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# Review of the Asian Development Bank's Service Charges for the Administration of Grant Cofinancing from External Sources

## ABBREVIATIONS

ADB	–	Asian Development Bank
AfDB	–	African Development Bank
DMC	–	developing member country
EBRD	-	European Bank for Reconstruction and Development
FPF	–	financing partnership facility
GEF	–	Global Environment Facility
IDB	–	Inter-American Development Bank
JSF	–	Japan Special Fund
MDB	–	multilateral development bank
OCO	–	Office of Cofinancing Operations
PSGA	–	project-specific grant arrangement
TA	–	technical assistance
TASF	–	Technical Assistance Special Fund
UTFA	–	umbrella trust fund arrangement

## NOTE

In this report, "\$" refers to US dollars

<b>Vice-President</b>	U. Schäfer-Preuss, Knowledge Management and Sustainable Development
<b>Principal Director</b>	W. E. Liepach, Office of Cofinancing Operations
<b>Director</b>	M. T. Kho, Office of Cofinancing Operations
<b>Team leader</b>	P. Tritasavit, Senior Financing Partnership Specialist, Office of Cofinancing Operations R. Loi, Lead Financing Partnerships Specialists, Office of Cofinancing Operations

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## I. BACKGROUND AND RATIONALE

1. Financing partnerships—and cofinancing as its key element in transactions—have gained strategic significance within the Asian Development Bank (ADB), as highlighted in Strategy 2020.<sup>1</sup> As a result, cofinancing is now included as a performance parameter in ADB's corporate results framework and is increasingly integrated in the work program and budget framework.

2. External grant cofinancing plays an important role in ADB operations, complementing its own concessional resources for both investment and technical assistance (TA) programs. External grants associated with investment projects are a useful way to augment Asian Development Fund resources. External grants for the TA programs are an important financing instrument, complementing ADB's own resources from the Technical Assistance Special Fund (TASF) and the Japan Special Fund (JSF).<sup>2</sup>

3. External grants are mobilized, effected, and fully administered through either trust fund arrangements (i.e., umbrella arrangements, covering multiple activities mainly for TA), or project-specific cofinancing agreements (i.e., with each agreement covering an individual grant under a project), usually to complement ADB investment activities.<sup>3</sup> ADB project initiatives cofinanced by external grants have grown rapidly. The portfolio of external grants being administered for TA and investment projects has increased from about \$77.1 million (for about 60 projects) at the end of 1999 to about \$1.5 billion (for about 300 projects) at the end of 2008.

4. As a standard requirement, ADB charges a fee for administering external grants. ADB's current policy on service fee charges for the administration of untied grant cofinancing was approved in March 2000.<sup>4</sup> At that time, the external grant resources were mainly mobilized from bilateral sources, and such grants were uncomplicated to mobilize, negotiate, and manage. ADB set up its first trust fund in the late 1970s, and until 2000 ADB's portfolio of active trust funds consisted of only 13 single-donor trust funds targeted at a selected group of recipient developing member countries (DMCs) and sector priorities. This first generation of trust funds was TA oriented, and easy to set up and administer.

5. Since 2000, significant developments and new initiatives have affected the ADB services required in administering financing partner funds.

6. **Strategic focus on cofinancing.** Since the late 1990s, ADB operations have increasingly placed more importance on TA and cofinancing to meet the vast development

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<sup>1</sup> ADB. 2008. *Strategy 2020: The Long-Term Strategic Framework of the Asian Development Bank, 2008–2020*. Manila.

<sup>2</sup> TASF and JSF are special funds, not trust funds. Unlike trust funds, they are treated as ADB's own resources. As such, the audited accounts of these funds are part of ADB's financial statement presented in the Annual Report. Thus, TASF and JSF are outside the scope of this paper. This paper also does not cover special funds with multidonor features, such as the Climate Change Fund, Regional Cooperation and Integration Fund, and emergency-related special funds such as the Asian Tsunami Fund and Pakistan Earthquake Fund.

<sup>3</sup> Under full administration, ADB provides a full range of services to the financing partner including processing and implementation activities, fiduciary arrangements for disbursement of funds, and special reporting. Another modality, called "partial administration," is also offered through which ADB's responsibility in providing services to the financing partner would be limited to procurement and/or disbursement supervision based on ADB standard reporting. The administrative fee for partial administration (introduced in 2003 and only applicable to grant for investment projects) is considered appropriate and therefore is excluded from this review.

