GLOBAL PARTNERSHIP for EDUCATION

GERF/2015/11 DOC 02
Meeting of the Governance, Ethics, Risk, and Finance Committee
Paris, France
November 5-6, 2015

FINANCIAL FORECAST

For Recommendation

1. STRATEGIC PURPOSE

1.1 The financial forecast is designed to provide the Governance, Ethics, Risk, and Finance Committee (GERF) with sufficient information on the expected financial position of the Global Partnership. This information is critical in order to make recommendations to the Board that will allow them to support implementation of GPE strategic objectives by allocating its financial resources for any recommended program implementation grant proposals by the Country Grants and Performance Committee (CGPC) in Round 2 of 2015, and indicatively allocating resources for future application rounds commencing in 2017.

2. RECOMMENDED DECISION

2.1 The GERF requests that the Board of Directors approve the following decision:

BOD/2015/12-XX—Approval of Maximum Country Allocations: The Board of Directors:

1. Approves the list of Maximum Country Allocations for Round 1 of 2017 bellow. The allocation for these countries will remain valid through the final application round of 2018 unless otherwise adjusted by the Board, and will be subject to the requirements of the funding model for the 2015–2018 period.

List of Eligible Countries *All Figures in USD Millions*	**Fixed (70%**	**Variable (30%)**	**Maximum Country Allocation**	**Earliest Application Round**
Burkina Faso	23.7	10.1	33.8	R1 2017
Cambodia	14.4	6.2	20.6	R1 2017
Eritrea	12.0	5.2	17.2	R1 2017
Haiti	11.5	5.0	16.5	R1 2017

Madagascar	32.8	14.0	46.8	R1 2017
Mali	24.9	10.7	35.6	R1 2017
Sierra Leone	12.0	5.2	17.2	R1 2017
Togo	9.8	4.2	14.0	R1 2017
Gambia	3.5	1.5	5.0	R2 2017
Benin	12.0	5.1	17.1	R2 2017
TOTAL	**156.6**	**67.2**	**223.8**	

List of Eligible Small Island and Landlocked Developing States *(All Figures in USD Millions)*	**Maximum Country Allocation**	**Earliest Application Round**
Sao Tome and Principe	**1.0**	**R1 2017**

2. Requests the GERF to conduct a review of the forecast of available resources at its next face-to-face meeting in 2016 and if possible to make recommendations for decision by the Board on potential positive adjustments to the Maximum Country Allocations for eligible countries impacted by the prioritization measures, and the resources available for the general provision.

3. Notes that due to continued adverse foreign exchange movements and a downward revision of a donor pledge, projected available resources are insufficient to provide allocations for a number of eligible GPE countries. The Board therefore calls on all partners to intensify their efforts to secure additional financing through the GPE Fund and for donors to fulfill their pledges in a timely manner.

3. BACKGROUND

3.1 As communicated in previous financial forecasts, it is important to note that the forecast is a projection of future events and is therefore subject to significant change that could both positively and/or negatively affect the forecast.

3.2 These changes can be permanent in nature, for example a reduction in donor contributions or an increase in commitments required. Alternatively they can also be temporary in nature such as a shift in the timing of a donor contribution from the end of one year to the start of another.

3.3 The assumptions used to develop the financial forecast and associated recommendations are outlined in the explanatory notes in Annex 7 and are based on the approach approved by the Board of Directors in June 2014 (BOD/2014/06-01).

3.4 The resources available for allocation are presented in both Annex 1 (calculation of the overall amount for allocation and impact on Maximum Country Allocations), and Annex 3 (Forecast of available resources to the end of 2018).

4. REASONS FOR RECOMMENDATION

4.1 Since the last Board meeting in May 2015, the projection of available resources has continued to decline. The primary reasons are an announcement from a major donor that they will not be able to fulfill the pledge made at the replenishment conference in June 2014 combined with communication from another donor that the initially planned increase to its pledge via a top up at the end of 2014 is unable to be provided as an increase, and therefore the top up payment must count against their original pledge.

4.2 Adverse foreign exchange rates have continued to put pressure on available resources, although not to the same extent as experienced over the July 2014 – March 2015 period as there has been relative stability in the US dollar/Euro exchange rate. Unfortunately, there has been a further strengthening of the US dollar against other GPE donor currencies, notably the Australian and Canadian dollars, as well as the Norwegian krone. The measures adopted by the Board to revalue Maximum Country Allocations based on the US dollar equivalent of the local currency allocation calculated at the time of the GPE replenishment in June 2014 to maintain the same allocation value in local currency has created a natural currency hedge that has limited the negative impact of these foreign exchange movements, albeit by reducing the US dollar value of the allocations.

