

**GF/B31/05 Revision 1**

**Board Decision**

## **TRANSITION FROM THE THIRD TO THE FOURTH REPLENISHMENT PERIOD**

### **Purpose:**

1. This paper identifies the financial and programmatic challenges related to the transition from the rounds-based funding model to the allocation-based funding model, which the Secretariat discussed with the Finance and Operational Performance Committee (the “FOPC”) and the Strategy, Investment and Impact Committee (the “SIIC”).
2. Accordingly, this paper presents, for Board approval, the joint recommendations of the FOPC and SIIC on the transitional measures required to address such challenges and facilitate the allocation of sources of funds for the 2014 – 2016 period.
3. The financial figures set forth in the paper and presented in the decision point recommended at the end of this paper have been updated to reflect the outcome of the Finance and Operational Performance Committee’s (the “FOPC”) teleconference on 21 February 2014. During this teleconference, the FOPC reviewed and endorsed updates to the calculation of the total sources of funds available for allocation, which were originally reviewed and affirmed by the FOPC at its 10th Meeting in January 2014. A more detailed description of the calculations is set forth in the Board paper titled “Initial and Total Allocation to Country Bands for the Fourth Replenishment Period” (GF/B31/06).

This document is part of an internal deliberative process of the Global Fund and as such cannot be made public until after the Board meeting.

## **PART 1: INTRODUCTION**

- 1.1 The allocation of sources of funds in 2014 marks the first under the allocation-based funding model adopted by the Board,<sup>1</sup> and is an instrument for delivering the 2012 – 2016 Strategy’s focus on investing for impact. It also coincides with the transition from the rounds-based funding model. The measures recommended in this paper aim to address transitional challenges while achieving the following:
- i. Target strategic investments towards countries with the higher disease burden and lesser ability to pay;
  - ii. Invest the entirety of funds in a comprehensive manner that directs the portfolio towards investments with the highest potential for impact;
  - iii. Provide maximized upfront indications of funding;
  - iv. Give applicants greater predictability with respect to available funding and greater flexibility with respect to the timing of funding requests; and
  - v. Enable the Secretariat to exercise operational flexibility to manage financial and programmatic implications dynamically so grants are structured to invest for impact.
- 1.2 In adopting this funding model, the Board decided to align the three-year replenishment period (i.e., the period over which donors pledge contributions that serve as sources of funds) with the allocation period (i.e., the period over which applicants may submit requests and receive Board approval to finance grants with the sources of funds available for the period).
- 1.3 The Board has further decided there will be one upfront allocation for each replenishment period. Consequently, the Comprehensive Funding Policy has been amended and restated, as set forth in GF/B31/04, to create a financial-management framework that can deliver a prudent, maximized upfront allocation. The intent is to provide applicants greater predictability regarding the funding as well as to provide flexibility to countries with respect to the timing of their funding request.
- 1.4 Such predictability and flexibility was not possible under the former rounds-based funding model because the timing and amount of funding depended on the timing of the rounds and the success of a grant proposal at that specific time. In addition, the Board approved grant proposals for periods that extended beyond each fixed three-year replenishment period (e.g., five- or six-year proposals). This created a system where new sources of funds arising from each replenishment period had to be used to finance the uses of funds remaining from prior replenishment periods. Consequently, the amount and timing of new funding that had been approved in principle was subject to fulfilment of actual and potential financial liabilities arising from prior replenishment periods.
- 1.5 The transition from the Third (2011 – 2013) to the Fourth (2014 – 2016) Replenishment Period coincides with the transition from the rounds-based funding model to the allocation-based funding model. As such, the Fourth Replenishment Period inherits an active pipeline of uses of funds that derive from grant proposals or other funding decisions approved by the Board prior to the Fourth Replenishment Period. Exceptional measures are necessary to address the unique challenges of this transition and to facilitate the 2014 – 2016 allocation.
- 1.6 This paper explains an approach that has been evaluated by the Secretariat, the Finance and Operational Performance Committee (the “FOPC”) and the Strategy, Investment and Impact Committee (the “SIIC”). It addresses the financial and programmatic

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<sup>1</sup> As adopted by the Board under GF/B27/DP7 and GF/B28/DP4.

consequences of the rounds-based system and moves the portfolio towards a funding distribution more aligned with the allocation formula.