<sup>4</sup> ADB. 2000. *Review of Service Charges for the Administration of Grant Cofinancing from Bilateral Sources*. Manila. (R68-00).

challenges of Asia and the Pacific. In its Financing Partnership Strategy, ADB made a commitment to move from "gap-filling" to operating in "genuine partnership," and from simply "adding cash" to "adding value".<sup>5</sup> This strategy also reemphasized financing solutions through partnerships and coordinated arrangements between financing partners, particularly for grant components of investment projects. These multidonor financing arrangements supporting a specific project are expected to promote greater efficiency and effectiveness in their application, and reduce the transaction costs for DMCs' clients in dealing with multiple partners. However, they will also result in greater administrative complexity and resource intensiveness for lead financing partners. In addition, an emphasis on cofinancing was also introduced in relation to funding for TA projects. The new ADB guidelines for the use of TA resources<sup>6</sup> encourage tapping external grants before resorting to ADB funds. These developments brought the trust funds and project-specific grants more into the mainstream of ADB operations. External funds will become even more important in contributing to the overall effectiveness of development aid across diverse countries, themes, and sectors.<sup>7</sup> ADB may need to have a balanced view regarding cost recovery in relation to the impact brought about by external grants.

**7. More diversity of financing partners.** With more global attention on development issues, the financing partner community has become more diverse. Emerging financing partners beyond the traditional bilateral sources now include grant windows from existing multilateral agencies, new multilateral agencies focused on specific issues, private sector entities, foundations, and other funding facilities. Each financing partner has different expectations and requirements, including budgetary cycles and procedures that are more rigorous than in previous years. Financing partners look for greater and more efficient delivery of ADB services with lower transaction costs.

**8. Intensified efforts at financing partner harmonization and aid effectiveness.** The Paris Declaration on Aid Effectiveness approved in 2005 reaffirms the commitment that ADB must continue to integrate the declaration's principles into its work program.<sup>8</sup> The declaration mandates financing partner harmonization. With the harmonization principle, financing partners are expecting to be identified more as development partners than cofinanciers. As such, financing partners of other institutions have already made a strong argument for cost-sharing in the administration of financing partner grants, and not a full cost recovery as a service provider.<sup>9</sup>

**9. More complexity in processing and administering external grants.** In response to the dynamic environment and changing demands, ADB's cofinancing product range has evolved. After starting out with single-donor trust funds used as instruments to bring about greater administrative efficiency in operations, ADB introduced in 2001 thematic trust funds to strengthen the operational focus. Thematic trust funds are usually packaged as multidonor initiatives to support projects with crosscutting concerns or, in high-priority areas of ADB (e.g., poverty reduction, governance, water), to bring about synergies in financing the development

<sup>5</sup> ADB. 2006. *Financing Partnership Strategy*. Manila (R56-06).

<sup>6</sup> *Guidelines for the Use of Technical Assistance Resources*, Strategy and Policy Department memo, 26 December 2008.

<sup>7</sup> Under its corporate results framework, ADB committed to a total share of direct value-added cofinancing in its operations of 20% by 2012, up from 9% during 2006–2008.

<sup>8</sup> Senior officials from about 60 countries and more than 50 multilateral and bilateral development institutions met at a high-level forum in Paris in March 2005 and endorsed a variety of measures in the Paris Declaration on Aid Effectiveness (<http://www.aidharmonization.org>). For a summary and implications for ADB, see ADB. 2005. *Paris Declaration on Aid Effectiveness*. Manila (IN310-05).

<sup>9</sup> World Bank. 2007. *A Management Framework for World Bank-Administered Trust Fund*. 14 September 2007

needs of all DMCs. The subsequent generations of thematic trust funds, which include the more recent ones under the financing partnership facilities (FPFs), fall within this category. Because of their technical nature, management of these funds became more complex requiring the designation of specific technical focal points. This type of setup requires stricter internal controls, and administration involves multiple layers of interdepartmental decision making and oversight, as well as more detailed procedures and reporting requirements.

10. In light of the issues discussed in paras. 5-9, and consistent with the requirement to assess the fee structure periodically, the Office of Cofinancing Operations (OCO), in consultation with concerned departments and offices, undertook a review of the ADB's service charges for the administration of grant cofinancing from external sources.

11. Board approval is sought (in Section V) for the proposed revision of the policy on ADB's service fee structure in light of the review's findings, harmonization principles, and a need to align grant operations with Strategy 2020.

## **II. EXISTING POLICY FRAMEWORK FOR GRANT COFINANCING FROM EXTERNAL SOURCES**

### **A. Service Fee Structure Parameters and Basic Principles**

12. The 2000 Board paper (footnote 4) covers all untied grants provided by financing partners to cofinance TA activities and components of investment projects, which may be exclusively or jointly funded by a bilateral or a multilateral source. Such cofinancing is usually channeled through one of the following: (i) single-donor and/or multidonor umbrella trust fund arrangements<sup>10</sup> (UTFAs); (ii) project-specific grant arrangements (PSGAs); or (iii) other special funding arrangements, such as those under the Global Environment Facility (GEF). This usually assumes that ADB is fully responsible for project processing and administration; acts as trustee and administrator of financing partners' grants; and provides a full range of services, including procurement of goods, selection and recruitment of consultants, supervision of implementation, and disbursement of cofinanced funds for project activities.

