LEVERAGE FUND – REPORT FROM THE FINANCE AND RISK COMMITTEE

For Decision

Please note: Board papers are deliberative in nature and, in accordance with the GPE Transparency Policy, are not public documents until the Board has considered them at the Board meeting.

1. STRATEGIC PURPOSE

1.1 Based on the Finance and Risk Committee (FRC) recommendations, the Board is asked to consider the proposed eligibility to access resources from the Leverage Fund along with the simplified methodology to determine the ceiling for individual country applications to the Leverage Fund, and an application process for eligible countries to apply and receive funds.

Summary of Committee Deliberations

- The FRC reached consensus on the eligibility proposal set out in Option 3 noting it struck a good balance between having enough countries to test the concept in a range of circumstances and associated transaction costs would not be significant.
- The FRC emphasized that flexibility in the roll-out of the Leverage Fund would be important in order to take advantage of opportunities or needed adjustments s as we move along.
- FRC members noted the importance of ensuring additionality is achieved, and the Secretariat clarified that this would need to be assessed and documented for each potential country before agreeing to move forward with the first batch.

2. EXECUTIVE SUMMARY

2.1 At its meeting on March 1st, 2017 the Board approved the creation of a Leverage Fund as recommended by the Strategic Financing Working Group that would combine GPE grant funding

with external funding to create larger funding packages in support of implementation of education sector plans.

2.2 The Board agreed to approve an initial US$100 million to allow this concept to be tested in countries that are eligible for an Education Sector Program Implementation Grant and those lower middle income countries that are not automatically eligible. Depending on initial interest in the Leverage Fund, prospects for success, and available resources, the Board may consider to increase its investment in this area. The FRC will be considering options in October 2017 for how GPE would allocate increased resources under the replenishment, while also examining options in the event of a low replenishment outcome.

2.3 The Board requested the FRC to develop a proposal on eligibility, allocation, and application process to access the initial US$100 million, stressing that the methodology for the allocation ceiling be simple, and takes into account prospects for success. It is important to emphasise that this work is just focused on the initial US$100 million, and is not considering eligibility, allocation methodology, or related processes should the fund be significantly increased.

2.4 The Secretariat proposed 4 potential options on eligibility with various pros and cons related to each approach. The FRC recommended option 3 which maintains eligibility for all non-ESPIG eligible LMICs while for ESPIG eligible countries, prioritizes those that have a reasonable expectation to apply in 2018 and are either subject to the ESPIG cap of US$100 million, or have low allocations (less than US$10 million) and would benefit from a top up from the Leverage Fund.

2.5 The allocation formula proposed is a simplified methodology that is based on grouping countries into a number of categories based on their primary and lower secondary school aged population given this is primarily the target group for GPE's education sector plan implementation funding. This approach should improve prospects for testing the concept out in a range of ESPIG and non-ESPIG eligible countries as requested by the Board.

2.6 Once countries are identified to test the concept, the process for applying and quality assuring applications from the fund will be similar to an ESPIG application given the same funding model requirements must be met. However the indicative timelines and process to identify the initial countries to participate could vary based on the number of potentially eligible and interested countries. Flexibility to adjust the process as it is rolled out maybe required to take advantage of opportunities that may arise or to overcome obstacles in a timely manner.

2.7 The design of the Leverage Fund is fully compatible with the International Finance Facility for Education as GPE funds could be used to blend with IFFed loans to provide even greater

concessional finance. However GPE's Leverage Fund may also be operationalized without this mechanism, and GPE is continuing to consult with the World Bank, Islamic Development Bank, and recently the African Development Bank on this concept.

2.8 Arising from discussions and initial reactions to the GPE's Case for Investment, the "Leverage Fund" may be rebranded to ensure that there is no confusion that all existing GPE financing helps leverage domestic financing, and that the new mechanism is designed to promote additionality and co-financing of external resources in support of implementation of good quality sector plans.

