Response to the Ministry of Justice proposed payment mechanism for the Rehabilitation programme

June 2013

About NCVO:

The National Council for Voluntary Organisations champions and strengthens the voluntary sector, with over 10,500 members, from the largest charities to the smallest community organisations.

NCVO has a range of specialist commissioning expertise that is relevant to this call for feedback and convenes: the Public Service Delivery Network of 2,500+ voluntary and statutory members; a Welfare to Work Special Interest Group of 160 sub-contractor organisations involved in the Work Programme; and the Voluntary Sector Payment-by-Results (PbR) Working Group set to be making recommendations on PbR implementation in September 2013.

Summary:

NCVO welcomes the Government's decision to seek feedback on the proposed payment mechanism for the Rehabilitation Programme. It is essential that Government is responsive to feedback from the voluntary, community and social enterprise (VCSE) market on how to design a mechanism which provides the triggers and structure necessary to engage an expert and plural market, and to ensure the delivery of the programme's intended outcomes of reduced reoffending.

In NCVO's response to the MoJ's consultation on 'Transforming Rehabilitation' in February 2013 we raised concerns that VCSE organisations would be squeezed out by large providers

with greater capital, and that the VCSE sector's proven expertise and ability to deliver outcomes across demographics would be under-utilised. Having reviewed the proposals set out in this payment model, we reiterate these concerns. This payment model will not drive continued improvement of reoffending outcomes, nor does it incentivise working with the hardest-to-reach offenders. The 'straw man' model also threatens the sustainability of experienced VCSEs that deliver Government funded rehabilitation services, and who also enhance these service outcomes by levering in around them their wider pools of funds and portfolios of integrated services. Through our answers to later questions we explain and evidence these concerns.

The Government's Open Public Services white paper 2011 set out five key principles for modernising public services, including that public services should be open to a range of providers and a commitment to ensuring fair access to public services.[1] These reforms conflict with these principles: this payment mechanism does not enable market diversity, nor does it ensure fair access to services across user groups.

We recognise and very much welcome the efforts that officials have made in engaging proactively and transparently with the VCSE sector both in the consultation process and in this period of market engagement, and we would urge a continuing dialogue with a range of providers of all sizes to ensure that VCSE organisations are not excluded by this payment model. Charities often deliver local and specialised services; it is in the interest of helping ex-offenders to rehabilitate, with the significant economic and social benefits that this brings, that this skill and expertise is not lost under these reforms.

[1] 'Open Public Services.' (2011). http://files.openpublicservices.cabinetoffice.gov.uk/OpenPublicServices-WhitePaper.pdf, p. 8

1. **<u>Are there any elements of the proposed payment mechanism that are not clear? Where would you like additional clarity?</u>**

The complexity of the model

The complexity of this model means that there are a number of variables within it which potential providers will need to account for in order to calculate the risks inherent to such contracts, and to evaluate whether these risks have been appropriately placed. These variables are:

- the WAV tolerance range for the fee for service (FFS)
- the percentage adjustments made to price when volumes fall outside this range
- WAV weightings reflecting differences in costs for different sentences
- the reoffending level set for the termination trigger
- the penalty baseline
- the target level baseline
- the payment cap

The level of detailed analysis of all these variables which will be required for providers to assess the feasibility of these contracts may present a barrier to bidding. For smaller providers, including those from the VCSE sector, this will be particularly challenging.

For VCSEs, understanding the risks presented by this model is essential in order to be able to assess the financial viability of their involvement, to plan for cash flow implications, and to set up appropriate risk management processes.[2] It is also important to be able to articulate risks to social investors and to partners within consortia, especially when these commercial relationships—as the previous halted PbR procurement has demonstrated—take considerable time and resource to develop. It is NCVO's experience that across public services, procurement timeframes do not allow for the development of these models, despite stated intentions.

[2] NCVO, CFG and ACEVO are developing a free risk register for VCSEs for payment-by-results.

Whilst we recognise that this mechanism is a 'straw man' at this stage, an indication from the MoJ of when the details of these unknowns listed above will be available would be welcomed. This information is essential for the market to be able to manage and plan for risk effectively.

The learning curve discount

We would welcome some further discussion of the rationale and purpose of the learning curve discount, and what the implications of this will be on provider behaviour. Although it is understood that costs for providers are likely to be high initially as the service is reconfigured and that these will lessen over time, the model does not make clear how applying this discount will specifically incentivise this behaviour. Importantly, MoJ should clarify what evidence there is for setting the rates of expected efficiency improvements, and whether expected efficiency gains are really viable and suitably incentivising for providers across the market.

The MoJ should indicate how steep the percentage reductions in the learning curve are expected to be and how this will be calculated. This will indicate to providers what level of efficiency the Government is expecting to see achieved. The MoJ should also make clear at what stage they will set this learning curve percentage, and whether this information will be made available before potential providers begin bidding.

