Establishing and managing trust funds
Issues note on multilateral management of non-core funding

This paper was prepared in December 2012, by Dr Marc Stephens, on behalf of Transtec as a reflexion on the potential development of Trusts Funds at EU level

BACKGROUND

Multilateral-administered trust funds have a long history, but have grown most rapidly in the last decade. Donors have used trust funds administered by the World Bank (WB) since the 1960s and the UN system since at least the early 1970s as a means of leveraging the infrastructure of these organisations to meet development and humanitarian objectives. The use of such trust funds by the international community increased in the 1990s following the end of the Cold War. This was primarily in response to geopolitical (e.g. West Bank and Gaza), environmental (post Montreal and Rio) and other (e.g. Heavily Indebted Poor Countries [HIPC]) needs. Use of trust funds rose even more sharply after 2000, as public constituencies sought increased financial accountability, improved aid coordination and, at times, an arm's length means of continuing to provide resources to contentious governments (e.g. Ethiopia, Bangladesh).

A handful of multilaterals dominate the administration of non-core or donor ear-marked funding: the WB (including IFC), WFP, UNDP, UNICEF and UNHCR represent about 84% of the total portfolio. These organizations typically have more than 20 contributors with average annual contributions per contributor of between US$50 million and US$150 million.

Of these, the WB—with approximately $3.5 billion under management—manages the largest portfolio although, because of its overall size, ear-marked or “non-core” funds continue to represent less than 30% of its overall resources. This is in contrast to the UN system where they represent about 70%.

THE CHALLENGE

For EU trust funds to be a credible alternative to, for example, WB or UNDP managed trust funds, they will have to demonstrate to users that they represent value for money i.e. the fees are reasonable (economy), the services provided for the fees are high quality (efficiency) and the results obtained through the services provided are impressive (effectiveness).

Although in some cases a single agency may be the obvious vehicle for managing funds—e.g. WFP in the case of emergency food aid—in other cases, donors can choose between trust funds based on value for money.

If the EU decides to allow non-EU members, e.g. East Asian, North American, Arab and private donors, to contribute to EU trust funds this would boost resources and perhaps lower unit administration costs, but could also require bespoke legal agreements, reporting and branding.

1 Non-core resources take different forms in different organisations, which complicates the task of comparison. In some organisations non-core resources are the vast bulk of total resources, while in others it is a small share. Organisations often sub-divide non-core resources into funding for mainstream activities and funding for subsidiary activity with the latter only referred to as ‘trust funds’. Other organisations refer to all non-core resources as trust funds. Still others use different terms altogether.
If the EU creates its own trust funds, it will have to consider the potential impact on existing multilateral trust funds that are—as per above—heavily dependent on EU funding.

The EU itself is currently a major contributor to several trust funds and is the largest contributor to the FAO, IFAD and UN and the second largest contributor to UNDP, WFP, UNHCR, UNRWA, ILO, UNESCO and the African Development Bank.

**ISSUES AND LESSONS**

**Resource mobilisation**

The EU will need to find a balance between central mobilization of resources to ensure control versus a more decentralized approach that incentivises delegations to leverage local relationships.

**Trust fund set-up**

The EU will need to develop one or more trust fund types that meet the preferences of a variety of donors in a range of situations including crisis and emergency.

Resource mobilisation (RM) is typically shared between a central RM team and, where they exist, country offices. Generally the more decentralised multilaterals—e.g. the WB and several UN agencies—mobilise relatively more resources through their field offices than more centralised agencies such as IMF or OECD. RM for high profile crisis or emergency situations e.g. at the WFP, or to manage the aftermath of disasters or wars as at the WB or UNDP, is normally managed centrally since donors are typically already sufficiently sensitised at headquarter level to respond to requests for rapid commitment of resources.

In organisations such as the WB, where non-core resources make up only a relatively small share of total resources, trust funds can be categorized as programmatic (e.g. the Afghanistan Reconstruction Trust Fund) or freestanding (multiple small examples, such as the USAID-funded Implementation of Economic Reform and Development Programme aimed at financing a real estate development in Amman, Jordan).

‘Programmatic’ refers to a fund with broad objectives to which applications for specific grants are made once the trust fund has been established, while ‘freestanding’ refers to a fund already established for a specific purpose for which subsequent applications are not possible; one is ‘wholesale’ while the other is ‘retail’. Both programmatic and freestanding trust funds may be used to co-finance other projects (existing or planned) and/or to finance stand-alone projects. They may be country-focused or thematic in focus.

