UNIVERSITY of MARYLAND
SCHOOL OF SOCIAL WORK

Public Sector Financing: Terms & Definitions

Compiled by The Institute for Innovation & Implementation,
University of Maryland School of Social Work
January 28, 2013

Below are some of the key terms used to discuss innovative financing in the public sector, organized from broadest to narrowest.

Pay for Success: A broad term used by the Obama Administration, among others, to describe innovative financing mechanisms that bring together public and private agencies and funders to create incentives for providers to achieve better outcomes at lower costs. Strategies such as social impact bonds and compacts are among those considered as part of Pay for Success.

Pay for Performance (P4P): Financial incentives that reward providers for the achievement of a range of payer objectives, including delivery efficiencies, submission of data and measures to payer, and improved quality and patient safety.[i]

Note: Pay for Performance (P4P) initiatives have become of considerable interest to federal, state, and local agencies, but it is critical to use caution with this approach. Woolhandler, Ariely & Himmelstein (2012) observe that, despite its intuitive appeal, the research on P4P has not shown its benefit to patients: "Studies have shown that monetary rewards can undermine motivation and worsen performance on cognitively complex and intrinsically rewarding work, suggesting that P4P may backfire.[ii]"

Shared Savings: A financial incentive whereby the payer and the provider share any accrued savings, rather than the payer keeping all of the savings in a traditional, fee-for-service model.

Risk-Based Contracts[iii]: Contracts where an organization is paid a fixed amount for a defined set of benefits regardless of the quantity or intensity of services provided. Direct, financial risk includes the following:

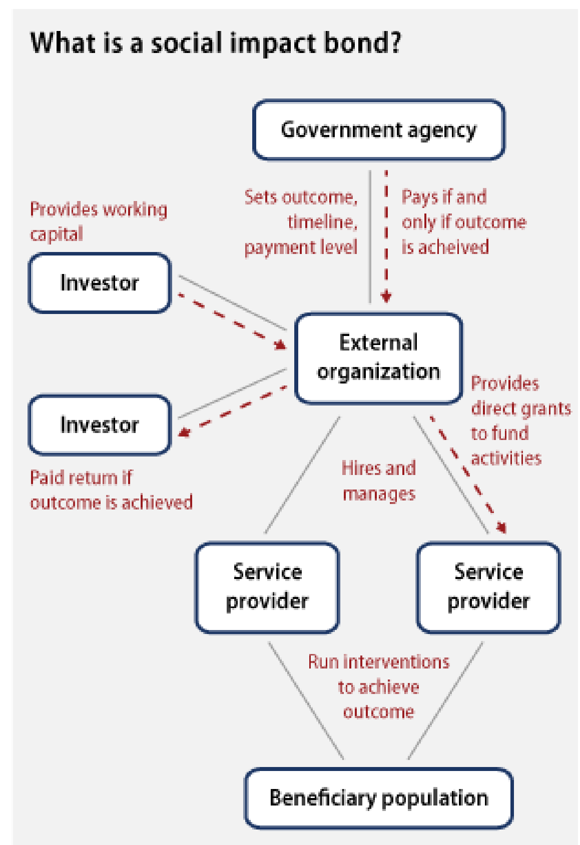
- *Utilization risk:* Risk that significantly more care is utilized than was estimated (the amount of service/care that is provided).
- *Morbidity risk:* Risk that is based on the "sickness" or intensity of the population being served (not how many sessions/treatments a particular person will need, but how many people of a particular acuity level will be encountered).
- *Demand risk:* Occurs when consumers/patients demand more treatment than expected, including as the result of advertising/social marketing or when a new intervention is offered.
- *Price risk:* The cost of the services that are provided versus the cost that is charged/budgeted for the service.
- *Beta risk:* Number of members/covered lives required to decrease or nullify the risk of loss based on the number of individuals who will have higher costs.