Elements of the mechanism which will be decided through competition

The 'straw man' creates uncertainty around which elements of the payment mechanism are going to be determined through competition. The model states that the fixed Annual Payment will be "the one variable of the payment mechanism that providers will bid against" (p.5). Yet elsewhere in the model, and in the Strategy for Reform, it is suggested that providers will bid on the percentage of their contract they will deliver through Payment by Results (PbR). Although the former might imply the later, clarity on this issue is necessary.

2. **<u>Do you think the proposed structure of the Fee for Service (FFS) element of the payment mechanism is appropriate for the services being contracted? If not, what are your concerns? How would you suggest the mechanism be improved?</u>**

The reforms set out in 'Transforming Rehabilitation' intend to generate efficiency savings by opening up the probation service to private providers in the context of MoJ's commitment to deliver annual savings of more than £2 billion by 2014/15. An expectation that the private sector can drive these efficiencies underpins the proposals in this 'Straw man,' yet it is not clear that there has been a comprehensive evaluation of the market's capacity to deliver these services. Nor has there been clear and detailed communication of the level of efficiencies that providers are expected to achieve.

The MoJ should provide a clear indication of what it expects the costs of the services in the FFS element of this model to be. Although it is understood that this will be determined through the competition stage, an approximation of the expected costs of services, and how these compare to current costs, would give an indication of the level efficiencies that these reforms are aiming to achieve.

If costs are cut to an unachievable level, this will impact upon the ability of the market to deliver sustainable and high quality services, with the ultimate cost of this market failure being paid by the state. The MoJ must therefore ensure they evaluate the market capacity for delivering these services, and work out what is feasible in terms of efficiency savings. This assessment should also account for variations of costs across markets in different regions.

One of NCVO's key concerns is about how funding and payments will flow, fairly and sustainably, throughout supply chains and we explore this is our response to question 6.

3. **<u>Do you think the proposed structure of the Payment by Results element of the payment mechanism is likely to incentivise providers to focus on reducing reoffending? If not, what are your concerns? How would you suggest the mechanism be improved?</u>**

There are clear attractions to using a Payment by Results (PbR) model, not least the transformational *potential* that a shift toward outcomes-based payment may bring. However, when the financial incentives of PbR are not correctly aligned, providers will be less willing to test innovative ways of delivering services, and to develop sustainable and diverse supply chains which include organisations with the local and specialist expertise necessary to improve reoffending outcomes.

We are concerned that the incentives proposed in this model are not suitable and will not result in an increased focus on rehabilitation. Without the appropriate incentives, the hardest-to-reach offenders will be 'parked' and those offenders committing the most crimes will continue to do so, with the cost of this being borne by the state and by society.

Maximising safe margins

The 'straw man' indicates that the PbR element of the model will be the 'profit' or 'reward' component of the payments made to providers which will be paid in addition to the FFS. This is intended to "incentivise bidders to continuously innovate and improve performance… and, reduce re-offending rates significantly beyond historic levels" (p.7). However, providers are motivated to protect against risk and to maximise their safe margins; because of this there is a concern that providers will seek to adjust their operating costs in order to increase the gains they can make from the FFS payment, therefore lessening the incentive to invest in the services necessary to achieve the 'PbR bonus payment' or 'super profit.'

A conservative approach to risk is also driven by the fact that, at this stage, the evidence base for what works in reducing reoffending isn't sufficient. Providers will be unwilling to invest in rehabilitation services where proven outcomes aren't available. Furthermore, this will mean that generating the evidence of what works, and collating the best practice which can be used to continually improve reoffending outcomes, will struggle to develop in the future.

Parking the hardest to reach offenders:

We are concerned that applying a payment cap will encourage providers to ‘park’ the hardest-to-reach, and the most prolific offenders. Capping payments received by providers through the PbR element means that it will not be financially expedient for providers to invest in services that work with those offenders who have the most complex needs, and who are often the most expensive to work with, and those who continually reoffend.

The preference for the binary metric in measuring reduced reoffending, suggested by the fact that “to receive *any* PbR payment, a provider will have to have improved performance on the binary metric to a point of statistical significance” (p.9), will also prompt the ‘parking’ of the most prolific offenders, those considered most difficult to achieve results with, where results are demonstrated by a decline in the frequency of offending as opposed to a complete desistence. Although the model includes a frequency metric, the binary ‘hurdle’ required for payment means that working with offenders who require sustained and complex interventions throughout their journey towards reform will not be sufficiently incentivised.

A further element of the mechanism which will prompt parking is that the payment model does not include ‘differentials’ of payments between different groups. This means that the more detailed interventions, which are more expensive to deliver, are not recognised within the payment model. This, coupled with the concerns above that the payment curve may not be sufficiently incentivising, means that the harder-to-reach offenders will be ‘parked’ as the cost of working with them does not match the payment received.

