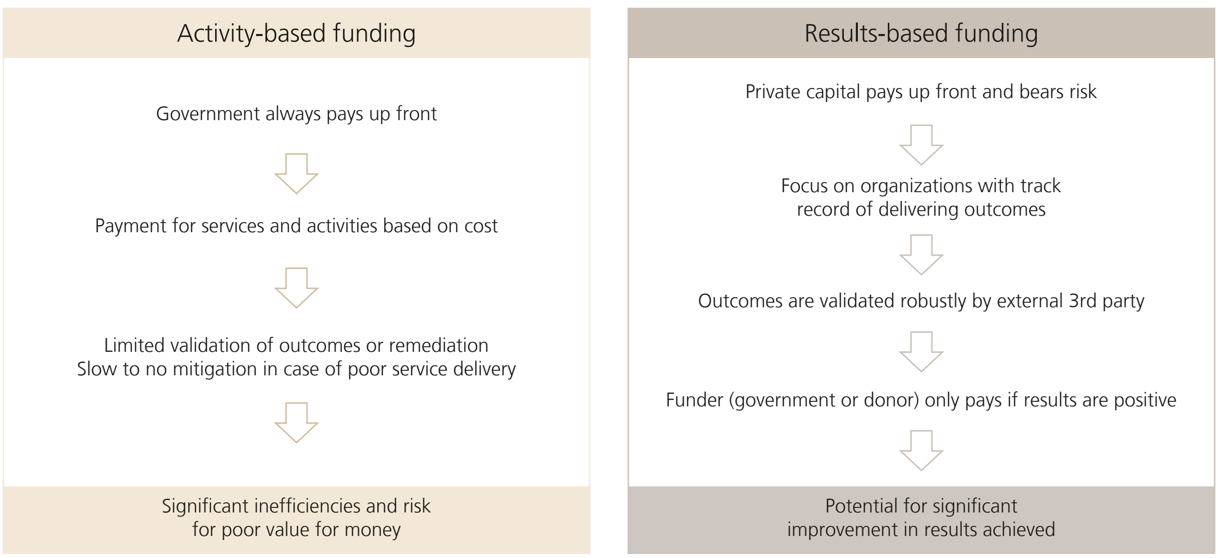
There's no doubt that some of the SDGs can be met through impact investments into areas like clean energy. But private solutions can only go so far. Private markets often don't reach the very poorest and don't address the most challenging problems: GIIN reports that only one-tenth of impact investing capital is currently allocated toward healthcare (7%) or education (3%).[8]

What about government?
It's partly the responsibility of government to meet the needs of the most vulnerable in society. So, why aren't government expenditures doing just that? We believe one of the issues is that governments tend to spend their money in a particular way. They tend to pay for activities. And they pay up front, often without any real assessment of results.

This kind of funding is frequently not achieving the social impact it intends to achieve. That's partly because government isn't really built for finding innovative solutions to social problems. Public servants are accountable to taxpayers, who are often risk averse to novel approaches. Plus, system inefficiencies and inflexible budgets – not to mention politics – often get in the way of trying out new and more effective ways of delivering social services.

A market for results
Fortunately there's another way. A promising shift is how various governments around the world are moving away from activity-based funding toward a paradigm of results-based funding. Instead of paying for things with mere hope that they work, private investors, philanthropists, foundations or other investors bear the risk but tie payments to outcomes.

With results-based funding, the investors fund organizations that have proof that they can deliver results in areas like education or healthcare. Not only social enterprises – also NGOs deliver results – independently evaluated, of course – then the government or donors purchases those outcomes. In this way, government only pays for results if they are achieved, with investment capital bearing the risk – quite better than throwing darts at activities.



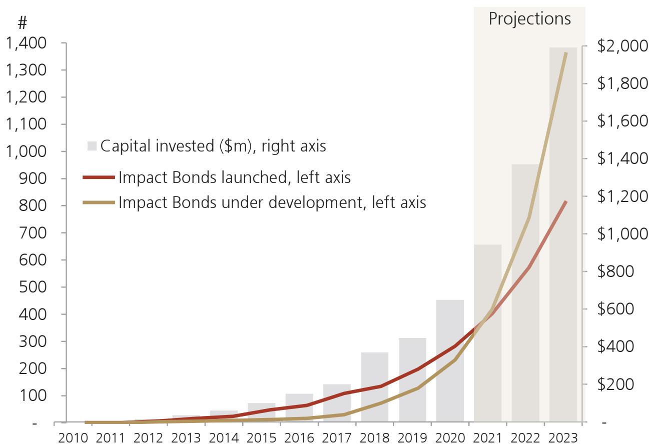
7 Credit Suisse, Global Wealth Report 2020.
8 Global Impact Investing Network, 2020 Annual Impact Investor Survey, p.33. https://thegiin.org/research/publication/impinv-survey-2020#charts

Results-based funding holds the key for advancing development. How does it work?