3. RECOMMENDED DECISION

3.1 The FRC requests that the Board of Directors approve the following decision:

BOD/2017/06-XX—<u>Leverage Fund</u>: The Board of Directors approves:

1. Initial eligibility to access the Leverage Fund to countries that may be eligible and ready to apply for funding in 2018 in the following categories:

   a. ESPIG eligible countries that are subject to the cap of US$100 million
   b. ESPIG eligible countries that have an allocation of less than US$10 million
   c. Non-ESPIG eligible countries that are approved as eligible for other forms of GPE Funding as set out in Board decision BOD/2017/03-07

2. Approves the basis for allocation of funds from the Leverage Fund as set out in BOD/2017/06-DOC 08.

3. Noting the importance of demonstrating the potential impact of the Leverage Fund, and with due consideration to ensuring additionality and co-financing approves the process for rolling out the operationalization of the Leverage Fund as set out in BOD/2017/06-DOC 08.

4. In the interests of ensuring efficiency and providing flexibility to test the concept, delegates authority to the Finance and Risk Committee to approve minor modifications to the approach that may arise in-between scheduled Board meetings.

4. BACKGROUND

4.1 The Board of Directors in March 2017 approved an ambitious Financing and Funding Framework for GPE. Included as part of these recommendations was a decision to create a Leverage Fund that would promote increased co-financing with GPE funds, and additional external financing for education.

BOD/2017/03/06 Extract:

c. Determines to create a Leverage Fund as described in BOD/2017/03 DOC 3 - Annex 1 and amended in BOD/2017/03-06. The Leverage Fund will target a limited number of GPE partner countries. Applications to the Leverage Fund must:

i. Meet GPE's funding model requirements around domestic financing, data, and credible education sector plans.

ii. Demonstrate additionality and co-financing from external sources of at least US$3 for every US$1 of GPE grant funds.

iii. Ensure at least 30% of GPE funds are subject to GPE's results-based funding approach.

d. Requests the Secretariat to develop a proposal for recommendation by the Finance and Risk Committee (FRC) to the Board in June 2017 on eligibility to access resources from the Leverage Fund along with a simplified methodology to determine the ceiling for individual country applications to the Leverage Fund, and an application process for eligible countries to apply and receive funds from the Leverage Fund.

e. Emphasizes the need to make selections among the potential eligible countries in a way that enables fair access by all countries and takes into account prospects of success.

4.2 The Board also agreed to create an initial provision of US$100 million for this purpose and agreed that any consideration of allocating further resources would be based on initial interest and progress.

4.3 The initial proposal on eligibility from the Strategic Financing Working Group (BOD/2017/03 DOC 3 - Annex 1) envisaged that the US$100 million Leverage Fund would be used to test the concept on 5-6 lower middle income countries (LMICs) that were not eligible for an Education Sector Program Implementation Grant (ESPIG). However the Board determined that it would be important to test the concept on a mix of countries including those eligible for an ESPIG and those that were not.

4.4 The Education Commission is currently developing a concept (IFFed) to develop a mechanism to raise a large pool of concessional financing that would potentially significantly increase the overall levels of external finance for education in lower middle income countries. In

order to increase the concessionality of such loans, it will be necessary to have grant funding. The GPE leverage fund offers an excellent opportunity to provide such grant funding to blend with loans that may be generated through the mechanism.

4.5 GPE is committed to coordinating with the Commission and supporting the development of the mechanism. However it is important to note that the Leverage Fund approach is not dependent on it. Therefore it can be tested out with a range of partners provided they can meet the requirements listed in 4.1 above and provide the minimum US$3 in funding to every US$1 of GPE funds.

4.6 The challenge that needs to be addressed is to come up with an approach that balances fair access to the funds, prospects for success, ensures a mix of countries, and keeps transaction costs to a minimum.

5. REASONS FOR RECOMMENDATION

Eligibility

5.1 There are 89 potentially eligible countries that could access the Leverage Fund. However with an initial envelope of US$100 million it would not be feasible to provide funding for all countries, and therefore some criteria would need to be applied to strike a balance between supply and demand. Depending on the allocation approach used, the Secretariat estimates the US$100 million would be sufficient for 5-6 countries.