Programmatic trust funds allow donors to pool funds rapidly against a broad set of objectives (country-specific or theme-specific) and approve specific projects at subsequent stages. They are thus suitable choices for supporting countries emerging from a crisis or emergency. They are also effective vehicles for channelling resources into sectors or themes where contributing donors do not feel the need to be highly prescriptive about the specific activities to be funded.2

Where donors wish to play an active role in shaping the investments made by the trust fund, this can be accommodated either a) by allowing donors to earmark their contributions (less desirable) and/or b) allowing donors to shape the overall strategic direction of the trust fund (preferred) through representation on boards and sub-committees.

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2 Within this category of trust funds, the WB has begun to develop ‘umbrella’ trust funds, which are large programmatic trust funds, underpinned by a sector strategy, and to invite contributions from donors against a broad set of objectives. This approach helps reduce administrative costs for the multilateral and gives the multilateral relatively greater control over the use of non-core resources. The success or otherwise of these umbrella funds is likely to depend on the extent to which the broad themes underpinning the trust funds are sufficiently focused to respond to individual donor requirements.
The mechanism for ensuring that smaller contributors are given sufficient but proportionate representation in such trust funds should reflect the organisational culture of the trustee, e.g. it may give each contributor equal weight or it may condition this on contributions.

Freestanding trust funds may still be a useful option if donors come together to fund a specific large, well-defined activity such as an infrastructure project. This may be an attractive option e.g. if donors are unable to channel resources through existing programmatic trust funds towards a specific project.

There may be a case for establishing a minimum threshold for trust funds. A few organisations e.g. the WB have a minimum threshold (US$1 million) for the establishment of trust funds to reduce fragmentation and unit costs of administration and increase coherence. Most organisations have no formal barriers to establishing trust funds whatever their size, although in practise most will discourage very small funds.

Types of grant
The EU may want to restrict itself to trustee (EU)-executed, rather than recipient-executed grants, at least in the short to medium term.

The grants funded by trust funds can be either exclusively recipient-executed or exclusively executed by the trustee organization or a combination of each. Responsibility for execution also implies responsibility for preparation of a project. All grants should have results frameworks that align with the results framework established at trust fund level.

Recipient-executed grants are preferred in situations where building the capacity of recipient (typically government) systems is an important aspect of the grant-making process. However, such grants are also often subject to greater delays than trustee-executed grants. Trustee-executed grants are typically preferred for funding technical assistance (TA) projects and analytical studies. All development banks (except the Asian Development Bank which is all trustee-executed) manage trust funds that function with a mix of recipient- and trustee-executed grants.

Streamlining processes to meet the needs of a crisis of emergency and/or to reduce delays in approving relatively small grants is a desirable approach and implies the creation of a lighter touch decision-making process and an approach to due diligence that balances risk and cost.

Very few organisations have developed streamlined processes for smaller (e.g. recipient-executed) grants. One exception is the WB, which has developed light touch processing and approval processes for ‘micro grants’ of less than US$500,000 and ‘small grants’ of less than US$5 million. The Bank has also approved streamlined operational policies, comprising rapid fiduciary assessments and decision-making processes, for crisis and emergency situations, which are applicable to trust fund grants over US$5 million. IFAD also has accelerated procedures for grants of US$200,000 or less.
**Results framework**

The EU should introduce robust results frameworks for all trust funds and grants to boost confidence on the part of donors and enable rigorous management by the EU itself.

Trust funds should have a results framework that should include the core, standard or harmonised indicators used by the trustee to monitor its performance in other, core-funded, projects and programs. This enables the trustee to report back to donors on the projects funded by a trust fund as a whole and to do so in a way that can be aggregated with the results of other projects funded by the trustee's core funding.

The results framework, however, at least at the level of specific targets, does not typically form part of the legal agreement between the trustee and donors. This is to avoid placing unmanageable and often unenforceable obligations on the trustee.

Establishing a results framework can be more challenging in the case of programmatic trust funds where the specific activities to be funded are as yet unknown at the time of finalising the trust fund. In such cases, an approach similar to a sector strategy may be adopted i.e. with broad objectives and indicators as well as internal performance indicators, but where targets are added dynamically to the results framework once the activities to be funded have become clearer. Simplified results frameworks are called for in trust funds established for crisis or emergency situations.

**Policies, procedures and guidance**

The EU will need to develop policies and procedures to regulate their trust funds as well as practical manuals and guidance to help staff working in this area.

Establishing a trust fund will typically require a concept note and discussion chaired by a senior staff member to establish the feasibility and desirability of the proposed trust fund; and the drafting of a legal agreement between the donor and the organisation as trustee. This requires input by lawyers, fiduciary staff (procurement and financial management), disbursement departments and trust fund administration units. The process can often take up to 3 or 4 months.