Positive outcomes through impact bonds
Results-based funding is experiencing strong growth over the last decade. Some Results based funding contracts are also called impact bonds. They aren't actually "bonds" in the traditional sense – they are pay-for-outcomes contracts. An investor provides upfront funding to a partner, and if that partner achieves certain results, or outcomes, a third party pays the investor.

Results-based funding started in the UK about 11 years ago. Since then there have been 194 outcomes contracts issued by different local and national governments around the world. Of those 194 impact bonds, 50 have now concluded. And there's a fairly good track record: outcomes have in fact been achieved and investors have been repaid in all cases but three.[9] These types of contracts are much more efficient for governments as they are able to see what's working and pay only for that. Plus, people who are putting up the risk capital, which up to now has almost exclusively been philanthropists, have actually been repaid by government due to successful interventions.

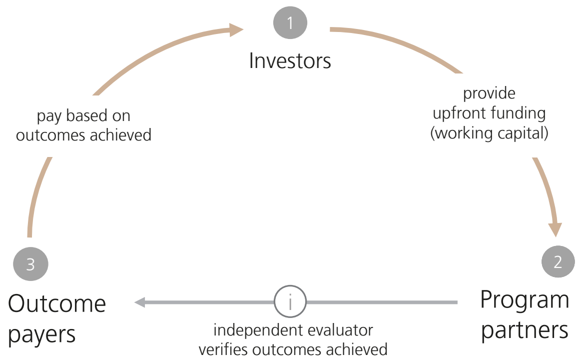
Impact bond market projections



Results-based funding in development
Development impact bonds (DIBs) are one way to develop an ecosystem that can encourage more investment in development programs that are 100 percent focused on creating measurable impact. By tying outcome payments to performance, program partners have an increased incentive to deliver results. Here's how it works:

- Social investors fund an intervention delivered by a program partner, often an NGO
- If the program partner's intervention achieves its goals, assessed against predetermined metrics, the outcome payer provides the social investors a return based on performance, part of which may go to the program partner
- Returns can then be recycled within the program or into further impactful development programs

Development impact bond (DIB) structure



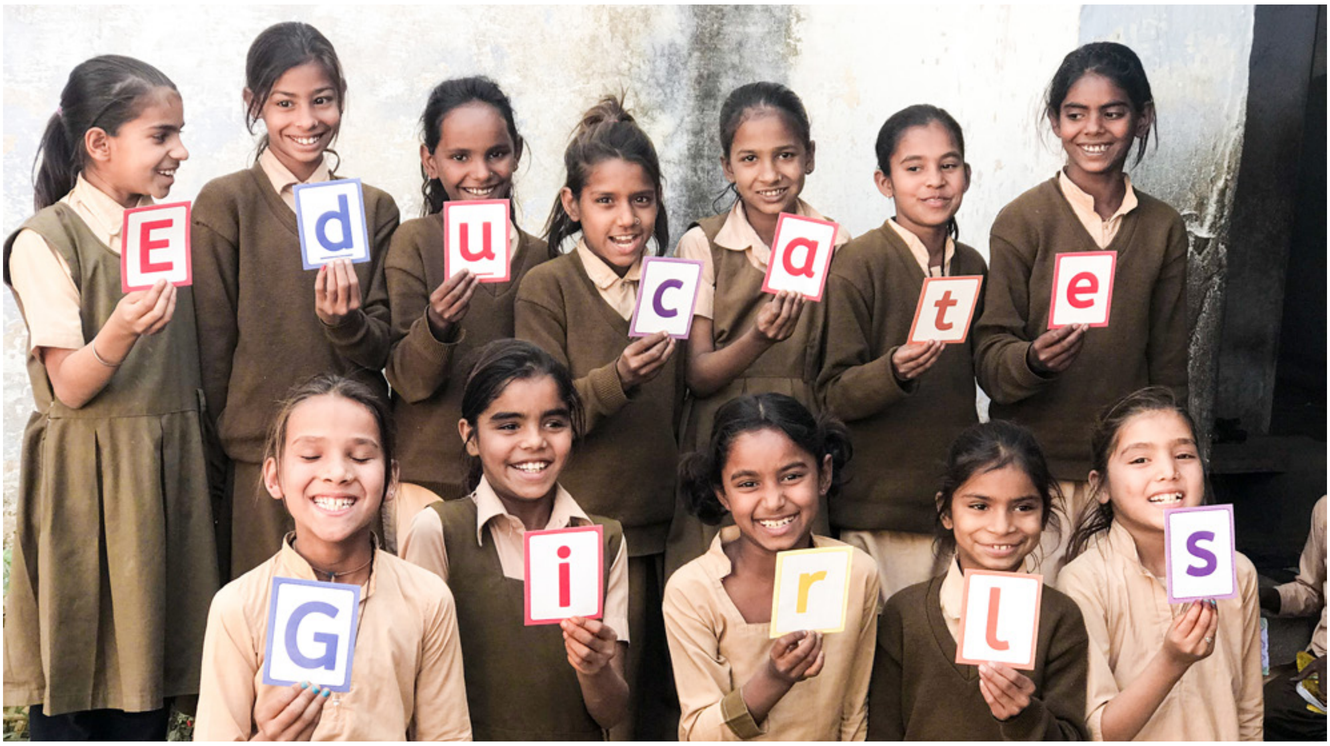
By using a contract where the investor gets paid for success, the impact of that social investment can be multiplied many times over. Let's say 100,000 US dollars are invested into an education program for out-of-school children. And the results are achieved: children get back to school and are learning. Then the outcome payer makes a payment to the investor. This outcome payment can then be reinvested into getting more children back to school. And so on.

