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Date: 7/15/2013 3:45:41 PM
Subject: Follow-Up on SIBs

Jonathan,

Thanks again for bringing the group together last Monday. Since you've asked the participants to provide some feedback, I wanted to pass along a few thoughts.

During the breakout sessions we specifically focused on the President's FY14 initiatives in the PFS arena. To step back, I took the overarching question as, how can the federal government promote innovative policy solutions (and cost containment) through the PFS model?

Washington can promote SIBs in a few ways. First, you can expand the playing field for prospective SIBs by ensuring that more social interventions receive rigorous scrutiny. The scarcity of "Top Tier" approaches means that there is a serious bottleneck at the very beginning of the SIB pipeline. I understand that OSTP and OMB are developing a proposal to expand the adoption of RCTs – that's a promising development that also has the virtue of being fairly inexpensive. Seeing Jon Baron there was a good sign, too.

You can also create an environment that is more conducive to innovative and/or evidence-based practices by tweaking the incentive structure for recipients of federal funds through programs that have no match requirement. For block grant or formula grant programs, there could be a slight premium paid to recipients that are deploying "Top Tier" interventions, for instance. This would be a "carrot only" approach. For discretionary grant programs, you could take more of a carrot-and-stick approach by reducing the allocations for states that don't use evidence-based practices and increasing grants for states that do. I suspect that you'd need a larger supply of "Top Tier" interventions before this approach would be politically feasible.

You might also be able to link the promotion of RCTs to your attempts to improve the overall environment for SIBs. I'll use CFDA 93.275 (SAMSHA's "Access to Recovery" grants program) as a hypothetical example. It's a program that essentially gives each state \$3.2 million to run a voucher program for substance abuse treatment services. Right now, states must use at least 85% of the money for vouchers, allowing up to 15% to go to our administrative costs. What if you cut the admin share and/or the total grant amounts for states that don't run an RCT on their program (or haven't in the past X years) and use that money to increase the overall grant amounts to states that have a recent or ongoing RCT? An RCT for a small program like this would probably cost \$50k-100k, which only represents 2-3% of a typical state's grant. This particular program might not be a perfect example, but you get the idea.

Sticking with financial incentives, the most important thing the feds can do is to ensure that Wrong Pocket Syndrome doesn't kill any SIB deals that otherwise make sense. Obviously, that's easier said than done, and it's clear that much rests on establishing a process through which (1) cost-avoidance can be scored at the federal level and (2) the savings can be shared with other SIB parties. It's clear that waivers will play a role in this and that HHS will be a central player since it is at the heart of the state/federal fiscal partnership.

I wonder if we can organize some of our efforts around the "most-favored nation" concept? For instance, if CMS grants one state a particular waiver in association with a PFS proposal, why not automatically grant the other states access to the same flexibility at the same time? Staying with CMS for a moment, in FY14, 15 states will have the minimum 50% FMAP rate, while five states will be at or above 70%. Barring changes to existing policy, states would presumably have to make success payments entirely out of state funds, even though the savings would inure either equally (New York's 50% FMAP) or primarily (Mississippi's 73% FMAP) to the federal government. The incentives are entirely upside-down here from a federal standpoint, since the greater the share that Washington pays for Medicaid in any given state, the harder it is for that state to make the financials work for a SIB, from its own perspective. If we applied the MFN approach to Medicaid, then every state could be treated as if it had a 50% FMAP for SIB payout purposes. Allowing a dollar-for-dollar match for everyone's success payments would keep a number of sound projects in the poorer states from losing viability. There's significant precedent for this approach – for

instance, a number of Medicaid IT projects are being funded around the country at an “enhanced FMAP” split of 90/10.

The other merit to this approach is that it would leave federal approval in the hands of the relevant program agency. CMS would decide whether or not to grant the enhanced match for each specific SIB project. I worry that adding Treasury to the mix would make each SIB contingent on yet another party’s approvals and conditions, which would add to the time and cost of some deals and cause others to fall through. I don’t want to speak for the investors who were there last week, but several were open with me that they shared that concern.

Getting back to specific actions you can take at the federal level to advance SIBs, I think it would be a good start to get CMS in particular to give all states access to whatever flexibility is granted to any individual state for a PFS-related waiver. I think there’s also value in directing agencies (by Executive Order or some other mechanism) to review their existing partnerships with states, locals, and other recipients and report back to you/OMB as to how they will promote PFS through financial incentives, waivers, or other programmatic/guidance changes. This would seem to be timely, given the President’s Management Agenda announcement.

With respect to the President’s FY14 PFS proposals, I think the federal government can be most effective if it focuses on facilitating SIB deals for projects in which it already has a stake, instead of offering sweeteners (either in the form of augmented success payments or credit enhancements) for SIBs in which it would otherwise not be a party. I think the “enhanced match” model described above for Medicaid is a good one that will be applicable to a number of SIB proposals. This is essentially the augmented success payment approach, but again – I would only use this model if you already have skin in the game.

As for credit enhancements, I think they should step down over the life of the project (likely 5 years on average). To be honest, I basically see them serving as a hedge against the risk of non-appropriation at the state level. Most states are going to have problems getting a “full faith and credit” pledge attached to their SIB contracts, meaning that the promise to pay will only really be backed by a contract, as opposed to strict bond covenant-style language. The investors will see this as a serious risk, since most states have a non-negotiable non-appropriations clause in their standard terms and conditions, which states that it’s tough luck for the vendors if the legislature decides not to appropriate sufficient funds for the efforts supported by the contract. If this is how the credit enhancements are used, then they should not only facilitate more SIB projects, but they should also not be depleted, since it’s exceptionally rare for a state to exercise this clause. The credit enhancements would be more like insurance.

That’s a little more long-winded than I’d intended, but we’re in the middle of standing up our SIB project right now, so I’ve spent some time thinking about these issues in recent weeks. Thanks again for bringing the group together; I hope the other attendees will take the time to share their thoughts as well.

CLS

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