4.3 It should be noted that between the impact of foreign exchange and reductions from donors, the value of pledges for this current replenishment period is down from US$2.31 billion (based on the value of pledges when initially made) to US$1.86 billion, a decline of some US$450 million in total.

4.4 As requested in May 2015, the Secretariat has continued to work with the Trustee to consider ways to mitigate GPE's exposure to adverse foreign exchange movements, however the situation has not significantly advanced and is unlikely to without a change in approach from GPE Donors and/or the World Bank. Annex 6 outlines further information on this subject.

4.5 As outlined in the previous financial forecast submitted to the Board in May 2015, without a substantial improvement in available resources, further prioritization measures would be required to ensure that the supply of available resources for allocation is matched as far as possible to the level of funding that the Board can indicatively make available for allocation. As the financial position has not improved, the Secretariat believes the Board will need to adopt further prioritization measures as outlined in Annex 2

4.6 Annex 1 – provides a calculation of the resources expected to be available for allocation for countries expecting to receive an indicative MCA in order to apply in 2017 or 2018. This calculation takes into account all the previous prioritization measures adopted by the Board through May of 2015. It takes into account the remaining commitments to be made on previously approved allocations, provisions for ongoing activities to the end of 2018, and the expected cost of providing allocations to countries with an indicative MCA already announced by the Board (i.e. countries expected to apply in 2015 or 2016). As can be seen from the calculation, there is a funding gap of over US$200m between the projected available resources and the amount required to provide new grant allocations for remaining eligible countries to the end of 2018

4.7 Annex 2 – explores the options for closing the projected gap in available resources. To close the US$200m plus forecasted gap, the Board must either take measures that will increase the supply of funds available for allocation and/or take measures that will reduce the demand for funding. In relation to the demand side, the prioritization measures agreed in June 2014 by the Board if applied will likely result in no forecasting of an allocation to any eligible Lower Middle Income Country (LMIC) beyond the indicative allocations already announced for those countries eligible to apply in 2015 and 2 2016. However even this measure is insufficient and therefore prioritization among Low Income Countries (LIC) would also be required.

4.6 The Secretariat recommends that based on the existing prioritization criteria agreed by the Board, no new indicative MCAs be announced at this time for remaining eligible LMICs (Cameroon, Kyrgyz Republic, Mauritania, Pakistan, Senegal, Sudan, and Yemen) and considering that two LICs (Uganda and Niger) have existing grants that are not expected to close prior to 2018 and may in fact be extended if they encounter delays, that no new allocations are provisioned for these two LICs at this stage, but that the Board should re-examine their circumstances closer to the time or as available resources improve. This approach would enable MCA's to be announced for remaining LICs expected to apply in 2017 without the need for further prioritization.

4.7 The Secretariat notes that based on the comprehensive funding guidelines, the Board will be in a position to approve any and all proposals recommended by the Country Grants and Performance Committee for approval in Round 2 of 2015. The calculations per the comprehensive funding guidelines are disclosed in Annex 4.

4.8 As fundraising efforts are ongoing and exchange rates may change over the course of 2015-2018 in a way that positively impacts the forecast, additional resources may become available. If so, the GERF may consider recommending to the Board an upward adjustment to these allocations at a future date. This may also include consideration of a new allocation for any eligible country approved in Round 2 of 2014 for which no future allocation is forecast before the end of 2018.

5. RISK

5.1 It should also be recognized, that there a number of considerable risks to GPE's financial position moving forward. Among these risks include the potential for a further strengthening of the US dollar in 2016, an inability to conclude lengthy negotiations between the World Bank and the European Commission on a contribution agreement to facilitate payment of EU funds, the risk that the ongoing refugee crisis in Europe either results in delays or reductions to donor contributions to the GPE Fund, and the risk that donors that may be in a position to increase funding in 2016 wait for the outcome of the Financing Commission in the second half of 2016.

5.2 A further reduction in projected available resources could trigger prioritization measures such as delaying of Board approval, or grant commitments as outlined in the Comprehensive Funding Guidelines approved by the Board in 2013.

6. NEXT STEPS

6.1 The financial forecast and recommended maximum country allocations will be amended if required based on the GERF's deliberations and presented as part of the GERF report to the Board.

6.2 In the event of any significant material change in the financial position prior to the Board meeting in December 2015, the GERF may be required to meet by audio conference to consider an updated forecast and adjustments to the recommendations to the Board.