Our track record
UBS Optimus Foundation is recognized as a thought leader in innovative financing mechanisms for social impact. We were instrumental in designing the world's first DIB in education: the Educate Girls DIB. Since that first pilot we've designed and invested into two additional impact bonds, with two more in development (the Educate Girls DIB and two currently underway are described on the next page).

In addition to these DIBs, we're also helping to design the impact bond ecosystem. We co-launched the Impact Bond Working Group along with a number of large donors. Alongside UK's FCDO we helped to launch the University of Oxford's Global Knowledge Platform for Impact Bonds.

Across all our efforts in this space, the objective is to help governments shift from activity-based funding to a focus on outcomes, only paying if and when results are achieved. And we aim to support program implementers in building capacity, accessing design funding and securing outcome funding.

9 Brookings Institution, Are Impact Bonds Delivering Outcomes and Paying Out Returns?, 2020. https://www.brookings.edu/research/are-impact-bonds-delivering-outcomes-and-paying-out-returns



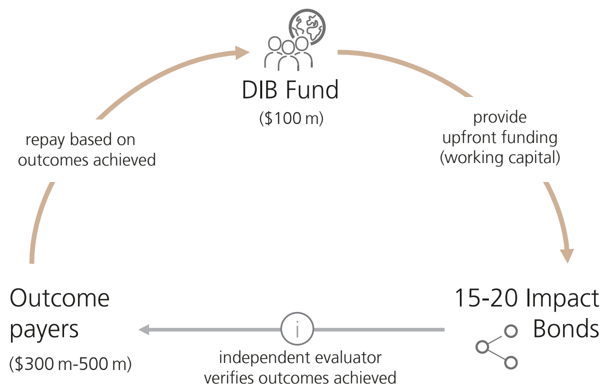
Educate Girls DIB 2015-2018	Utkrisht DIB 2018-2021	Quality Education India DIB 2018-2022
Beneficiaries: 7,300 children in 166 schools	Beneficiaries: 600,000 pregnant women served by 360 small, private, rural healthcare organizations	Beneficiaries: 200,000 primary school children
Location: Rajasthan, India, where girls are twice as likely to be out of school compared to boys	Location: Rajasthan, India	Location: Northern India
Investor: UBS Optimus Foundation Program partner: Educate Girls	Investor: UBS Optimus Foundation Program partners: HLFPPT and PSI	Investor: UBS Optimus Foundation Program partners: Pratham InfoTech Foundation, Society for All Round Development (SARD),Kaivalya Education Foundation, Gyan Shala
Outcome funder: Children's Investment Fund Foundation (CIFF)	Outcome funders: MSD for Mothers and USAID	Outcome funders: British Asian Trust and Michael & Susan Dell Foundation
Results: – 768 girls enrolled in school (116% of final target achieved) – improving learning level (160% of final target achieved) Achieved IRR: 15% (max. IRR) USD 420k outcome vs. USD 270k investment In addition to a bonus payment for overachieving on targets, Educate Girls was able to raise USD 80 million in additional funding for their entire five-year plan.	Target IRR: 5-8% (max. 8%) USD 8m outcome vs. USD 2.9m investment The Utkrisht DIB is focused on improving maternal and newborn health through improved quality standards for at least 360 small healthcare organizations. These improvements will also allow them to get accredited so that they can benefit from the national insurance scheme as well as some government subsidies for low-income patients. The improved healthcare facilities have already served over 200,000 pregnant women and newborns and is on track to meet targets.	Target IRR: 8% USD 10m outcome vs. USD 3m investment Within this world's largest DIB in education we're working with four different NGO implementers offering diverse operating models ranging from teacher and headmaster training to education technology. We discontinued one model after the first year because of underperformance, shifting funding to an outperforming model, highlighting the benefit of ability to course correct to optimize learning. We've just finalized year two of this DIB exceeding targets and reaching over 100,000 children.