Several organisations already have in place provisions for dealing with crisis or emergency situations that allow for streamlined preparation and decision-making processes which can be applied to trust funds.

In developing the policies and procedures and IT infrastructure (document storage and retrieval, processing, analytics etc) needed to support the establishment and management of trust funds and the making of grants, the EU should aim to apply as much of its existing corpus of policies and procedures as possible so that trust funds do not become an anomaly within the broader working systems of the organization. Trust fund resources are often not well integrated into work programs and budgets although this is an increasingly important focus for organisations for which trust fund resources are an important, but still minor, share of overall resources.

The aspects of trust funds that are ‘sui generis’ comprise: the establishment of a trust fund including the legal agreement between donor and trustee; the management of donor funds (typically pooled with core funding and invested in the same way); financial and activity requirements (where there is a trade-off between customisation-content and frequency—in the interest of donors vs. streamlining administration from the perspective of the trustee), and the closure of funds. Most other aspects of trust funds, including the preparation and execution of activities funded by trust funds should be “funding neutral” and adopt the trustee’s standard policies and procedures for quality assurance and due diligence.
Cost recovery
The fees charged for trust fund administration is an area where the EU must demonstrate economy and transparency.

Ensuring the proper recovery of costs associated with establishing and managing trust funds is tackled in different ways by different organisations. Within the UN system there is typically a 7% indirect cost charge plus additional charges for project specific costs. The WB has a system that varies with the size of the trust fund and distinguishes between administrative, program and operational costs. Some organisations, such as EBRD, do not seek to recover costs fully. In general, the perceived high level of fees and their lack of transparency are a source of regular complaint by donors.

Roles and responsibilities
A new central function will need to be created to take overall responsibility for trust funds under a head who is directly answerable to top leadership.

Most multilateral organisations have a central department that is responsible for resource mobilisation and ongoing trust fund management and operations and policy. At the EU this could be a separate DEVCO, probably reporting initially directly to the Director General and later coming under a Deputy Director. The WB also has one staff person (a "Trust Fund Coordinator") per region whose job is to oversee all trust fund-related matters arising in their regions. This person could be located in each of the regional DEVCOs. There will be a need for leads on trust funds within the legal, financial management, procurement, and disbursement departments as well as a separate trust fund accounting function.

Large individual trust funds will typically have a secretariat comprising a full time manager (and an assistant in large trust funds) while each grant will require someone to prepare and implement it.

Communication and stakeholder management
Communication—both internal and external—is an important part of trust fund administration.

Communication is an important and often onerous aspect of trust fund management because of the large number of stakeholders involved, especially as represented by multiple donors. This involves financial and activity reporting, capturing and communicating the results of activities funded, dealing with replenishment of trust funds, decisions around extensions and closures, delays, etc as well as agreeing on branding rights for individual donors up front and implementing this.

Discharging these duties effectively can be helped with state-of-the-art IT infrastructure (the Multi Partner Trust Fund Office which coordinates trust funds within the UN system is a leader in this respect).

Managing communication is best undertaken proactively, with internal and external communication strategies drafted while the trust fund is being planned, so that implementation of stakeholder management activities can begin immediately, if not prior to, the trust fund coming online.
CONCLUSIONS

Key donors report a high degree of frustration with the leading multilateral administrators of trust funds in the area of development and humanitarian assistance. But the lack of a viable alternative means that the existing leaders in the field are continuing to increase their market share.

The EU can meet the needs of these donors by avoiding the pitfalls of other multilaterals and building on good practice. In particular the EU should:

- Ensure that costs are in line with or less than the WB’s fee structure
- Develop a core model of trust fund that is programmatic to respond to country and/or thematic needs but consider also the option of freestanding trust funds for specific investments
- Develop a model of governance that gives sufficient voice within trust funds to smaller contributors to prevent fragmentation of trust funds
- Only set a limit on the size of trust funds once the EU’s trust fund business has developed to a certain stage
- Evaluate the case for starting with an EU-executed model of grants and move to recipient-executed grants only once a system for rapid fiduciary assessment of recipients is in place
- If there are to be recipient-executed grants consider the case for a minimum size of grant
- Develop a robust results framework that reflects donor priorities as well as the open-ended nature of programmatic trust funds that are funding stand alone activities
- Ensure that operational policies for trust funds draw as closely as possible from existing operational policies to avoid creating a parallel system
- Develop practical guidance for those setting up and managing trust funds including templates
- Ensure that roles and responsibilities are well-defined and that processes have been automated as much as possible before rolling out the first trust fund