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

8. ANNEXES OR INFORMATION

8.1 The following Annexes are included in this paper

Annex 1 – Calculation of the Available Resources for Maximum Country Allocation

Annex 2 – Prioritization Options

Annex 3 – Forecast of Available Resources to the end of 2018

Annex 4 – Forecast for the Purpose of Program Implementation Grant Approvals

Annex 5 – List of Indicative Maximum Country Allocations Proposed for 2017

Annex 6 –Foreign Exchange

Annex 7 – Explanatory Notes and Assumptions for Forecast of Available Resources

ANNEX 1 – CALCULATION OF THE AVAILABLE RESOURCES FOR MAXIMUM COUNTRY ALLOCATION

Current Projected Shortfall required to fund all GPE eligible countries and activities based on prioritization measures agreed by the Board as of May 2015

SCENARIO	1
MCA Calculation Amount (2,000 = Minimum)	*2000*
Opening Uncommitted Cash Balance 1 July 2015	77
Balance on Signed Contribution Agreements	190
Donor Pledges (after discounting for uncertainty)	1,161
Projections of Additional Contributions - Secretariat Recommended	219
Projected Carryover from 2015-2018 Approvals (20% of MCA)	291
RESOURCES FOR FORECASTING PURPOSES (A)	**1,938**
Remaining Commitments to be made on Existing Approved Grants (2013-2015)	-756
Provisions for other Grants (Plan Development, Program Development, CSEF)	-51
Provisions for other costs (Supervision, Agency, Secretariat, Trustee)	-106
General Provision (Leverage Fund and Contingencies)	0
TOTAL AMOUNT TO BE SET ASIDE (B)	**-913**
AVAILABLE FOR IMPLEMENTATION GRANTS (A-B)	**1,025**
Categories of Countries Requiring Funds	**MCA**
Countries with MCA's announced by the Board but Grant Application Not Yet Approved (Round 2 2015 and 2016)	-740
Low Income Countries Expected to Apply in Round 1 2017	-202
Low Income Countries Expected to Apply in Round 2 2017	-22
Low Income Countries Expected to Apply in 2018	-109
Lower Middle Income Countries Expected to Apply in 2017 or 2018	-159
TOTAL REQUIRED AMOUNT	**-1,232**
PROJECTED SURPLUS / (SHORTFALL)	**-207**

ANNEX 2 – PRIORITIZATION OPTIONS

As outlined above, there is a forecasted shortfall of US$207m dollars. The Board of Directors will need to consider prioritization measures to address this issue.

Option 1 - Adopt the Agreed Prioritization Approach

Based on the agreed prioritization measures previously adopted by the Board, the projected shortfall can be closed by no longer forecasting any allocation for the remaining eligible LMICs that have not yet had an indicative Maximum Country Allocation (MCA) announced and a general reduction of 25% in the value of allocations for all remaining eligible LICs that have not yet had an MCA announced (i.e. those expected to apply from Round 1 2017 onwards). The affected LMICs would be: Cameroon, Kyrgyz Republic, Mauritania, Pakistan, Senegal, Sudan, and Yemen.

Option 2 - Introduce an Efficiency Gain Target

An alternative approach would be to continue to no longer forecast an allocation for the remaining eligible LMICs and instead of an automatic approach to reducing the MCAs for the LICs, the Board could keep the LIC allocations intact but establish an efficiency gain target to be achieved on the grant portfolio.

For example: An efficiency gain target of approximately US$75 million would close the forecasted gap. However it would require savings to be found on existing grants (this would imply limitations on grant extensions to use up unspent funds) or new applications (savings to be found during the Quality Assurance Review process, or during proposal review by the CGPC).

While an efficiency gain target might actually improve the value for money of GPE grants in terms of costs to delivering the programs, it may create strains in the partnership, particularly between the Secretariat, SE/MEs, and the Developing Country Partners (DCPs) as it would involve the Secretariat questioning the merits of certain activities and the costs included in proposals developed by the SE/MEs and DCPs. It may also lead to a simple reductions of targets to come up with the funds required rather than genuine efficiency gains being achieved

At this stage, it is not recommended to set a specific target because of the challenges outlined above. However as already requested by the Board in May of 2015, all GPE partner should seek to achieve efficiency gains to help close the funding gap.

Option 3 (Secretariat Recommended) – Announce Allocations for LICs in 2017 but no longer provision for countries with existing grants ending in 2018

Continue not to forecast any allocation for remaining eligible LMICs and in addition, do not forecast an allocation for LICs with existing grants scheduled to end in 2018. Both Uganda and Niger are LICs with existing grants scheduled to end in 2018. If no provision was made to provide an allocation in the forecast for these countries, then there would not be a need to apply a 25% further reduction to all remaining LICs scheduled to apply in 2017 and 2018.