- 1.7 It also directs the portfolio towards sustainable rates of investment by recognizing the need for operational flexibility to address country-specific context with respect to not only the amount of funding allocated to country components, but also the duration of grants and the utilization of such funding.
- 1.8 It further demonstrates that the entirety of funds will be invested comprehensively through a country-dialogue process informed by an applicant's full expression of demand. Altogether, it aims to put the Global Fund in a position where future replenishment periods will not require exceptional measures and the portfolio consists of more strategic and impactful investments.

## **PART 2: DISCUSSION**

### **Existing Grants Pipeline and Funding**

- 2.1 In order to address the inherent imbalance whereby uses of funds could exceed sources of funds under the rounds-based funding model, the Board approved the full term of a grant proposal in principle, but only committed a portion of funding for an initial phase of grant implementation (e.g., two or three years) upon the signature of a grant agreement. The remaining balance of the aggregate amount approved in principle was subject to subsequent review and Board authorization, and then committed in annual tranches (i.e., "1+1+1 rule").
- 2.2 Consequently, at any point in time, grant proposals approved by the Board created a potential pipeline of grant funding for existing grants comprised of the following categories (the "Existing Grants Pipeline"):
  - i. Amounts approved only in principle by the Board, subject to further review and affirmation, and therefore uncommitted (e.g., Phase 2 funding amount pending a Board approval for continued funding);
  - ii. Amounts approved by the Board and committed under a grant agreement; and
  - iii. Amounts approved by the Board, but yet to be committed under a grant agreement (e.g., remaining tranches under the "1+1+1 rule").
- 2.3 The Existing Grants Pipeline, as at 31 December 2013, was USD 9.06 billion. As at 31 December 2013, the amounts of undisbursed sources of funds originating from the Third Replenishment, or earlier, (the "Existing Funds") was USD 5.55 billion. This amount is net of USD 0.31 billion for existing regional programs and newly ineligible grants. Accordingly, under the rounds-based funding model, USD 3.51 billion of the Existing Grants Pipeline would need to be funded by the new sources of funds from the Fourth Replenishment.

### **Guiding Principles for the Transition**

- 2.4 The overarching Board-approved principle guiding the allocation of sources of funds is to use a comprehensive scope to invest the entirety of funds strategically in areas

positioned to achieve higher impact.<sup>2</sup> Furthermore, to achieve the Board's intent of prudently maximizing upfront allocations, the uses of funds arising from a particular replenishment period are matched to the sources of funds arising from the same period.