13. The fee structure for administering grants under these two operations is based on the principle of full recovery of incremental costs related to the cofinancing components as a whole. Thus, a flat fee structure, to be applied based on modality or nature of activity (grant for an investment project or a TA), is considered most suitable for bringing greater simplicity, transparency, consistency, and administrative efficiency. The existing fee structure also takes into account the size of grants, activities to be funded, the scope of services, and the complexity of the project and/or the arrangement, as well as the implementation duration.

### **B. Service Fee Framework and Charges**

14. ADB's policy governing the fee structure under the first generation of the trust funds approved in 2000 has set the service fees at 5% for TA projects and 2% for grant components of investment projects of the amount disbursed under the contribution for funds fully administered by ADB. This fee structure differentiates between grants for TA and grants for investment projects, based on the recognition that TA is more expensive to process and

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<sup>10</sup> Trust funds usually have been traditionally effected through either full-fledged channel financing agreements with each contributing financing partner or through simplified and standardized instruments of contributions, with each partner agreeing to the same documentation as in the recent case of trust funds under FPFs.

administer than investment grant activities. However, it does not differentiate between cofinancing modalities, i.e., whether grant for a TA or a grant for an investment project is channeled through a trust fund. The same fee structure was applied to the subsequent types of trust funds (i.e., thematic and FPF-related trust funds) introduced after Board approval of the 2000 service charge paper.<sup>11</sup>

**Table 1: ADB's Existing Service Charges for Different Cofinancing Modalities**

<b>Cofinancing Modality</b>	<b>TA</b>	<b>Grants</b>
Umbrella Trust Funds Arrangements	5%	2%
Project-Specific Cofinancing Arrangements	5%	2%

15. Other special funding modalities include the GEF. As a global partnership fund with a much more complex governance structure than that of regular trust funds and grants, the GEF has its own unique fee system. Initially, the fee was negotiated on a project-by-project basis. In 2005, the GEF introduced a flat percentage-based fee (currently 10%), which is applicable to all project types and all the GEF's executing agencies, including ADB.

### **C. Service Fee Waiver**

16. In 2005, a formal mechanism was put in place to allow some flexibility in waiving service fees under certain criteria. In those limited cases, where size of the contribution is small and disbursement can be made quickly within a short period or in one installment, the fee could be waived.<sup>12</sup>

## **III. PRACTICES OF OTHER MULTILATERAL DEVELOPMENT BANKS**

17. Over the past decade, other MDBs such as the World Bank, Inter-American Development Bank (IDB), and African Development Bank (AfDB) have reformed their cofinanced grants and trust fund policies, including the service fee system. ADB's experiences and issues are similar to those of the other multilateral development banks (MDBs). The cost recovery calculation is a complex exercise that needs to take into account institutional particularities and business models. As such, there is no explicit indication or any clear rules for how the service fees to recover incremental costs are calculated. While ADB's major comparators have deployed flat percentage-based fee systems in charging service fees, the methods used to estimate and calculate the service fees vary. Only the World Bank has a comprehensive time recording system to capture staff time required to manage the trust funds. Other MDBs are adopting information technology systems to track such time to improve accuracy in calculating the incremental costs and subsequently in determining the service fees.

18. Unlike ADB, many of the other MDBs, until recently, have accommodated trust funds tied to national procurement requirements. One of the key reforms of these MDBs is to move from administering tied grants to untied arrangements. Thus, their administrative arrangements are now closer to those of ADB. However, the European Bank for Reconstruction and

<sup>11</sup>The above fee structure is not applicable to the Japan Fund for Poverty Reduction (JFPR), which has a different setup and fund management structure. The JFPR does not have any fixed-fee rate, and identifiable administrative costs are reimbursed directly to the fund at a rate agreed upon with the financing partner.

<sup>12</sup>Service Charges for the Administration of Grant Cofinancing – Proposal for Flexibility in the Interpretation of the ADB Policy in Special Cases. OCO memorandum approved by the Vice-President (Knowledge Management and Sustainable Development), 16 December 2005.