We believe this model will be in breach of the Government’s Open Public Services principle of ‘fair access’ to services as providers ‘park’ those most in need of intervention, and on the basis of discriminatory, financially driven practice. We ask that MoJ seek to safeguard around this principle of ‘fair access’ and conduct an Equality Impact Assessment on this ‘Straw man’ in order to understand the impact it proposes.

The practice of 'parking' not only means that individuals are not receiving the support they need to rehabilitate—which will ultimately result in costs to the prison service, the courts and the police—the poorly designed incentives will also impact on the sustainability of diverse supply chains and therefore the market's access to specialist staff experienced in working with the most entrenched and prolific offenders.

Where there is a lack of funding from lead providers to work with the 'hardest to reach' as a result of the PbR element of the contract being poorly designed, organisations that work with these offenders will face difficult financial decisions about the continuity of this provision.

VCSE organisations are governed by their charitable mission. Where a lack of funding means that they have to consider not working with some of their users, or turning people down for their services, this poses a serious governance issue. The consequences of this have been seen in the Work Programme, where the cost of interventions carried out by subcontractors exceeded the amount paid by prime providers. NCVO's survey of VCSE subcontractors found that over a third of these organisations chose to subsidise delivery from their own reserves.[3] This is clearly neither acceptable nor sustainable.

The sustainability of the voluntary sector has wider implications above and beyond the success of the rehabilitation programme. Voluntary sector income comes from a range of sources, of which payments for contracted services and public sector fees accounts for 29%.[4] Disrupting one income stream will impact across the wider work of an organisation, the sustainability of other services, and the added social value often brought by voluntary sector public service delivery.

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[3] 'The Work Programme-Perceptions and Experiences of the Voluntary Sector.' (2012). http://www.ncvo-vol.org.uk/sites/default/files/sig_survey_june_2012_report_17.9.12.pdf , p.13

[4] NCVO UK Civil Society Almanac. (2013) '*What are the sector's different sources and types of income?'* http://data.ncvo-vol.org.uk/a/almanac13/income/what-are-the-sectors-different-sources-and-types-of-income-2/

Testing this model

This payment model demonstrates that the MoJ does not have a sufficient understanding of market attitudes to risk and the incentives that are necessary to stimulate behaviours which will improve reoffending rates. We strongly recommend that the MoJ test this model thoroughly with the market to identify the kinds of behaviours that will be driven by this payment mechanism. This will be important in evaluating the impact of certain decisions made by providers and in understanding the drivers which underpin these decisions. This process should account for different provider motivations, depending on both size and sector, as different incentives will drive different organisations.

This should take a similar form to the Gaming Commission which was set up in 2011 to identify gaming opportunities within the Drug and Alcohol Recovery PbR pilot schemes. This commission brought together a group of people that had operational experience in service provision, as commissioners, providers, and service users, and made recommendations of how perverse incentives could be eradicated or lessened. [5] A process of this kind should be applied to the proposed payment model for the rehabilitation programme and the findings should be made widely available.

4. **The model proposes that contractors put a substantial part of their total fee (cost plus margin) at risk for reductions in reoffending. What minimum level of "at risk" payment would you consider to be sufficiently incentivising? What maximum level of total fee "at risk" would be acceptable?**

As described above in question 3, there is a danger that, despite the intention to use risk to drive reductions in reoffending, providers will be able to maximise their gains from the FFS element of the contract. This suggests that, although risk has been built in to the system through the inclusion of a PbR element, there has not been a thorough assessment of whether this is appropriately assigned in order to trigger improved reoffending outcomes.

[5] Report from the Gaming Commission. (2011). http://media.dh.gov.uk/network/342/files/2012/03/Gaming-Commission-Report.pdf

The model proposes a foundation payment to be paid to providers monthly, which forms part of the ‘normal’ profit element of PbR, and will be subject to clawback or top-up depending on the results which are achieved. We are concerned that the impact of clawback on provider behaviour has not been sufficiently evidenced; the threat of having payments clawed back will impact upon the financial planning of the provider and may prompt a risk adverse strategy. As described above, risk aversion will result in under-investment throughout the supply chain, and a lack of improved reoffending outcomes. A clawback mechanism will also have implications for the way in which payments are made throughout the supply chain and this is discussed further in our response to question 6. It is necessary that a thorough evaluation of the impact of clawback on provider behaviour is carried out. This would be found from a thorough process of market testing, as recommended above.

5. **<u>Are there any elements of the proposed payment mechanism that would incentive the "wrong" behaviours? If so, what are these and what behaviours could they drive?</u>**

As has been explained above, there are a number of areas of this payment model which will prompt the parking of the hardest-to-reach and most prolific offenders, and which will result in an underinvestment throughout the supply chain, threatening the diversity of the rehabilitation market.