As a significant number of GPE grants often require extensions, any delay in implementation for either country would push its next application out of the current replenishment period, and therefore the 25% reduction to allocations for those countries seeking to apply in 2017 may have been unnecessary.

Both grants currently have low disbursement rates. However in the event that this option was selected, and one or both countries accelerated funding and finished on schedule, the GERF and Board could consider the possibility of a costed extension to bridge any GPE funding gap into the next replenishment.

ANNEX 3 - FORECAST OF UNCOMMITTED ASSETS (BASED ON OPTION 3 PRIORITIZATION)				
All Figures in USD Millions	**Semester 2 2015**	**2016**	**2017**	**2018**
A. Opening Balance Cash and Promissory Notes	562	477	390	444
A1. Total Committed	485	242	318	396
A2. Total Uncommitted/Available for Approval	77	235	72	48
B. Inflows	215	413	454	469
Contribution Agreement	25	36	56	73
Pledges	190	327	348	277
Projections	-	50	50	119
C. Outflows	300	500	400	400
D. New Commitments	57	576	478	435
Commitments (Existing Approved Grants)	25	371	259	96
Projected Commitments (Round 2 2015)	-	4	4	4
Projected Commitments (New Allocations 2016 - 2017)	-	150	163	313
Other Commitments	32	50	52	22
E. Closing Balance Cash and Promissory Notes (A+B-C)	477	390	444	513
E1. Total Committed (A1-C+D)	242	318	396	431
E2. Total Uncommitted/Available for Approval (A2+B-D)	235	72	48	82

While the forecast shows that there should be sufficient liquidity to manage commitments to meet demand based on expected timing of applications, there is a risk of temporary funding shortages if donor contributions are delayed or grant implementation accelerates significantly requiring the application of actions outlined in GPE's Comprehensive Funding Guidelines.

ANNEX 4 - FORECAST FOR THE PURPOSE OF PROGRAM IMPLEMENTATION GRANT APPROVALS

The Comprehensive Funding Guidelines approved by the Board of Directors in May 2013 outlines the approach to be taken for the forecast of funds and timelines that should be taken into consideration by the Board when considering approval of new program implementation grants.

The recommended approach has the following key features:

- The forecast is over a shorter period (6 months) to reflect the typical grant signing timeframes. It still considers the overall longer term financial projections as set out in Annex 2 of this paper.
- The forecast of contributions excludes Secretariat projections of additional contributions as there is less certainty that these funds will actually materialize compared to expected contributions arising from pledges and signed contribution agreements.
- The forecast seeks to determine whether there are sufficient funds to be able to finance the first commitment within the Semester following Board review of the proposal in order to provide the Board with an appropriate basis for approving a proposal.
- As the Board will approve proposals for their full amount requested, consideration needs to be given as to the likelihood that we will be able to also finance the second and any subsequent commitments. This is provided by reviewing the longer-term forecast scenarios (set out in Annex 2) and ensuring that there are no projected future shortfalls in funds available for commitments, and also by prioritizing upcoming (within the next six months) second and subsequent commitments, along with recurrent costs of the Global Partnership prior to financing commitments for newly approved proposals.

Following the approach recommended in the Comprehensive Funding Guidelines, the following forecast was determined.

FORECAST JANUARY 1, 2016 – JUNE 30, 2016	AMOUNT in USD millions
Estimated Available Assets on Hand January 1, 2016 (excluding projected contributions to December 31, 2015)	267
Pledged and Signed Contributions January 1, 2016 – June 30, 2016	107
Total Projected Assets	**374**
Recurrent Costs (Secretariat and Trustee budgets, Plan and Program Development Grants, CSEF etc) – January 1, 2016 – June 30, 2016	(35)
Projected Commitments for Existing Grants falling due January 1, 2016 – June 30, 2016	(184)
Total Projected Liabilities	**(219)**
Available Assets for First Grant Commitment of Round 2 of 2015 Applications	**155**
First Commitment of Round 2 of 2015 proposals required by June 30, 2016 (including related Supervision and Agency Fees)	(4)
Projected Surplus/(Shortfall)	**151**

The expected available cash along with pledged and signed contributions predicted to be made during the period less known liabilities arising from prior Board approvals or recurrent costs exceeds the amount required to make the first Commitment of Round 2 of 2015 proposals and related supervision and agency costs.

In addition, no shortfall in available assets is predicted over the course of either of the longer-term forecast scenario presented in Annex 3 that would necessitate including a provision for a commitment reserve in this calculation of available funds.

Based on the Comprehensive Funding Guidelines, the Board can therefore approve the maximum proposal value for Round 2 of 2015 program implementation grant applications should it wish to.