Development (EBRD) still has some tied arrangements. Thus, its fee structure may not provide a relevant basis for comparison, so it was excluded from this review. It is charging a 2% service fee regardless of whether they will recover the administration costs in full. Instead, EBRD's fee is based on a cost-sharing principle as agreed upon with financing partners. All MDBs believe that the costs of administration of trust funds and project-specific grants have to be recovered, at least partially.<sup>13</sup>

19. The World Bank launched a series of trust fund reforms in 2001 and then in 2004 to put in place standard policies and procedures, as well as the information technology system to improve trust fund management. The latest reform was carried out in 2007 to address the increasingly complicated demands of financing partners and recipients. As a consequence, World Bank has (i) increased the minimum size of trust funds from \$200,000 to \$1 million, (ii) introduced a start-up fee of \$35,000 for the new standard fee-based trust funds regardless of the size, (iii) increased the fee from 2% to 5% for the trust funds smaller than \$30 million, (iv) continued not to charge a fee for the debt service trust funds, and (v) applied customized fees for all other trust funds regardless of size to recover full costs. The World Bank has continued to mainstream their quality control into day-to-day management of the trust funds, including providing financing partners with online access to reporting of fund utilizations. The World Bank has adopted a cost-sharing approach rather than a full cost recovery principle specifically for the trust funds that support the World Bank's own work and those supporting the preparation of bank-financed operations.

20. In 2008, IDB introduced a new framework for technical cooperation, including the fee system. It is conducting another review of service charges this year. IDB's service fee is set at 5% for all single-donor and multidonor trust funds. In addition, a one-time flat fee of \$35,000 is charged to cover the initial cost to set up new single-donor trust funds. A fee of 5% is applied to grants under project-specific cofinancing. However, as a result of the ongoing review, a proposal is being considered to charge 5% up to \$5 million in cofinancing and 2% for cofinancing larger than \$5 million. One of IDB's reforms was the adoption of the Lawson software package, which will allow service costs to be tracked more accurately.

21. AfDB reformed the administration of its TA cooperation funds in 2006 in response to its initiatives to pursue various types of partnership arrangements to mobilize additional resources. One of the key reforms was the introduction of a uniform cost recovery mechanism for all trust funds. AfDB has set a minimum standard fee of 5% for all funds it administers. While the new fee was set at a higher level with respect to the previous one, this was justified by the expected improvement in services as a result of the implementation of the reforms.

22. Most MDBs have raised their fees with justifications that their procedures have been streamlined as a result of trust fund management reforms. Table 2 shows a comparison of the service fee charges adopted by MDBs.

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<sup>13</sup> In the context of other MDBs, "trust funds" refers to those exclusively provided by external financing partners to support a single project or a number of projects. Those exclusively provided to cofinance with other funding sources are referred to as a "cofinancing fund."

**Table 2: Service Fees Currently Applied by Major Multilateral Development Banks**

	<b>ADB</b>	<b>AfDB</b>	<b>IDB</b>	<b>World Bank</b>
Single-Donor Trust Fund	Standard fee of 5% for TA projects or 2% for investment grants	Standard fee of 5% for all funds administered by the bank  With minimum of \$1 million	Standard fee of 5% for TA projects and for cofinancing  \$35,000 one-time set-up fee for single-donor trust funds  Additional fees for any extra administration required by single-donor trust funds	Flat fee of 5% for TA projects and for cofinancing grant of less than \$30 million  Raised minimum of \$200,000 to \$1 million  A start-up fee of \$35,000 for all new standard fee-based trust funds  Customized fee for cofinancing grants larger than \$30 million and other nonstandard fee trust funds
Multidonor Trust Funds	5% or 2%, as applicable	Standard fee of 5%, with minimum of \$2 million	Standard fee of 5% for TA projects and for cofinancing	Minimum of \$1 million with an upfront fee of \$35,000. Flat fee of 5% for TA projects and for cofinancing grant of less than \$30 million. Customized fee for grants larger than \$30 million and other trust funds
Project-Specific Financing or Cofinancing	5% or 2%, as applicable	Standard fee of 5% for all funds administered by the bank	Standard fee of 5% for TA projects and for cofinancing	Minimum of \$1 million with an upfront fee of \$35,000. Flat fee of 5% for TA projects and for cofinancing grants of less than \$30 million. Customized fee for grants larger than \$30 million and other nonstandard fee trust funds

Source: OCO Records

#### IV. REVIEW OF ADB'S SERVICE CHARGES

##### A. Approach and Methodology

23. A wide range of activities is involved in the establishment and implementation of trust funds and project-specific grants to be covered through administration fees. These include discussing and coordinating with financing partners for fund mobilization and implementation activities; preparing and negotiating trust fund and cofinancing agreements; processing and preparing Board papers and implementing guidelines; allocating funds to projects; and fund monitoring and reporting. ADB's internal administrative budget normally absorbs project-specific processing activities, such as business travel or staff time, except for incremental costs directly related to the cofinancing arrangements, e.g., preparing specific financial and implementation reports for financing partners.