5.2 Given the desire for the Board to test out this concept, the Secretariat believes a focus on countries that could apply in 2018 would be appropriate. If the Board expanded the size of the Leverage Fund at a later date, then eligibility could be expanded to those that may apply in 2019 or 2020. If we exclude countries with existing Maximum Country Allocations as they're already in planning processes, and focus on LMICs that are not eligible for ESPIGs, or those countries eligible for a new MCA for the 2018-2020 period but that would be eligible to apply as early as 2018, then this would reduce the number of potentially eligible countries from 89 to 42 (22 Non ESPIG eligible, and 20 ESPIG eligible countries)

5.3 That number could be further reduced if we applied additional eligibility criteria as follows

For ESPIG Eligible countries:

- Allow ESPIG eligible countries impacted by the cap of US$100m to access the Leverage Fund considering that without a cap, the needs based allocation formula would calculate a larger share of funds – ***Ethiopia***

- Allow countries with small allocation sizes (e.g. less than US$10 million) to access the funds considering that larger programs would reduce the proportion of administrative costs and potentially improve prospects for successful funding model implementation – ***Djibouti, Ghana, Guyana, Kenya, Mauritania, Nepal, Zambia***

This approach would reduce the potentially ESPIG eligible countries from 20 to 8, although the number may change slightly depending on when countries are able to apply.

For Non-ESPIG Eligible countries, all 22 countries could be considered, or else the pool of eligible countries could be further reduced to just existing GPE partners.

- ***Kyrgyz Republic, Tajikistan, Uzbekistan, Vietnam, Moldova, Mongolia, Congo Republic, Honduras,***

5.4 Other criteria could be considered however the approach above basically sets out 4 different options on eligibility for the initial US$100 million. It is important to note that this eligibility criteria is not permanent and should help facilitate testing of the concept. Whatever option is selected, the criteria should be re-examined if the pool of funds is increased or decreased (as a result of lower than expected replenishment). The FRC recommends Option 3 striking the best balance between transaction costs and getting a good mix of countries for the initial test.

Option	Countries	Pros	Cons
1	**89 (67 ESPIG / 22 Non-ESPIG)**	• Allows equal access to all • Maximizes potential to find countries to test the concept	• High costs and effort to explain options to all countries/partner and risks significant diversion of country facing Secretariat staff to the Leverage Fund • Imbalance between supply and demand • May necessitate the need for competition and require effort that is ultimately not rewarded • Due to timing, may not be able to test out the concept quickly if some applications only come in 2019 and 2020
2	**42 (20 ESPIG / 22 Non-ESPIG)**	• Allows equal access for those countries ready to apply in 2018 • Likely to have no issues finding	• Will require significant effort to explain options to countries / partners and risks diverting country facing staff • Supply likely to outstrip demand

		countries to test concept out early	• Competition or secondary prioritization criteria likely
3	**30 (8 ESPIG / 22 Non-ESPIG**	• Allows all Non-ESPIG eligible countries an opportunity to access funds • likely to be able to find sufficient demand to test the concept	• Supply could outstrip demand • Competition or secondary prioritization criteria likely among non-ESPIG eligible countries
4	**16 (8 ESPIG / 8 Non-ESPIG)**	• Relatively low level of effort to explain concept/engage with countries • Likely to be able to satisfy demand from interested/suitable countries • Balances ESPIG and Non-ESPIG countries	• Number of countries may be too small to generate sufficient interest. • Risks disappointing interested countries not included in reduced eligibility criteria • Leaves 14 Non-ESPIG eligible countries with no opportunity to access education sector implementation funding from GPE

Allocation

5.5 In line with the Board's request for a **simplified methodology** to develop the ceilings for individual country applications, the Secretariat proposes the following approach that considers the size of the primary and lower secondary school aged populations of each eligible country given this is primarily the target group for GPE's education sector plan implementation funding. The proposed approach would allow testing in a range of contexts with differing needs, and at different funding amounts. The basis of allocation should be re-examined if the Leverage Fund is to be increased beyond the initial US$100 million