- 2.5 To achieve these two principles, the methodology for calculating the overall sources of funds to be allocated for the 2014 – 2016 allocation period recognizes both Existing Funds, as well as the new sources of funds, as derived from the adjusted results of the Fourth Replenishment, taking into account appropriate deductions and adjustments (the “Initial Allocation”). The methodology for calculating the Initial Allocation is outlined further in GF/B31/06, and in the amended and restated Comprehensive Funding Policy, as set forth in Annex 1 to GF/B31/04.
- i. The inclusion of Existing Funds ensures that undisbursed sources of funds are also taken into account when applying the principles of the allocation-funding model.
  - ii. The derivation of the Initial Allocation, which determines the amount of incentive funding available, aligns with the approach to be taken in future allocations whereby sources of funds arising from pledges for a new replenishment period will be matched against the uses of funds that arise in the same period.
- 2.6 The allocation-based funding model was designed to make upfront determinations of the sources of funds to be available for allocation over such period. The standard implementation period for grants funded by such sources of funds was also set at three years. As such, the intent was to utilize the sources of funds arising from a new replenishment period over a three-year period, while preserving flexibility for applicants with respect to the timing of their funding request.
- 2.7 Another principle of the allocation-based funding model is to direct the portfolio towards both sustainable rates of spending, and also a fairer distribution of funding in accordance with the allocation formula, such that strategic, high-impact investments are made in the countries with higher disease burden and less ability to pay. As the intent of the allocation-based funding model is to utilize the Initial Allocation, over a three-year period, the inclusion of the Existing Funds in the overall allocation has an impact on the dual goal of maintaining sustainable rates of spending and moving towards a fairer distribution of funding. The amount and timing of funding impacts both of these factors. As such, allocations containing both the Existing Funds and the Initial Allocation would need to be utilized over a period that will typically be greater than three years, depending on country-specific circumstances.
- 2.8 Because what may be considered as a sustainable rate of spending is relative to and dependent upon country-specific context, operational flexibility is necessary to structure grants so that the rate and nature of spending positions the program to achieve greater impact throughout the term of a grant. This flexibility enables the Secretariat to work with applicants to develop programs with the appropriate duration and range of investments to strategically utilize funding and achieve greater impact.
- 2.9 The Board further recognized, in its adoption of the allocation-based funding model, that financial commitments to some countries should not fall below a minimum required level.<sup>3</sup> As such, some country disease components will receive funding levels that are over and under their notional shares under the allocation methodology (the “Notionally Over-Allocated” and “Notionally Under-Allocated,” respectively).

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<sup>2</sup> As adopted by the Board under GF/B28/DP4, paragraph 4.a.v.

<sup>3</sup> As adopted under Board decision point GF/B28/DP4, paragraph 4.d.

- 2.10 Accordingly, the Board decided to apply a target minimum 20-percent reduction, compared to the most recent available three-year disbursement levels, across the portfolio of Notionally Over-Allocated components (the “20% Graduated Reduction”). This is based on an assumed reduction rate of 10% per year over a three year period. At a disease component level, the net amount after applying the 20% Graduated Reduction represents the minimum required level (the “MRL”).
- 2.11 Because the 20% Graduated Reduction arose from models assuming a three-year implementation period, an increased implementation period would warrant an increase to the minimum target reduction to be achieved over the extended period. Though it adds to the time it takes to transition fully to a formula-based funding distribution, the existence of the 20% Graduated Reduction and MRL highlight another guiding principle—recognition of past funding levels and the need to address them appropriately through the allocation.
- 2.12 The 2014 – 2016 replenishment period inherits an Existing Grants Pipeline created under a different funding model and financial framework. However, the Existing Grants Pipeline reflects investments and programs that are in the middle-to-latter stages of implementation. As with the Board’s recognition of the need for the MRL, the Existing Grants Pipeline establishes another benchmark for appropriate funding levels.
- 2.13 Transitioning from the rounds-based funding model to the allocation-based funding model requires unique, exceptional measures to account for the nexus of financial and programmatic challenges attributed to the transition. The transitional measures proposed in this paper address the following competing needs:
- i. Investing the entirety of funds in a comprehensive manner that is strategically focused and positioned to achieve higher impact;
  - ii. Prudently maximize the upfront allocation to provide funding predictability to countries;
  - iii. Provide flexibility to countries with respect to the timing of their request for funding;
  - iv. Transition to a formula-derived distribution of funding based on disease burden and ability to pay;
  - v. Recognition of the Existing Grants Pipeline;
  - vi. Maintain sustainable rates of spending at the portfolio and country level while preserving operational flexibility to structure appropriate periods and uses of funding to achieve greater impact; and
  - vii. Ensure future replenishment periods do not require similar extraordinary transitional measures.