Risk-Sharing[iv]: A contractual agreement where the payer and the provider share both the financial risks but also the savings that may occur. There are multiple program designs to risk-sharing

agreements, including a) bonus payments at-risk; b) market share risk (consumers may select certain providers, leaving the provider at risk of a market share loss); c) risk of baseline revenue loss (failure to meet certain thresholds or if actual costs exceed target costs); and, d) financial risk for patient population, whole or partial.

Note: Delbanco, Anderson, Major, Kiser & Wammack (2011) observe that there are very few operational shared-risk models other than a traditional capitated HMO models and that providers need significant infrastructure to assume and manage risk successfully, some of which can be provided by the payer. They also observed that most of the shared-risk models evolved from shared savings models.

Social Impact Bond: A financing arrangement between the government and an external organization/intermediary. The government identifies the specific outcome (s) it wants to achieve related to a particular population over an identified period of time and agrees to pay the intermediary a pre-arranged sum *if* the organization achieves the desired outcome. The intermediary is responsible for contracting with service providers as well as obtaining investments from outside entities. If the outcome is achieved, the intermediary will pay the investors a return on their money. The risk is held by the investor(s) and the intermediary, not the government, with the government only paying if the outcomes are achieved.[v]



Note: Social Impact Bonds require timely availability of high quality data that measure specific indicators that have been shown to directly relate to the outcome desired. Assuming that the social impact bonds are structured over a short-term period (i.e., within 5 years), the intervention/service that is being implemented must demonstrate that it has achieve the outcomes that it said it would achieve in a short period of time. For example, interventions with adults in the criminal justice system to reduce recidivism rates are often considered for social impact bonds because the interventions can be implemented in a short period of time, the environment is more controlled (i.e., prison, rather than in the community), and the outcome can be consistently measured (not recidivating within a period of time). There are data available to establish baseline levels of recidivism and research to support the use of particular interventions with specific populations. *For more information, please see the resources at the end of this document.*

Opportunity Compact: Similar to a Social Impact Bond, under the Opportunity Compact (pioneered in Maryland), the financing for the service/intervention is provided by a private entity, not by the government. However, the government signs an agreement with the intermediary who is brokering the Compact stating that, if the service/intervention produces monetary savings, the government will reinvest a portion of the savings into maintaining proven programs, as specified in the agreement. In the Maryland Opportunity Compact, investors are not repaid for their investments but instead treat the investment as a grant. In return, they are assured that their funding will

promote sustainability of the initiative or other proven programs. The government benefits by holding no risk for the intervention and, if the intervention is successful, the government has an opportunity to invest in further programming and interventions shown to work.[vi]

---

[i] Agency for Healthcare Research and Quality. (2012). *Pay for Performance (P4P): AHRQ Resources* . Available online from the AHRQ website: ttp://www.ahrq.gov/qual/pay4per.htm

[ii]Woolhandler, S., Ariely, D., & Himmelstein, D. (2012). *Will Pay for Performance backfire? Insights from behavioral economics.* Available from the Health Affairs website: *http://healthaffairs.org/blog/2012/10/11/will-pay-for-performance-backfire-insights-from-behavioral-economics/*

[iii] Information in this section is from *Oss, Monica E. (2013, January). Understanding The "Risk" In An "At-Risk" Contract. OPEN MINDS Management Newsletter.*

[iv] Information on this section comes from Delbanco, S.F., Martin Anderson, K., Major, C.E., Kiser, M.B., & Toner, B.W. (2011). *Promising Payment Reform: Risk-Sharing with Accountable Care Organizations*. Available from The Commonwealth Fund's website: http://www.commonwealthfund.org/Publications/Fund-Reports/2011/Jul/Promising-Payment-Reform.aspx

[v] Costa, K., Shah, S., Ungar, S. & The Social Impact Bonds Working Group. (2012*). Frequently asked questions: Social Impact Bonds.* Available online from The Center for American Progress website: http://www.americanprogress.org/issues/economy/report/2012/12/05/46934/frequently-asked-questions-social-impact-bonds/#n0

[vi] Maryland Opportunity Compact. (2013). Available from the More for Maryland website: http://moreformaryland.org/page.php?id=30