24. ADB has not implemented a recording system to capture staff time spent in the administration of financing partner funds. As such, the same approach and methodology which was applied in the 2000 review was also used in this study. Detailed data on the average incremental time required to process and administer activities financed or cofinanced by external grants were generated through questionnaires and interviews with staff of user and operations departments and offices, as well as the Office of General Counsel, Controller's Department, Treasury Department, and OCO. The surveys were validated internally, and follow-up discussions were held to ensure consistency. The sample of activities surveyed included all cofinanced TAs and investment projects approved during 2006–2008. The average staff costs, including administrative overhead, were taken from the ADB budget document. The estimated average implementation period applied for grants under TA projects is 1 year, and for grants under components of investment projects is 4 years.<sup>14</sup>

25. In addition to the staff time survey for processing and administering projects financed by trust funds or project-specific arrangements, the surveyed sample activities were expanded to capture the cost for incremental staff time spent setting up a trust fund as well as the cost for running it. The survey and interview participants included departments and offices identified as the technical focal points, the Office of General Counsel, Controller's Department, and OCO. The same average staff costs were applied to derive at the estimated setup and running costs of trust funds.

26. Thus, the cost of activities to mobilize, process, and administer external grants can be grouped into three categories: (i) setup of a trust fund, (ii) day-to-day administration of a trust fund, (iii) processing and administering grants for specific projects. This review has analyzed all three cost dimensions.

## **B. Analysis of the Existing Service Charge Structure**

### **1. Setup of a Trust Fund**

27. The analysis of the sample shows that the average costs to set up trust funds are \$41,912 for non-FPF-related trust funds and \$103,168 for FPF-related trust funds, or a weighted average of about \$57,226.

### **2. Day-to-Day Administration of a Trust Fund**

28. According to the survey, the annual cost of managing the funds varied from trust fund to trust fund, depending on the structure chosen by ADB to manage such funds. The cost ranged between \$42,735 and \$1.47 million. Thematic trust funds tend to require more staff and consultant resources than traditional trust funds because of their management structures.

### **3. Processing and Administering Grants for Specific Projects**

29. An analysis of the sample reveals that overall the 5% service fee charge is not fully recovering the cost of administering TA grants either through the trust funds or project-specific arrangements. The administration costs for small TA grants are under-recovered under the