We need to unlock private capital to meet the funding gap. What's this got to do with philanthropy? Blended finance holds the key.

Bundling for efficiency and impact
Development impact bonds (DIBs) shift the emphasis in development from activities to results, thereby getting more impact for every dollar spent. And we think we can do even better by investing in a portfolio of impact bonds under one umbrella. The rationale for setting up a fund of impact bonds is to bring in cost efficiencies through standardizing contracting and measurement while achieving scale. Pooled funding across multiple programs with pooled outcome funding also diversifies risk.

The DIB Fund will invest in 15 to 20 DIBs over the next decade. Rather than investing in one DIB in one area, we'll invest in a portfolio of impact bonds in healthcare, education and livelihoods with validated outcomes for the most vulnerable people across different geographies.

The DIB Fund



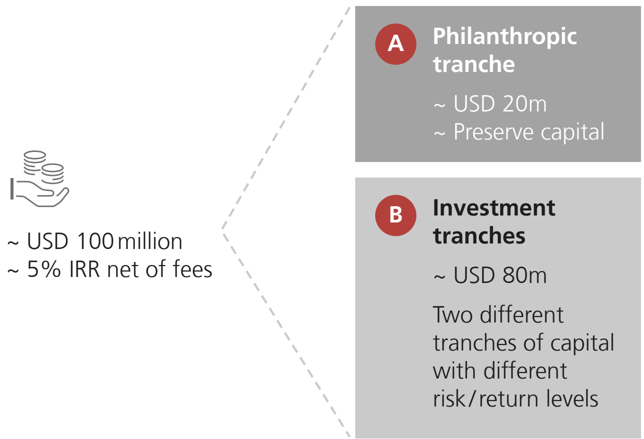
Unlocking private capital
Beyond the efficiencies and greater scale, we see the bundling of impact bonds into a fund as a way to leverage the power of philanthropy to attract private capital. Blended finance – the use of catalytic capital from public or philanthropic sources to increase private sector investment in sustainable development – is not new.[10] But its application here is. The DIB Fund applies this concept to DIBs for the first time, with a focus on health, education and livelihoods – areas that are currently underfunded.[11]

The DIB Fund will be a 100 million US dollar fund where 20 percent, or 20 million, will be philanthropic capital. The remaining 80 percent, or 80 million, will be commercial capital. The philanthropic capital acts as a catalyst for the entire structure, unlocking that additional 80 percent of commercial capital that otherwise might not engage because of perceived risk. The philanthropic capital aims to take the first loss risk, protecting the more senior investors.

The outcome payers of the DIB Fund will include entities like the World Bank, donor agencies and governments. Initial pledges come up to 300-500 million US dollars if predetermined results are achieved and independently verified.

The DIB Fund will invest in projects where the social and financial returns are correlated: for example, the more children that attend school and show learning advances, the larger the outcome payments. More social returns leads to more financial returns – and, importantly, returns are not correlated to the market, an attractive feature for investors.