ANNEX 5: MAXIMUM COUNTRY ALLOCATIONS VALID FROM ROUND 1 AND 2 OF 2017

List of Eligible Countries *All Figures in USD Millions*	Fixed (70%	Variable (30%)	Maximum Country Allocation	Earliest Application Round
Burkina Faso	23.7	10.1	33.8	R1 2017
Cambodia	14.4	6.2	20.6	R1 2017
Eritrea	12.0	5.2	17.2	R1 2017
Haiti	11.5	5.0	16.5	R1 2017
Madagascar	32.8	14.0	46.8	R1 2017
Mali	24.9	10.7	35.6	R1 2017
Sierra Leone	12.0	5.2	17.2	R1 2017
Togo	9.8	4.2	14.0	R1 2017
Gambia	3.5	1.5	5.0	R2 2017
Benin	12.0	5.1	17.1	R2 2017
TOTAL	**156.6**	**67.2**	**223.8**	

List of Eligible Small Island and Landlocked Developing States *(All Figures in USD Millions)*	Maximum Country Allocation	Earliest Application Round
Sao Tome and Principe	1.0	R1 2017

ANNEX 6 – FOREIGN EXCHANGE (FX)

Introduction

As requested by the Board in May 2015, the World Bank as Trustee was asked to work with the Secretariat to consider the feasibility of euro denominated grants and development of a hedging strategy for GPE.

The Trustee prepared the following information notes on both subjects below:

Evaluation of Introducing an Additional Operating Currency under the GPE Fund

Objective
This note presents the background on the operating currency of the Global Partnership for Education Fund and issues to consider if the GPEF were to add a second operating currency.

Background
The GPE Secretariat requested the Trustee to look into the possible introduction of the Euro as an operating currency under the GPEF, in addition to the US dollar, given the demand from recipient countries. In addition, introducing the Euro as a second operating currency could help mitigate reductions in indicative country allocations due to FX movements between the time a donor commits to a contribution and the time of actual payment. The GPEF currently has one operating currency, the US dollar, and all contributions received from donors in non-US dollar currencies are converted to US dollar at the time of receipt. Commitments and transfers to Supervising/Managing Entities (SE/MEs) are also in US dollars. The SE/MEs are free to convert to local currencies to facilitate operations, with the condition that any FX loss incurred would be borne by the SE/MEs.

Introducing a New Operating Currency
World Bank policies and procedures related to trust funds do not restrict the use of multiple currencies as operating currencies. A few Financial Intermediary Funds (FIFs) administered or managed by the World Bank already operate in multiple currencies (Global Fund, CIFs).

To manage two operating currencies in a cost-effective manner, the Euro supply should match with the expected demand for Euro. As shown in Table 1, contributions committed in Euro account for 19% of the total cumulative contributions (US$ 269 million out of the total cumulative contributions of US$1,410 million). If the demand for Euro were lower than US$ 269 million, a decision would need to be made as to which donor contributions would be kept in Euro and which donor contributions would be converted to US dollar. Operating in two currencies would also require meticulous financial management, both at the Secretariat and the Trustee, to manage the timing of inflows and outflows in dual currency.

Table 1: Contribution Status of the GPEF

Contributor	Curr	Signed in Currency	Signed in USD eq.	Contribution Share
Australia	AUD	270.0	257.6	18.26%
Belgium	EUR	36.0	48.4	3.43%
Canada a/	CAD	46.2	46.3	3.28%
Denmark	DKK	920.0	164.8	11.68%
Finland	EUR	4.0	5.6	0.39%
Germany	EUR	1.6	2.1	0.15%
Ireland a/	EUR	16.1	21.6	1.53%
Italy	EUR	1.5	2.0	0.14%
Japan	USD	10.4	10.4	0.74%
Luxemburg a/	EUR	0.6	0.8	0.06%
Netherlands	EUR	120.0	161.4	11.44%
Norway	NOK	730.0	123.8	8.78%
Romania	EUR	0.1	0.1	0.01%
Spain a/	EUR	20.1	26.9	1.91%
Sweden	SEK	400.0	60.3	4.27%
Switzerland	CHF	24.5	27.0	1.91%
United Kingdom	GBP	269.6	431.3	30.58%
United States	USD	20.0	20.0	1.42%
Total			**1,410.6**	**100%**

Another option could be considered—wherein the Trustee converts US dollars to Euro at the time of commitments [to SE/MEs] and/or disbursements. This approach could be appropriate if the demand for Euro was unknown at the time a Contribution Agreement is signed with donors. However, lessons learned from this approach implemented by another FIF are that there will be additional transaction costs for conversion from US dollar to Euro. There could also be potential FX losses at the time of the transaction. Therefore, maintaining Euro contributions (i.e., no FX conversion at the time of payment) to cover commitments and disbursements would a better option, as long as the demand for Euro is predictable and robust.