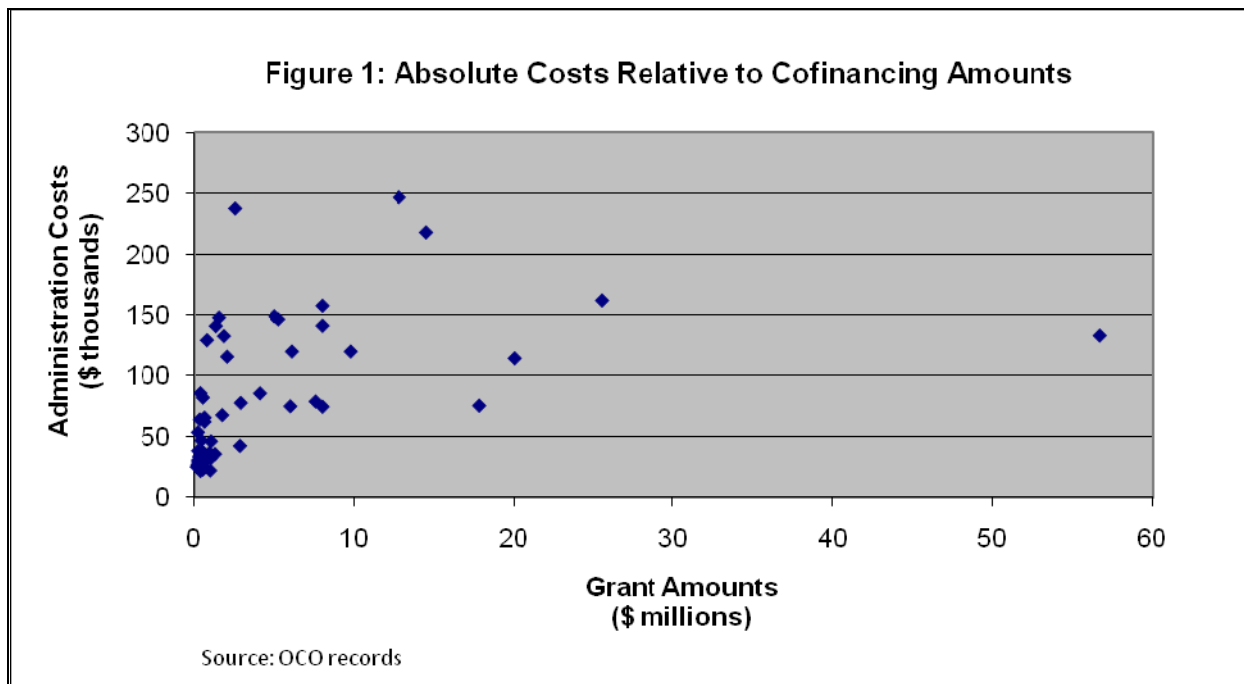
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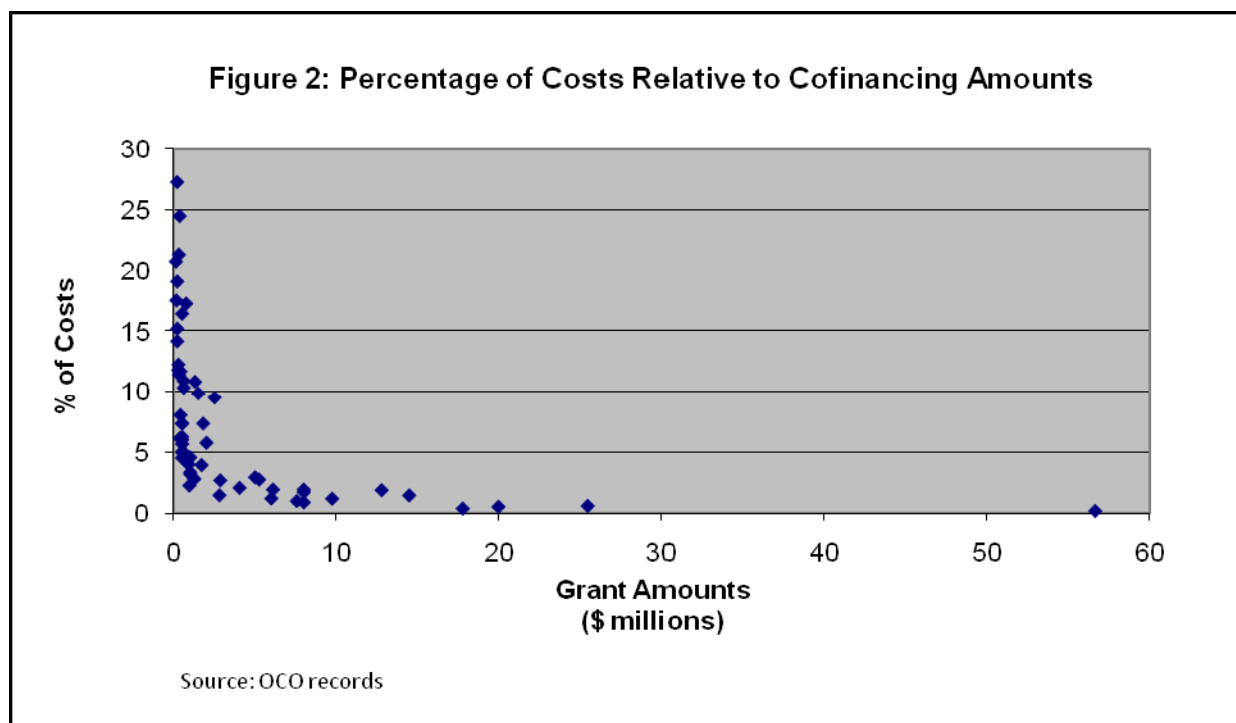
<sup>14</sup> This is an average figure based on the duration of the cofinanced project, as per the original TA or investment project document. It does not factor in delays in the implementation of the project. It is possible, at least in the case of investment projects, that the duration of implementation of project components financed by external grants could be shorter than the actual duration of the overall project.

current 5% fee charge but are cross-subsidized in part by the fees collected for larger TA projects. The amount of TA grants ranged between \$120,000 and \$17.8 million, with an average of about \$1.5 million (\$500,000 in most cases). An average cost of administering TA grants under UTFAs was 10.08% of the amount of such grants; for PSGAs, it was 5.36%. This resulted in a weighted average of 8.47%. If TA grants of less than \$500,000 were removed from the samples, the weighted average fell to about 5.80%, which is closer to the current fee charge of 5%. This implies that TA grants of less than \$500,000 are less cost-efficient and disproportionately more expensive to administer.

30. Likewise, with the 2% fee charge, ADB is not fully recovering the costs of administering grants that finance or cofinance components of investment projects. The costs of administering smaller grants for components of investment projects were under-recovered in varying magnitudes, depending on duration and complexity of the implementation. The size of grants that financed or cofinanced components of investment projects in the survey samples ranged between \$350,000 and \$56.7 million, with an average of about \$10 million (with a majority of grants between \$7 million and \$8 million). The average cost of administering grants for cofinanced components under UTFAs was 14.34% of the amount of such grants, and under PSGAs was 2.97%. This resulted in a weighted average of 5.36%. Further analysis shows that the average cost of administering grants of less than \$10 million was 6.93%. This decreases to 5.58% if grants smaller than \$500,000 are removed from the samples.