Leverage Fund Ceiling / Minimum Co-Finance Requirement	School Aged Pop	Option 1 (89 Countries)	Option 2 (42 Countries)	Option 3 (30 Countries) (FRC Recommended)	Option 4 (16 Countries)
US$25 million / $75 million	+10m	Nigeria, Indonesia Pakistan, Bangladesh, Ethiopia, Philippines, DRC, Egypt, Tanzania, Vietnam, Uganda, India	Indonesia, Pakistan, Bangladesh, Ethiopia, Philippines Egypt, Vietnam, Uganda, India	Indonesia, Ethiopia, Philippines Egypt, Vietnam, , India	Ethiopia, Vietnam
US$15 million / US$45 million	5-10m	Kenya, Myanmar, Afghanistan, Sudan, Mozambique, Yemen, Rep, Cameroon, Côte d'Ivoire, Ghana, Madagascar, Morocco, Nepal, Niger,	Kenya, Sudan, Mozambique, Cameroon, Ghana, Morocco, Nepal, Niger	Kenya, Ghana, Morocco, Nepal,	Kenya, Ghana, Nepal
US$10 million / US$30 million	1-5m	Ukraine, Burkina Faso, Uzbekistan, Malawi, Syria, Mali, Zambia, Chad, Senegal, Zimbabwe, Guatemala, Sri Lanka, Guinea, Cambodia, Benin, Rwanda, Burundi, South Sudan, Somalia, Haiti, Bolivia, Togo, Papua New Guinea, Honduras, Tajikistan, Sierra Leone, Tunisia, Lao PDR, Central African Republic, Congo, Rep, West Bank and Gaza, Eritrea, Nicaragua, Liberia, El Salvador	Ukraine, Uzbekistan, Syria, Zambia, Senegal Guatemala, Sri Lanka, Guinea, Rwanda, Bolivia, Honduras, Tajikistan, Tunisia, Central African Republic, Congo, Rep, West Bank and Gaza, El Salvador	Ukraine, Uzbekistan, , Zambia, Guatemala, Sri Lanka, Bolivia, Honduras, Tajikistan, Tunisia, Congo, Rep, West Bank and Gaza, El Salvador	Uzbekistan, Zambia, Honduras, Tajikistan Congo, Rep.
US$5 million / US$15 million	100k-1m	Mauritania, Kyrgyz Republic, Lesotho, Gambia, The, Mongolia, Guinea-Bissau, Moldova, Armenia, Swaziland, Timor-Leste, Comoros, Djibouti, Bhutan, Guyana, Solomon Islands	Mauritania, Kyrgyz Republic, Mongolia Moldova, Armenia Swaziland, Djibouti, Guyana	Mauritania, Kyrgyz Republic, Mongolia Moldova, Armenia Swaziland, Djibouti, Guyana	Mauritania, Kyrgyz Republic, Mongolia Moldova, Djibouti, Guyana
US$1 million / US$3 million	Less than 100k	Cabo Verde, Maldives, Vanuatu, Sao Tome and Principe, Samoa, Tonga, St. Lucia, Kiribati, Micronesia, Fed. Sts., St. Vincent and the Grenadines, Grenada, Marshall Islands, Dominica, Tuvalu			

Total GPE Funds Required if all Countries Applied at Maximum Ceiling		**US937 million**	**US$555 million**	**US$370 million**	**US$175 million**
% that could be met from US100 million Leverage Fund		**11%**	**18%**	**27%**	**57%**

Allocations in Non-ESPIG Countries

5.6 The amounts proposed would be a ceiling that countries could apply to subject to meeting the US$3 to US$1 co-financing requirement. For example, a country that could apply for up to US$25 million would therefore have to bring an additional US$75 million in external financing. If only $60 million in external financing was available to co-finance with the GPE Funds, then that country would only be able to apply for US$20 million from GPE to meet the ratio.

Allocations in ESPIG Countries

5.7 For ESPIG eligible countries, **the Leverage Funds would be additional to their MCA**. For example – the MCA for Zambia under a low resource scenario would be just US9.7 million, however they could increase GPE Funding by up to US$10 million more through the Leverage Fund to a total of US$19.7 million. With external co-financing of US$30 million (US$10m X 3) more, a program of just under US$50 million could be developed.

Process to Apply

5.8 The process is likely to be different depending on the eligibility option proposed. However the principle set out in the Board decisions of fair access and prospects for success would need to be respected, while also ensuring that the Leverage Fund could be tested in a range of countries with different circumstances. From the Secretariat's perspective, the importance of not significantly increasing burden on country level actors or incurring excessive Secretariat staff time or budget relative to the initial size of the fund are also important considerations

5.9 A possible approach under each scenario that seeks to balance these considerations is set out below, however some flexibility may be needed as the work further progresses to take advantage of opportunities that may present themselves and to deal with any unexpected obstacles that may arise.