In both options, SE/MEs need to agree on using the Euro as their operating currency if they are selected to take on Euro projects by the GPE Board.

Introducing a second currency would increase operating expenses for both the Secretariat and the Trustee. The Secretariat would need to manage project pipelines in both currencies, while the Trustee would need to maintain both USD commitment authority and the EUR commitment authority applications and reports. It would also lead to an increase in the financial management and accounting costs that are part of the Trustee budget. There would be no set-up fee, but the transition would entail certain costs (e.g. Contribution agreements would need to be revised as they currently specify the US$ as the holding currency of the GPE Fund, there would also be a need to enter into a supplemental agreement to the Financial Procedures Agreement with certain SE/MEs to allow financial accounts and reports related to the GPEF to be expressed in Euro).

Table 2: Contribution Status of the GPEF

	FY16	FY17	Total
Additional Costs Associated with Trustee Services			
Set up Fee	-	-	-
Financial and Program Management	100,000	80,000	**180,000**
Investment Management	10,000	10,000	**20,000**
Accounting and Reporting	27,000	27,000	**54,000**
Legal Services to amend the Contribution Agreement	25,000	-	**25,000**
Total	**162,000**	**117,000**	**279,000**
Other Estimated Costs			
Negative impact from Euribor interest rate	35,000	35,000	**70,000**
Foregone income on T1 and T2	-	-	-
Estimated market losses from exiting T2 early	-	-	-
Total	**35,000**	**35,000**	**70,000**
Total Additional Cost			
In USD	**197,000**	**152,000**	**349,000**
As % of total	0.78%	0.60%	1.38%

If the demand for Euro was not predictable and the Secretariat overestimated the demand, the Trustee could be instructed to sell the surplus balances, which could possibly incur an FX loss (difference between the USD equivalent amount at the receipt of the contribution in Euro and the time they sell the surplus). In such a situation, the FX loss would not be mitigated.

Finally, splitting the GPE resources in two separate investment pools could have adverse consequences for the investment income of the GPEF if it prevented the Trust Fund from investing towards longer maturities. In addition, investment income in Euro could be exposed to negative return, given the current market conditions in Europe. Finally, if delays in donor contributions, accelerated disbursements to countries, or other adjustments in the financial management of GPE were to lead to anticipated liquidation of financial assets, the risk of market losses would increase significantly. As Euro rates have fallen in the recent past, this potential cost does not appear in the cost analysis detailed in Table 2 but it exists and is significant given the absolute level of interest rates on Euro and US$ investments.

Conclusion

The Trustee can accommodate a request to introduce the Euro as a new operating currency if GPE so desires. The need for this second currency should take into account the cost, complexity and time required to implement, the level and predictability of demand from recipient countries, the willingness of SE/MEs to handle dual currencies in terms of cash management and reporting and the potential benefit it could bring to the Partnership in terms of mitigating FX risk.

Options for the GPE Fund in Mitigating Foreign Exchange Variations

Objective

This note presents options to mitigate foreign exchange variations for the Global Partnership for Education Fund (GPEF)

Background

From the Trustee's perspective, the GPEF is not exposed to any foreign exchange risks. FIFs face foreign exchange exposure when their basis of commitments includes future donor receivables, beyond cash already received from donors. Under the GPEF, the Trustee only commits funding for recipients in US dollars based on cash already received from donors. It does not commit funding using donor contribution receivables. This financially-prudent approach eliminates foreign currency exposure to the GPEF.

The concern raised relates to the impact of foreign exchange on resource projections. **It does not involve any legal liability for the GPEF.** The uncertainty on resource projections increases with the length of the receivable; donor contributions are typically "paid in" over an agreed time period. The value of contributions to the GPE replenishment is not fully "locked in" until the last payment is received, typically four years after the start of the replenishment.

Mitigation Measures

From the GPEF perspective, the simplest option is for donors to contribute in US$, the operating currency of GPE. Donors would then bear the consequences of the foreign exchange variations.

A hedging strategy using currency derivatives to convert future donor receivables into the holding and commitment currency of the trust fund would also be an effective tool to manage currency fluctuations. While the benefits are clearly significant, the challenges faced are numerous and complex.

Firstly, the majority of trust funds, including GPE, do not have a credit rating, which prohibits them from gaining direct market access to the financial instruments required to hedge currency exposure. The cost and time required to obtain a credit rating would be significant, and there is no guarantee that an acceptable rating would be achieved.