### **Discussions by the FOPC and SIIC**

- 2.14 The FOPC and SIIC reviewed the financial and programmatic implications of the transitional approach outlined in this paper. The FOPC focused on the methodology and rationale for calculating the Initial Allocation, Existing Funds and Existing Grants Pipeline. Furthermore, it validated the resulting financial figures. The SIIC reviewed the strategic and programmatic implications of the transitional measures proposed in this paper, and evaluated the resulting composition of and allocation to country bands based on the methodology and the financial figures validated by the FOPC.
- 2.15 During these deliberations, questions arose whether the Existing Grants Pipeline was an appropriate basis for determining certain disease components’ overall allocation. Additionally, discussions focused on whether recognition of the Existing Grants Pipeline

continued to perpetuate the level, type and distribution of funding under the rounds-based funding model. These concerns were addressed by explaining that the utilization of funds under the Existing Grants Pipeline would be targeted towards more strategic and impactful areas by applying principles of the allocation-based funding model.

- 2.16 Additional points of discussion included whether financial safeguards that would balance sources and uses of funds over the replenishment period hindered the ambitious principles behind the Global Fund Strategy and the principles of the allocation-based funding model. However, such financial safeguards would be the basis for providing a maximized upfront allocation of funding that is predictable. Furthermore, the use of a dynamic financial management and forecasting system would deliver greater visibility at the portfolio level. This enables the Secretariat to adjust the duration of grants and type of investments so that annual spending rates align closer to the distribution of funding derived from the allocation formula and investments are strategic and impactful.
- 2.17 There was also broad discussion on whether certain categories within the Existing Grants Pipeline should be excluded. Nevertheless, the Committees acknowledged that partitioning the Existing Grants Pipeline according to the status of grants on a particular cutoff date could raise equity issues for similarly situated country components.
- 2.18 With respect to the calculation methodology of the Initial Allocation and Existing Funds, Committee members acknowledged the greater pressure that increased incentive funding could create for the allocation methodology. Still, the available incentive funding, as well as potential unfunded quality demand, remain significant tools to incentivize strong, full expressions of demand, invest in areas of greater impact, and further transition the portfolio towards a fairer distribution of funding based on the allocation formula.
- 2.19 Furthermore, Committee members received an explanation for how an implementation period greater than three years could provide applicants an opportunity to develop funding requests in the first year for the ensuing years of program implementation. In the case of a typical four-year implementation period, doing so would create a natural one-year stagger between the start of the next replenishment period and the likely first wave of funding requests in that replenishment period, which could reduce operational and logistical burdens experienced with this initial implementation of the allocation methodology.
- 2.20 Ultimately, the technical and thorough discussions concluded with the FOPC and SIIC jointly recommending the transitional measures presented in this paper.

### **PART 3: RECOMMENDATION**

- 3.1 Accordingly, based on the analyses and presentations of the Secretariat, the FOPC and SIIC recommend the following transitional measures:
  - i. Total Allocation: The total amount that will be allocated through the allocation methodology for the 2014 – 2016 allocation period:
    - a. Initial Allocation, which determines the amount of incentive funding available, and will be divided into indicative and incentive funding; and
    - b. Existing Funds, the entirety of which will be allocated as indicative funding.