The DIB Fund – a blended finance structure

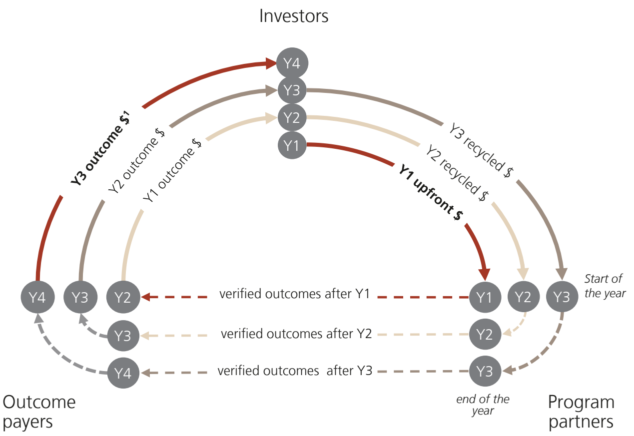


10 Convergence, "Blended Finance." https://www.convergence.finance/blended-finance
11 Global Impact Investing Network, 2020 Annual Impact Investor Survey, p.33. https://thegiin.org/research/publication/impinv-survey-2020#charts

Philanthropists want social impact. How does 15 times the impact sound?

The multiplier effect
With individual DIBs philanthropists multiply their impact through the recycling of outcome payments throughout the lifecycle of the program. On average impact is three times traditional philanthropic giving, depending on the structure and length of the program.

Program multiplier through recycling funds



1 Outcome payments usually include the required working capital plus a success premium, as defined in the contract between the different parties.

When a 3-year DIB is successful, the initial philanthropic investment is recovered from the program, potentially alongside a premium. When UBS Optimus Foundation invests into and recovers funds from DIBs, funds are reinvested into other DIBs or philanthropic programs.

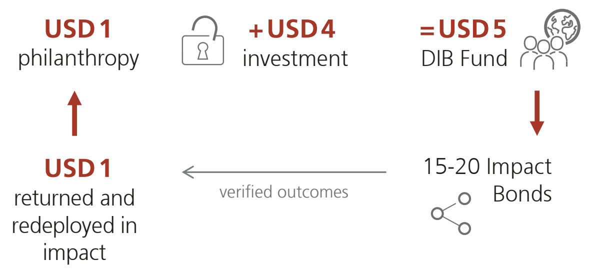
Even greater impact through the DIB Fund
The philanthropic tranche is the most important tranche of the DIB Fund. Each philanthropic donation can achieve at least 15 times the social impact. That's because the DIB Fund not only has the program multiplier of three times through the recycling of funds, it also leverages additional private investment capital, mobilizing up to five times the original funding.

Let's say a philanthropist contributes 1 million US dollars. The philanthropist's money unlocks 4 million additional US dollars from investors, maybe even institutional investors like pension funds, by taking this first loss piece. Through the program multiplier effect, this 5 million US dollars results in a total of 15 million US dollars spent on high-impact interventions like educating children, improving hospitals and getting young people into jobs. And, if everything works as we expect it to, that initial investment will be returned to the philanthropist at the end of the DIB Fund cycle, ideally with an inflation-linked return or possibly slightly more if the DIB Fund has outperformed.

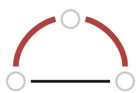
We think this offers an incredible social return on philanthropic investment – a very compelling proposition for people who are already motivated to move the needle on development. The DIB Fund is a way to use philanthropy more efficiently and effectively to fill this funding gap by leveraging it with traditional investment capital and recycling it within programs.

The multiplier effect of the philanthropic tranche

1 **Capital multiplier**
5x leverage and capital preservation



2 **Program multiplier**
3-5x times through recycling of funds



Impact Bonds require less investments versus outcome payments. Envisioned average ratio will be 1:3 in the DIB Fund.

Unlocking capital and maximizing impact
Philanthropists are giving more than ever before. Yet there is still an annual 2.5 trillion dollar funding gap to achieve the UN sustainable development goals (SDGs) by 2030. Private enterprise isn't addressing the most trenchant problems and governments often aren't maximizing their spending.