5.10 Under the FRC recommended Option 3, the following approach is proposed.

Option 3 – 30 Countries

For Non-ESPIG eligible countries (22)

1. For Non-ESPIG eligible countries, Secretariat prepares communications materials/organizes webinars, and reaches out to all eligible countries to explain the Leverage Fund and related requirements. (July-September 2017)
2. All eligible countries are invited to express interest in applying including identifying indicative timing of an application, amounts involved, potential source of co-financing, and confirmation of additionality. (October 2017 – December 2017) It's assumed that not all countries will express interest and this will help reduce demand from the initial 22
3. Secretariat reviews each expression of interest and clarifies with countries where necessary any aspects that would appear not to meet requirements (January 2018). It's assumed that not all countries that express interest may meet the requirements and this will further reduce demand. E.g. some countries may look to buy-down existing loans, or attempt to satisfy the leverage requirement by referencing existing external financing.

(ESPIG Eligible Countries – can start at Point 4)

4. Secretariat conducts targeted outreach to all eligible and interested countries to explain the offering and requirements, discuss requirements and process with potentially interested external financing partners, and confirms intention to apply (July-September 2017 for ESPIG eligible, January-March for all others). At this stage, it's expected that some countries may drop out.
5. Secretariat prepares an analysis of each interested country for submission to the Grants and Performance Committee focusing in particular on risks, and prospects for success (October 2017 and April 2018)
6. Grants and Performance Committee recommend to the Board to provide MCAs up to the value of available funds in the Leverage Fund ensuring resources are available for both ESPIG and non-ESPIG eligible countries, and Board approves MCAs (December 2017 or first Board meeting after replenishment for first batch of countries and June 2018 for Non-ESPIG eligible)
7. Country Selects Grant Agent to develop the proposal, and Secretariat works closely with Grant Agent/External Financing Partner (likely to be same as Grant Agent in many cases),

and LEG to quality assure proposal in the same way as an ESPIG and facilitate the program. (First programs could be approved as early as June 2018, but likely to be December 2018 for Non-ESPIG eligible countries)

5.11 The FRC stressed that the proposed approach should be considered as a guideline for rolling this out, and GPE will need to have the flexibility to adapt it should opportunities arise that would allow the US$100 million to be allocated and rolled out quickly while still meeting the Board's desire to focus on a mix of countries. (E.g. should a country and potential financing partner(s) approach the Secretariat with a proposition that meets the criteria set out in para 4.1, it could be considered)

6. RISKS AND RESOURCE IMPLICATIONS

6.1 A key risk for the Leverage Fund is under or over subscription from interested countries. In the event that more countries are interested than available funds (most likely in Option 1 and 2), GPE will need to either expand the size of the leverage fund, or accept that it will need to prioritize among these countries risking disappointment among those not selected. In the event of under-subscription (most likely in Option 4), GPE can either seek to further expand eligibility, lower the leverage requirement, or reprogram unutilized funds for other GPE initiatives.

6.2 An additional risk is excessive burden of effort on both country level partners, and the Secretariat. Narrower eligibility would reduce this risk, along with a focus on prioritizing countries that show the most interest and have highest prospects for success.

6.3 A lack of clarity on the relationship of the Leverage Fund with IFFEd. This risk can be mitigated by continuous information sharing and coordination between the GPE Secretariat, and Education Commission on the design of IFFEd and rolling out of the Leverage Fund.

6.4 The Secretariat expects to have sufficient human resources to support operationalization of the Leverage Fund once already approved headcount are on-board. Secretariat travel, some short term consultants to prepare communications materials, or to advise on agreements with multilateral development banks may be needed depending on the quantity and nature of applications under the Leverage Fund, and modest provisions will be included in the Secretariat's FY18 budget and work plan. The key challenge will be in the initial outreach and screening of interested countries. The broader the eligibility, the higher the potential interest and therefore the more resources will need to be drawn from country facing staff to cope.

7. NEXT STEPS

7.1 Subject to Board approval, the Secretariat will begin to rollout the process outlined in this paper

7.2 The Secretariat will also continue to reach out to the Education Commission to update them on progress and to work with them on the design of their new mechanism

7.3 The "Leverage Fund" may be rebranded with a different name over the coming weeks to ensure there is no confusion that all ESPIG funding is designed to leverage additional financing, particularly domestic financing, and the purpose of this initiative is to incentivize increased external financing and co-financing for implementation of quality education sector plans.

7.4 Once implementation commences, it will be important to ensure that it is incorporated into GPE's evaluation strategy to test whether it meets its intended purpose and to learn lessons.

8. PLEASE CONTACT: Padraig Power at ppower@globalpartnership.org for further information.