31. The relationship between absolute cost and the amount of grant for TA or grant for investment project is illustrated in Figure 1. The relationship between percentage of cost and the amount of grant for TA or grant for investment project is in Figure 2.





32. The sample reveals a weighted average of 7.43% for the administration cost of grants financing TA projects (8.47%) and components of investment projects (5.36%).

## C. Proposed Revision

### 1. Guiding Principles

33. It is generally agreed within and outside ADB that a standardized fee structure is the appropriate way to ensure simplicity, transparency, consistency, and administrative efficiency. This finding is consistent with the practices of other MDBs that have adopted a cost-sharing scheme for similar types of cofinanced activities. Therefore, it is appropriate and practical for ADB to adopt a fee structure that allows for cost-sharing (except in cases as described in para. 37). A cost-sharing rather than full cost recovery approach is justified because ADB, as a financing partner, plays a larger role than an executing agency. In addition, cofinancing with its partners allows ADB to further its strategic agenda more efficiently than it could otherwise. This approach will also be in line with the spirit of harmonization with other MDBs' practices. The cost-sharing principle, proposed here to be applied to the administration of external funds for TA and investment project-related grants, is consistent with the Agreement Establishing the Asian Development Bank (the Charter).<sup>15</sup> Recognizing the need to respond flexibly to specific situations, the revised approach will also allow for customized fee arrangements when justified.

### 2. Revised Fee Structure

34. If approved, the revised fee structure will be implemented in 2009 and will be in place for another several years. As such, the charges would take into consideration factors such as the increase in staff costs and administrative workload, while keeping in mind the proposed cost-sharing and harmonization principles. In this light, it is proposed that the service fee charges be

<sup>15</sup> ADB. 1965. *Agreement Establishing the Asian Development Bank*. Manila.

set at (i) 5% of amounts disbursed for TA projects financed under UTFAs and PSGAs (same as before); and (ii) 5% of amounts disbursed for grant components of investment projects financed under UTFAs and PSGAs up to \$5 million (an increase from 2%), or 2% of amounts disbursed for the same type of grants above \$5 million with a minimum of \$250,000, whichever is greater. This change is based on the awareness that, with the introduction of trust funds under the FPFs, the number of smaller grants that are comparable to the processing and administration of similar-sized TA projects has increased.<sup>16</sup>

35. Table 3 summarizes the proposed service charges for untied grants from external sources by cofinancing modality.

**Table 3: ADB Service Fee Structure for Different Cofinancing Modalities**

Cofinancing Modality	TA Projects	Grants
Umbrella Trust Funds Arrangements	5%	5% for grants up to \$5 million, or 2% with a minimum of \$250,000 (whichever is greater) for grants above \$5 million
Project-Specific Financing or Cofinancing Arrangements	5%	5% for grants up to \$5 million, or 2% with a minimum of \$250,000 (whichever is greater) for grants above \$5 million

36. It is proposed that ADB apply the revised fee structure to cover the processing and administration of grants for specific projects and absorb costs of setting up and managing trust funds instead of charging it to the financing partners. This is because trust funds are normally used to support initiatives that are in thematic priority areas where ADB needs additional funds to support its grant resources. The costs for managing thematic funds are more directly related to technical and operations matters than the administration work. This proposal is consistent with the principle of cost-sharing arrangement proposed in para. 33.

**3. Other Proposed Revisions**

37. **Customized fee arrangements.** Where efficient and appropriate, or in extraordinary cases of financing partners requiring extra services that fall outside the scope of the services provided by ADB for administering untied grants from external sources, it is further proposed that ADB allow the adoption of customized fees to recover the associated costs of providing such extra services to an extent deemed satisfactory. It is also proposed that consideration of cases in this category be delegated by the Board to the President (acting through the Vice-President for Knowledge Management and Sustainable Development).

38. **Fee waivers.** It is proposed that consideration of fee waivers in cases, for example, when incremental costs for administering financing partner's grants, if any, are negligible, (and any similar scenarios which may be applicable in the future) also be delegated by the Board to the President (acting through the Vice-President for Knowledge Management and Sustainable Development).