- ii. Typical 4-Year Implementation Period: The total amount allocated to a disease component will typically cover a four-year period starting from 1 January 2014. It is expected the first year will provide applicants with an opportunity to transition and engage with the Secretariat to further develop or re-program the activities and initiatives to be funded over the next three years. Grant implementation will continue during this first year as applicants prepare and submit funding requests. Accordingly, the Secretariat will engage in the country-dialogue process to structure disbursement-ready grants that comprehensively put all funding to use in the ensuing years.
- iii. Operational Flexibility: Nevertheless, the Secretariat may work with applicants during the country dialogue process to structure appropriate implementation periods. In doing so, the Secretariat will be guided by the aim to achieve greater strategic impact with sustainable spending rates and a funding distribution derived from the allocation formula. The Secretariat will use country-specific context, including whether such country component is Notionally Over-Allocated or Notionally Under-Allocated, to structure grant programs with appropriate implementation periods and investments to achieve these aims.
- iv. Graduated Reduction: The 20% Graduated Reduction will be modified so the target minimum reduction applied across the portfolio of Notionally Over-Allocated components, compared to most recent available four-year disbursement levels, will be 25-percent (the “25% Graduated Reduction”). This is based on an assumed reduction rate of 10% per year over a four year period.
- v. Existing Grants Pipeline: If a disease component’s Existing Grants Pipeline exceeds the amount derived by applying the 25% Graduated Reduction, the Existing Grants Pipeline serves as a basis for determining its total allocation.

## **PART 4: DECISION POINT**

4.1 Based on the discussion above, the FOPC and SIIC jointly recommend the following decision point to the Board for approval at the Thirty-First Board Meeting.

4.2 If the financial figures listed in the decision point are updated prior to the Thirty-First Board Meeting, the Committees will review and confirm the final recommendation to the Board.

### **Decision Point: GF/B31/DPXX**

- 1. The Board notes its prior decision to approve the Amended and Restated Comprehensive Funding Policy (GF/B31/DPXX) (the “CFP”) as a standard financial management framework, and acknowledges unique measures are required to facilitate the 2014 allocation of resources to Country Bands, the first under the allocation-based funding model, to manage the transition from the rounds-based system.**
- 2. Accordingly, based on the joint recommendation of the Finance and Operational Performance Committee (the “FOPC”) and the Strategy, Investment and Impact Committee (the “SIIC”), the Board adopts the following transition framework:**
  - a. The total amount that will be allocated to Country Bands (the “Total Allocation”) using the allocation methodology will be comprised of the following amounts:**
    - i. The Initial Allocation, in the amount of USD 10.22 billion, as approved under decision point GF/B31/DPXX; which will determine the amount of incentive funding; and**
    - ii. The amount of Sources of Funds, as defined in the CFP, originating from the Third Replenishment Period (2011 – 2013), or earlier, which have not been disbursed as at 31 December 2013 (the “Existing Funds”), in the amount of USD 5.55 billion, as recommended by the FOPC.**
  - b. While each grant applicant’s portion of the Total Allocation must be requested by the applicant and approved by the Board prior to 31 December 2016, it may be utilized beyond such date in accordance with the terms of the relevant grant agreement;**
  - c. The Total Allocation will address the remaining pipeline of grant funding due to Board-approved proposals or other Board decisions originating from the Third Replenishment Period, or earlier, as at 31 December 2013, (the “Existing Grants Pipeline”) while taking a comprehensive approach such that performance and strategic impact are reflected in the investment of the entirety of funds;**
  - d. While each disease component’s portion of the Total Allocation will typically cover a period of four years starting from 1 January 2014, the Secretariat, working together with countries and/or regions, has the operational flexibility to structure longer or shorter grant implementation periods while applying the principles of the allocation**



*model (GF/B28/DP4) to guide funding levels towards the amounts derived from the allocation formula;*

- e. Accordingly, a 25-percent target minimum reduction compared to the most recent available four-year disbursement levels (the “Graduated Reduction”) will be applied across the portfolio of disease components that have funding levels above their notional shares under the allocation methodology; and*
  - f. If a disease component’s Existing Grants Pipeline exceeds the amount that would result from applying the Graduated Reduction described in paragraph 2.e. above, then instead of applying the Graduated Reduction, the disease component’s Existing Grants Pipeline will serve as a basis to determine its total allocation starting from 1 January 2014.*
- 3. The Board notes the transition framework established under this decision represents measures tailored to address the unique circumstances and challenges of transitioning from the rounds-based system to the allocation-based funding model and shall not apply to subsequent allocations and Replenishment Periods.*

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