

**World Bank****Trustee for The Global Fund to Fight AIDS, Tuberculosis and Malaria**

Trustee Report

May 31, 2004

I. Introduction

1. This report provides an update to the Global Fund Board on the status of the Trust Fund for the Global Fund (the “Trust Fund”) as of May 31, 2004. The next section addresses a number of current financial management issues, namely, the evolving financial risks facing the Global Fund, the potential impact of multi-currency grants, and the recent changes to investment policy for Trust Funds administered by the World Bank. The Financial Status Report on the Global Fund Trust Fund in the last section highlights key information on donor contributions, grant commitment and disbursements, investment income earned and commitment authority.

II. Overview of Financial Management Issues

2. **Risk Management:** Over the course of the last two years, the Global Fund’s financial management framework has evolved through a series of financial and operational policy decisions, including the adoption of a comprehensive funding policy, the decision to work towards a voluntary replenishment model with the corresponding potential expanded use of promissory notes, and the developing policies governing Phase 2 renewals. In addition, a number of policy issues such as how to mitigate the foreign exchange exposure of grant recipients are currently under review by Global Fund Committees and the Board. The combined effect of these adopted and potential framework changes will have a significant impact on the management of the Trust Fund portfolio and raise a number of risk management and other issues that will need to be monitored and managed more closely than under the previous policies and framework. We anticipate working closely with the Secretariat to develop financial processes and risk mitigating strategies in order to continue to ensure prudent management of the fund.

3. To illustrate, donors that use promissory notes and choose to denominate these notes in national currency add uncertainty concerning the encashed value of the donor contribution prior to encashment. In addition to the foreign exchange risk of promissory notes, there are also credit and liquidity risks to consider that will include decisions on such issues as: (i) whether and which promissory notes to include in the calculation of available commitment authority, (ii) whether to discount the value of the notes, and (iii) the choice and impact of the applicable encashment schedules. All of these will have implications on the value of the funds available for commitment and on the policies and actions needed to ensure the adequacy of liquidity at all times for disbursement.

4. Similarly, should a multi-currency grant policy be adopted, the risks arising out of the currency mismatches between the Global Fund’s assets (including promissory notes) that are the basis for commitment and the value of multi-currency grants would need to be addressed. If these risks are not well managed, the Global Fund, having committed to a grant, could end up with insufficient funds to fulfill that commitment.

5. **Multi currency option and impact on systems development:** As set out in our previous Trustee Reports, we have been designing a business system to support the Global Fund Trust Fund. The systems development that has been undertaken reflected the single operational currency (i.e., USD) nature of the trust fund as specified in the basic design of the Global Fund and the Trustee Agreement. The agreed systems development process is already well advanced with the initial phases expected to go live in July 2004. However, following the Board discussion in March 2004 and the MEFA Committee meeting in May, the systems development team has--within the basic system development framework, and within the context of the late stage of the system development process--incorporated certain elements of the multi-currency structure where possible to provide as much future flexibility as possible.

6. Moving forward, we believe that there are two main issues to address from the trustee perspective prior to full implementation of a multi-currency operation should the Board decide to do so. First, as noted above, the risks arising out of the currency mismatches between the Global Fund's assets (including promissory notes) that are the basis for commitment and the value of multi-currency grants would need to be addressed. If these risks are not well managed, the Global Fund, having committed to a grant, could end up with insufficient funds to fulfill the commitment. Second, the Global Fund's financial management systems and processes would still need to be changed to record and monitor multi-currency operations. A multi-currency paradigm is a fundamental change in the financial framework and will require additional changes to the system's module originally designed to accommodate a single currency operation as specified in the basic design of the Global Fund and the Trustee Agreement.

7. We have in the meantime undertaken further assessment of the additional development work required and the cost of the remaining systems development work should the Board decide to adopt multi-currency operations. The revised cost estimate and timing of implementation will depend on factors such as timing of the Board's decision, availability of key staff and other systems development work.

8. **Investment Policy:** The World Bank has recently conducted a review of the Trust Fund investment strategy (covering all World Bank administered trust funds) which has resulted in a number of important changes to the existing strategy¹. This revised strategy broadly differentiates trust funds into two separate portfolios with different risk bearing capacity and optimizes the returns subject to their respective risk tolerances and cashflow requirements.

9. Under the new investment strategy, the first (short-term) tranche "Tranche 1" will be managed to a similar risk tolerance and time horizon as that which currently applies to the current commingled Trust Funds portfolio. The second (longer-term) tranche "Tranche 2" will be managed over a 3 year investment horizon to accommodate the trust funds that have a longer term cashflow profile, such as the Global Fund, and that seek to enhance their returns to increase their envelope for commitments. The new Tranche 2 portfolio will include a wider range of investment instruments, currently approved for IBRD and IDA, such as asset backed securities including mortgage backed securities. While some of the assets used for Tranche 2 may be considered higher risk than those used in Tranche 1, they fall within the group of investments in which the World Bank Treasury already has extensive experience managing. Those funds invested in this tranche should be able to absorb shorter term volatility for potentially higher returns. It is currently expected that Tranche 2 would be operational by calendar year of 2005.