39. **Charging of other related expenses to ADB.** In addition to the standard processing and administration costs examined in the paper, ADB can incur other expenses such as the costs of providing management assertions and outside auditors' attestations on the adequacy of

<sup>16</sup> The introduction of a minimum fee will ensure a gradual reduction of the relative (%) change for grants larger than \$5 million, until they reach 2% at \$12.5 million.

internal control over financial reporting (or similar assertion and attestation),<sup>17</sup> and foreign exchange losses.<sup>18</sup> In the case of foreign exchange losses, these costs cannot be determined upfront. It is proposed that ADB absorb this type of cost of doing business, generally involving relatively minor amounts, if any.

#### **4. Entry into Force and Further Reviews of the Revised Fee Structure**

40. The revised fee structure will not apply to the existing UTFAs and PSGAs. It will be applied to new UTFAs, new grants under a PSGA, and replenishments of existing UTFAs and of existing PSGAs. The service fee structure will be reviewed at least once every 5 years.

#### **D. Administrative and Operational Implications**

41. Since the introduction of the fee structure policy in March 2000, ADB operations related to the processing and administration of external grants have become more complex, and the current fee structure needs to be revised to achieve a more appropriate level of cost recovery. Cofinancing funds have been key financing instruments to augment and leverage ADB's own resources and to magnify the impact of development assistance to its DMCs. These funds also help enhance and strengthen links with external partners. Therefore, the proposed revision of the fee structure is based on the cost-sharing principle, which recognizes that the availability of cofinancing would also ease the burden on the use of ADB's constrained grant financing resources, particularly for TA funds. In addition, cofinancing brings more favorable development impact that may far exceed the issue of full cost recovery. The proposed revision of service charges recognizes that, despite the introduction of a cost-sharing principle, this new fee structure represents a slight increase in fees. At the same time, under a full cost recovery approach, the fees would need to be raised to reflect the greater complexity of cofinancing operations and partner demands. However, this would be contrary to the principles of harmonization with other MDBs, and would also place ADB in a less advantageous position as cofinancing partner.

42. The review's findings and the proposed revisions are generally consistent with the practices of other MDBs, some of which have been operating under fee systems that are based on cost-sharing considerations. The proposed revision of the service fee charge structure is particularly comparable with the fee system being considered by IDB. It is aligned with the harmonization agenda of the 2005 Paris Declaration on Aid Effectiveness.

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<sup>17</sup> ADB is carrying out an attestation on the adequacy of internal controls over financial reporting, but it is currently applied only to ADB's own funds. Some financing partners have asked that ADB also extend this exercise to external funds. Such assertion and attestation is becoming standard good governance practice in assuring financing partners that funds are being administered in accordance with the related agreements and ADB's policies and procedures, and are reported as such.

<sup>18</sup> Foreign exchange losses may be incurred when one currency is required to be converted into another currency and the financing partner, as reflected in the cofinancing agreement, does not allow for such losses to be charged to the external grants. As most projects under the administration of ADB are denominated in US dollars, ADB has established a policy to mitigate financing risks by requiring financing partners to provide the contributions in US dollars (or allow ADB to convert funds received into US dollars). If a financing partner does not allow the recognition of foreign exchange losses, to the extent practical, the fund and the related budget, procurement, and disbursements are managed in the currency of contribution. Despite the policy and procedures, sometimes DMC recipients of project activities are not in a position to accept payments in the currency of contribution. As such, when there are excess funds that have to be returned to ADB, they need to be converted back to the currency of contribution, potentially resulting in currency-related losses for ADB.

43. The proposed fee structure is expected to better align ADB with Strategy 2020 as the structure reflects a more reasonable cost recovery level, while maintaining a cost sharing overall. Consistent with Strategy 2020, the cost-sharing approach is appropriate to transform ADB from a service provider to a financing partner, which would help bring external grants more into the mainstream of ADB operations. The implementation of the revised fee policy on cost-effectiveness will be monitored during the annual budget review process.

## **V. CONCLUSION AND RECOMMENDATIONS**

44. As cofinancing operations have become more comprehensive, the current service fee framework no longer fully recovers ADB's incremental cost for the full administration of grants for TA and investment projects. A revision of the service fee structure for the full administration of untied grants from external sources is proposed, based on the principle of sharing incremental costs incurred by ADB for administering grants from external sources. The proposed fee structure is transparent, administratively efficient, simple to implement, and competitive while at the same time harmonized with other MDBs. The proposed fee structure has further taken into account the cost aspects of managing small and large grants, and options for cost recovery arrangements.

45. In view of the above, the President recommends that the Board approve the following proposed revision of the service charges, which shall supersede those approved in the 2000 paper:

- (i) Revision of the service charge structure as presented in paragraphs 34 to 39 of this paper, which will be applicable to the new funds as described in paragraph 40 of this paper; and
- (ii) Delegation of approving authority from the Board to the President (acting through the Vice-President for Knowledge Management and Sustainable Development) as described in paragraphs 37 and 38 of this paper.