Addressing these areas will be fundamental to making significant improvements in reoffending outcomes. They have been summarised below:

- Payment cap: implementing a cap on payments is a disincentive for continued improvement and will encourage ‘parking.’
- PbR incentive curve: if this is not steep enough, improving reoffending outcomes will not be incentivised.
- The binary hurdle: is a disincentive for working with the most prolific offenders

- The impact of clawback: this impact of clawback on provider behaviour and financial planning has not been sufficiently explored.

6. <u>Do you have any other comments regarding the proposed payment mechanism?</u>

Different offender groups

As described above, NCVO are concerned about the impact of not differentiating payments between different offender groups. An explanation of why the MoJ have not segmented offender groups in order to incentivise working across all different needs would be welcomed.

NCVO recommends that the MoJ should work towards a payment model which can segment offender groups in the future. It is critical that segmentation be underpinned by robust needs assessment and carefully calculated payment differentials which are adequate enough to incentivise more detailed interventions, and this requires a substantial evidence base. Building this will involve using learning from this programme to highlight the gaps in the evidence that would be needed to intelligently segment in this way. We suggest that a pilot which tests segmentation, and which pays providers according to the complexity of the service that will be required, should be developed at an early stage to run in conjunction with this model.

In terms of the impact that reforms to this programme will have on female offenders and BME offenders, we are concerned that this payment mechanism fails to facilitate a diverse supply chain which includes those organisations with the skills and experience of working with these groups. The principles of the Compact are of relevance here, in particular the following:

- In managing changes to programmes and services, Compact principle 4.2 states that Government must: "Assess the impact on beneficiaries, service users and volunteers before deciding to reduce or end funding. Assess the need to re-allocate funds to another organisation serving the same group."[6]

[6] 'The Compact' http://www.compactvoice.org.uk/sites/default/files/the_compact.pdf, Section 4.2

- Compact principle 5.1 states that the Government must "Work with CSOs that represent, support or provide services to people specifically protected by legislation and other under-represented and disadvantaged groups. Understand the specific needs of these groups by actively seeking the views of service users and clients. Take these views into account, including assessing impact, when designing and implementing policies, programmes and services."[7]

The Government must adhere to these principles in order to assess the equalities impact of these reforms. The requirement to demonstrate visible commitment to the Compact principles is in all departmental business plans.

Supply chains

NCVO has previously recommended that Government should retain a direct and clear sense of accountability for interventions and performance, and that the management of supply chains, with the consequence on the treatment of service users and use of public funds, is not only a matter for prime contractors. [8] We welcome the MoJ's intention to produce a set of Market Stewardship Principles and have offered to work with them in designing and testing these.

Integral to supply chain governance is understanding and managing where risk sits. The burden of risk will be dependent on a number of variables, as outlined in our response to question 1, and these will impact the likely transfer of risk within supply chains. MoJ must ensure it has modelled how this payment mechanism places risk, and the impact of this throughout the supply chains. For example, where clawback is applied to prime providers, clear communication around how this is fairly and sustainably apportioned throughout the supply chain is necessary.

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[7] 'The Compact' http://www.compactvoice.org.uk/sites/default/files/the_compact.pdf, Section 5.1
[8] NCVO's response to 'Transforming Rehabilitation.' (2013). http://www.ncvo-vol.org.uk/sites/default/files/ncvo_response_to_transforming_rehabilitation_consultation.pdf, p. 16

It will be important that the MoJ, as the commissioner of these services, ensures that it enables the overcoming of significant cashflow problems which would destabilise the market. This includes ensuring that payments are flowed throughout the supply chain in a proportionate and sustainable way. Prime or lead contractors should use a diverse range of financial mechanisms as possible in the tendering process, including grants and standard service delivery contracts, and should expect to be held accountable for their decisions, explaining how they have configured funding mechanisms to interventions.

When considering the barriers to VCSE participation in PbR systems, the following principles of the Compact[9] are particularly relevant:

- Compact 3.9: Discuss and allocate risks to the organisation(s) best equipped to manage them. Where prime contractors are used, ensure they adhere to the principles of this Compact in allocating risk. Ensure delivery terms and risks are proportionate to the nature and value of the opportunity.

- Compact 3.10: Ensure that the widest possible range of organisations can be involved in the provision of services through appropriate funding and financing models, for example outcome based payments and payment in advance of expenditure. Payment in advance of expenditure should be considered on a case by case basis where this represents value for money.

- Compact 3.11: Ensure all bodies distributing funds on the Government's behalf adhere to the commitments in this Compact. This includes the relationship between prime contractors and their supply chains. Demonstrate how funding arrangements and financial support can allow smaller and specialist providers to play a greater part.

[9] 'The Compact' http://www.compactvoice.org.uk/sites/default/files/the_compact.pdf, Section 3.9, 3.10, 3.11