¹ A similar review of the World Bank Trust Fund investment strategy was conducted in 1999.

III. Financial Status Report on the Global Fund Trust Fund

10. Table 1 below provides an overview of Trust Fund activities by calendar year, from May 31, 2002 (inception) through May 31, 2004.

Table 1
Trust Fund Activities as of May 31, 2004
Amount in USD millions

	For the period May 31, 2002 - Dec 31, 2002	For the period Jan 01, 2003 to Dec 31, 2003	For the five months Jan - May 31, 2004	Total For the period May 31, 2002 - May 31, 2004
Contributions received	701.7 <i>a/</i>	1,343.3 <i>a/</i>	276.2 <i>a/</i>	2,321.2 <i>b/</i>
Grant Commitments	7.3	1,100.6	154.8	1,262.6 <i>c/</i>
Grant disbursements	0.9	231.2	114.7	346.8
Operating budget commitments	28.7	31.0	38.7	98.3 <i>c/</i>
Operating budget disbursements	28.7	30.4	15.3	74.4
Investment income earned	8.9	28.9	9.8	47.6

a/ Includes receipt of Promissory Notes for value Euro 50 million

b/ Contributions received does not include contribution agreements still awaiting signature or future installment payments (receivables).

c/ Commitments are based on signed grant agreements and approved operating budgets; Board approved projects for which Grant agreements have yet to be signed are not included.

11. **Donor Contributions:** To date, the Trustee has negotiated and signed contribution agreements with 39 donors² with total contributions received in cash and notes of \$2,321.2 million. Details of contributions received by donor are listed in Annex 1. In addition, there is one contribution from France awaiting signature of the contribution agreement, for which a promissory note amounting to EUR 100.0 million has already been received (refer to Table 1, footnote “b”).

12. As of May 31, 2004, \$108.7 million is expected to be received into the Trust Fund, before the end of CY04, from signed contribution agreements which are payable upon effectiveness or include an installment schedule with a payment(s) in CY04.³ The donors involved are: Cameroon, the European Commission, Iceland, the Netherlands, the Russian Federation, Saudi Arabia, Spain, Sweden and the United Nations Foundation. Installment payments scheduled for CY05 and beyond are \$227.2 million. See Annex II for detailed breakdown.

13. **Grant Commitments and Disbursements:** Based on instructions received from the Global Fund, the Trustee has committed \$1,361.0 million of which \$346.8 million has been disbursed towards approved grants and \$74.5 million towards approved operating budgets.

² The actual number of donors that have contributed to the Global Fund is greater than 39 since the UN Foundation receives contributions from individual donors. These contributions are pooled and paid to the Trust Fund by the UN Foundation.

³ This is based only on signed contribution agreements. It does not include CY04 donor pledges which have not yet been translated into signed agreements such as the pledged CY04 contribution by the US and the pending contribution from the European Commission. In addition, at the time of the preparation of this report, contribution agreements were in process with Australia, Denmark, Korea, New Zealand and Uganda.

Annex III provides a comprehensive list, in dollar terms, of commitments and disbursements from inception, for approved grants.

14. As of May 31, 2004 the Trust Fund has earned \$47.6 million in investment income which is available to the Trust Fund for commitment of grant agreements and other expenses.

15. **Commitment Authority:** Table 2 below provides the current resource availability based on contributions received, grant agreements and approved operating budgets. As of May 31, 2004, net funds (cash and notes encashable in 2004) available for commitment towards new grant agreements amount to \$1,007.8 million. Of the total Phase 1 proposals that have been approved by the Board (Rounds 1, 2 and 3), \$796.3 million are yet to be formalized into signed grant agreements⁴ and submitted to the Trustee and therefore are not included in Table 2 below. Should all these pending grant proposals be signed at the full amount set out in the approved proposals, the remaining commitment authority on funds currently available to the Trust Fund for new project approvals would be \$211.5 million.

Table 2
GFATM Trust Fund
Funding Status as of 5/31//2004

		<u>Amount in USD</u> *
a)	Contribution amounts received on signed agreements (1+2)	2,321,213,634
	(1) Contributions received in cash	2,199,648,634
	(2) Promissory Notes	121,565,000
b)	Add: Cumulative Investment Income	47,553,649
	Cumulative funds available for commitment	2,368,767,283
c)	Less: Commitments made for projects & approved budget	(1,360,958,601)
	Net funds available for commitment as of 5/31//2004	1,007,808,682
	Add:	
d)	Amounts available upon receipt of signed contribution agreement(s)	121,565,000 **
e)	Contribution amounts due on signed agreements	335,995,146 ***
	Net funds potentially available for commitment	1,465,368,828
* Valued on the basis of May 31, 2004 exchange rates.		
** Contribution amount has already been received by Trustee and will be made available for commitment on receipt of duly signed contribution agreement. This includes France's additional contribution of Euro 100 million in the form of Promissory Notes.		
*** Only a part of the amount is due immediately; the remainder is payable on a schedule over one or more years. See Annex II		

⁴ As reported in Global Fund Web page on May 26, 2004