An alternative would be for IBRD to act as intermediary between the trust fund and market counterparties. This would however require a policy decision by the Bank's Executive Directors, which would also be a lengthy process with a very uncertain outcome at this stage. If the Bank's Executive Directors were to consider favorably this change of policy, donors would be responsible for the cost of the hedging transactions and any required collateral payments. The GPE Fund would probably not be in a position to make collateral payments as collateral would diminish commitment authority (dollar for dollar).

Since the Bank has never hedged the currency risk for a Trust Fund, it would be necessary to establish processes and systems for the execution, settlement, tracking and reporting on such transactions. These processes would have to be created on the donors' side as well, which could be costly and complex.

Secondly, at a minimum, donors would need to agree to legally binding payment schedules, to contractual obligations to exchange cash flows on set dates, etc. In the event of non-payment, the Trustee and donors would need to determine policies around the unwinding of derivatives transactions and the donors to accept to cover the costs involved.

Conclusion

The GPE Fund does not commit funds beyond cash already received from donors. The status quo appears reasonable, while donors might be encouraged to contribute in US dollars.

The Trustee would be happy to continue working towards addressing these challenges, with the aim of developing a feasible approach for hedging currency exposure of the GPE Fund, provided some individual donors convey their willingness and ability 1) to agree to legally binding payment schedules, 2) to set up collateral payment systems, and 3) to bear the costs associated with hedging.

Secretariat Opinion

In relation to the option to open up a euro fund and providing grants in euro, the Secretariat believes that the downsides of such an initiative currently outweigh the upsides. The key challenge is the lack of predictability on both supply of euro contributions and timing of potential euro grants, combined with GPE's tight liquidity and uncommitted asset balance. Nevertheless, this option should be revisited around the time of GPE's next replenishment when considering how allocations should be made.

In relation to the options for currency hedging, as outlined by the Trustee, the issues are complex and beyond the control of GPE Secretariat. The reality is that without donors willing to enter into legally binding payment schedules that would cover the costs of the World Bank as Trustee in the event of non-payment, a hedging solution is unlikely in the short term.

The approach introduced by the Board in May of 2015 to revalue MCA's using the US Dollar equivalent of the local currency allocation at the time of the replenishment in June 2014 has already created a natural hedge that reduces the impact of foreign currency volatility to some degree.

STATUS OF 2015-2018 Replenishment (All figures in Millions)		Brussels Pledge + Post Brussels Pledges and Adjustments		Paid to Date (Sep 30, 2015)	Remaining Pledge Value (Sep 30, 2015)	Total Value of Pledge + Paid in (Sep 30, 2015)	FX Related Change in Value (as of Sep 30, 2015)
Donor	**CUR**	**Pledged Amount**	**USD Equivalent**	**USD Value**	**USD Value**	**USD Value (in millions)**	**USD Value (in millions)**
Australia	AUD	140.0	131.8	49.4	53.8	103.2	(28.6)
Belgium	EUR	36.0	49.0	12.1	28.1	40.2	(8.8)
Canada	CAD	120.0	94.2	23.5	67.1	90.7	(3.5)
CIFF	USD	22.0	22.0	-	22.0	22.0	-
Denmark[1]	DKK	1,125.0	205.4	8.3	161.9	170.1	(35.3)
Dubai Cares	USD	1.0	1.0	-	1.0	1.0	-
EC	EUR	375.0	510.5	-	421.3	421.3	(89.2)
Finland	EUR	4.8	6.6	2.1	3.4	5.4	(1.2)
France	EUR	1.0	1.1	-	1.1	1.1	(0.0)
Germany	EUR	35.0	47.6	12.6	27.5	40.1	(7.6)
Ireland	EUR	16.0	21.8	4.4	13.5	17.9	(3.9)
Italy	EUR	7.5	10.2	3.5	5.1	8.5	(1.7)
Japan	USD	2.4	2.4	2.4	-	2.4	-
Norway	NOK	1,660.0	270.0	26.5	173.0	199.6	(70.4)
Korea	USD	5.0	5.0	-	5.0	5.0	-
Luxembourg	EUR	0.3	0.4	0.3	-	0.3	(0.1)
Sweden[2]	SEK	1,300.0	192.9	85.4	74.9	160.3	(32.6)
Switzerland	CHF	26.0	29.1	6.8	20.0	26.9	(2.2)
United Kingdom	GBP	300.0	510.8	-	455.7	455.7	(55.1)
United States	USD	90.0	90.0	40.0	50.0	90.0	-
Total			**2,201.9**	**277.4**	**1,584.4**	**1,861.8**	(340.2)

[1] Denmark's pledge of DKK 1,600m for 2015-2018 has been reduced to DKK 1,075m. The figure of DKK 1,125 reflects a DKK 50m top up paid in December 2014

[2] Sweden's pledge of SEK 1,300m is consistent with its Brussels pledge. An increase of the pledge based on a supplementary payment of SEK 220m made in December 2014 has been reversed based on information that this payment should now be counted against the initial pledge.