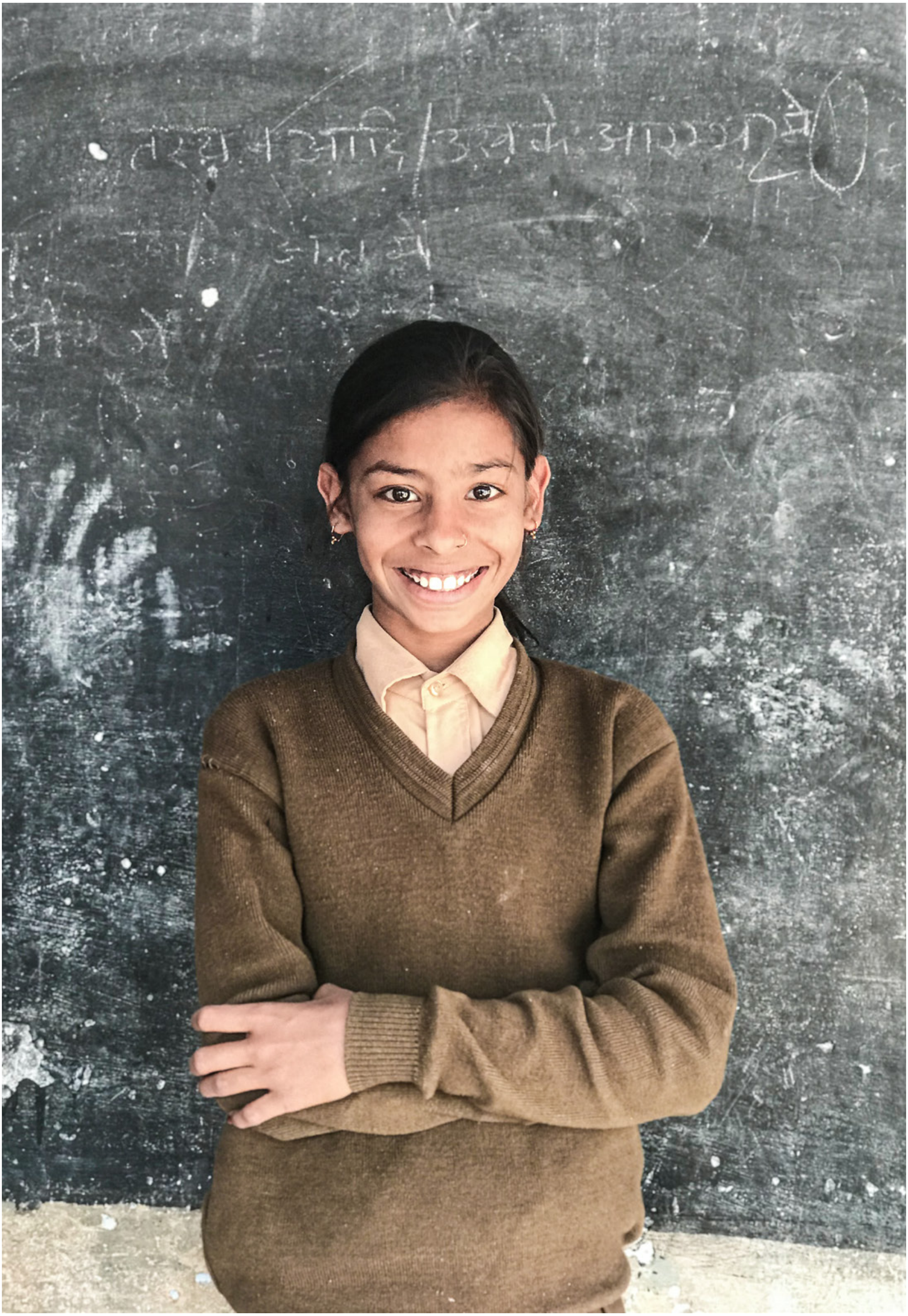
We've seen the benefits of results-based funding in the development impact bonds (DIBs) we've helped create and led as social investor. Within these DIBs, social and financial returns are fully correlated, allowing impactful programs to get support by evidencing effective results in solving some of the world's most intractable problems.

What we need now is more evidence-based funding at scale to make progress improving the lives of the most vulnerable. We need more capital. And we need to spend that capital in a way that maximizes results. The DIB Fund can address both of these needs through the use of blended finance.

The DIB Fund will invest 100 million US dollars in 15 to 20 DIBs in diverse geographies globally that improve health-care, education and livelihoods. Through the DIB Fund, we'll get outcome payments tied to real results. Impact will be magnified by unlocking private capital and recycling out-come funds as working capital each year. Philanthropists will get 15 times the usual impact of their contribution (with funding ultimately paid back with a potential return).

A bold opportunity
We think using blended finance in this way is the most exciting philanthropic initiative available at the moment. It has real potential to set a paradigm for how we reach the most vulnerable. We know philanthropists are interested in seeing that their contributions are spent efficiently and effectively, creating impact and changing the lives of some of the world's most vulnerable people. And we think this exciting new vehicle will be of great interest to commercial investors also. Most importantly, we can make great strides improving lives of the underprivileged globally.

We look forward to working with enterprising philanthro-pists who will take the lead in providing the capital neces-sary to mobilize the private capital flows we need to get to scale. Together, we will invest in impactful programs to bring sustainable solutions to the least privileged among us.



Please note this is not an investment proposal.

This is a presentation on the DIB Fund overall and the philanthropic tranche specifically.