ANNEX 7 - EXPLANATORY NOTES TO ANNEX 1 and 3

Opening Balance

The opening balance of funds in Annex 1 and 3 reflects the cash available in both the Catalytic Funds and GPE Funds as of July 1, 2015.

In Annex 3, Committed Assets refers to the amount of assets that are earmarked to pay for existing obligations such as program implementation grants already approved by the Board of Directors but not as yet disbursed.

Uncommitted Assets/Available for Approval refers to the amount of funds available that can be allocated to new activities approved by the Board of Directors.

Inflows

Inflows are comprised primarily of funding from donors that fall into three categories:

- **Signed Contribution Agreements:** Agreements signed between the donor and trustee outlining the amount that a donor agrees to pay, payment schedule, and any conditions attached to such payments. The balance on signed contribution agreements as of July 1 2015 was **US$190 million.**

- **Pledges:** These are amounts which donors have announced they expect to contribute either through a replenishment conference, public announcement, or written communication from an authorized official, but which have not yet been signed into a contribution agreement. It is important to note that while some donors pledge over a multi-year period, they are only in a position to sign a contribution agreement on an annual basis. The balance on outstanding pledges after discounting is **US$1,161 million. The following pledges have been discounted:**

    i. *The full value of the pledge for the UK has not been factored into the forecast primarily because the pledge is subject to a limit of 15% of the value of total new contributions and due to additional performance conditions that are attached to the pledge but for which progress has not yet been assessed by DFID. As a result, only US$208 million out of a maximum potential pledge of US$456 million has been factored into the forecast of available resources to take account of these risks.*
    ii. *The full value of the Danish pledge has been reduced based on new information provided that 2015-2018 contributions are expected to be US$162 million compared to US$240 million*

- **Projections:** These are estimates developed by the Secretariat of additional contributions that are expected to be made based on the information available to it from its interactions with current and potential donors. For the purpose of the financial forecast, only reasonable projections from donors that have a track record of contributing to the Global Partnership have been included. The value of projections included in the forecast is **US$219 million** and the only adjustment from the previous forecast relates to foreign exchange adjustments.

Outflows

Outflows reflect the cash transfers from the Trust Funds to Supervising and Managing Entities and the transfer of funds to cover the operational expenses of the Secretariat and Trustee.

The majority of outflows relate to transfers of funds from the Trustee to finance disbursements for program implementation grants. The current outflows are based on simple projections that implementation grants will be disbursed over a three to four year period to account for any projected delays in signings or grant extensions.

It is important to note that outflows impact the level of committed assets and have no impact on the level of uncommitted assets which are used for the purpose of making financial commitments.

New Commitments

Grant commitments are obligations for the provision of financial resources to Supervising and Managing Entities over a predetermined period of time. The practice since January 1, 2013 is to commit funds for program implementation grants in annual tranches over the lifetime of the grant. (i.e. three tranches for a three-year grant)

The forecast of grant commitments for program implementation grants is based on the Secretariat's assessment of when applications will be received from relevant countries and only based on grants already approved by the Board or MCAs announced or to be announced at the next Board meeting. It should be noted that in a number of cases, the Secretariat's assessment differs from when the country has indicated they will submit an application. Where information is available on the split of a proposal budget over the lifetime of a grant, this is reflected in the forecast, where this is not available, the Secretariat makes assumptions of commitments over a 3 to 4 year timeframe in line with the new funding model.

Closing Balance

The closing balance reflects the projected level of assets available at the end of each period.

The uncommitted/available for approval balance is not projected to be negative indicating that there should be no disruption to program implementation grants due to lack of funding. However, as forecasts are subject to change, any negative event such as reduced or delayed donor contributions, or higher or earlier than anticipated applications for funding could create a shortfall in uncommitted assets. In these cases, as the Trustee cannot commit negative funds, the impact is that the commitment of funds (and subsequent cash transfer) for grants would be delayed until new contributions had arrived to eliminate the negative balance. These issues are covered in greater detail in the Comprehensive Funding Guidelines approved by the Board of Directors in May 2013.

At present there is a risk of temporary funding shortfalls should additional donors reduce their pledges, and/or seek to backload their pledges to the latter years of the replenishment, or if grant implementation accelerates.