



منظمة الأغذية
والزراعة
للأمم المتحدة

联合国
粮食及
农业组织

Food
and
Agriculture
Organization
of
the
United
Nations

Organisation
des
Nations
Unies
pour
l'alimentation
et
l'agriculture

Продовольственная и
сельскохозяйственная
организация
Объединенных
Наций

Organización
de las
Naciones
Unidas
para la
Agricultura
y la
Alimentación

FINANCE COMMITTEE

Hundred and Thirty-fourth Session

Rome, 21 – 22 October 2010

REVIEW OF THE WORKING CAPITAL FINANCING FACILITY

Queries on the substantive content of this document may be addressed to:

Mr Sean O'Brien

Director, Budget and Programming Division, Deputy CFO

World Food Programme

Tel: +3906 6513 2682

This document is printed in limited numbers to minimize the environmental impact of FAO's processes and contribute to climate neutrality. Delegates and observers are kindly requested to bring their copies to meetings and to avoid asking for additional copies. Most FAO meeting documents are available on the Internet at www.fao.org

EXECUTIVE SUMMARY

- **The Review of the Working Capital Financing Facility is presented to the Board for approval. The document outlines the rationale to support the Secretariat's proposal of increasing the ceiling of the Working Capital Financing Facility from US\$180 million to US\$557 million.**

GUIDANCE SOUGHT FROM THE FINANCE COMMITTEE

- The Finance Committee is requested to note WFP's proposed Working Capital Financing Facility document, and to endorse it for consideration and approval by the Executive Board (EB).

Draft Advice

In accordance with Article XIV of the General Regulations of WFP, the FAO Finance Committee advises the WFP Executive Board to approve the "Working Capital Financing Facility".

برنامج
الأغذية
العالمي



Programme
Alimentaire
Mondial

World
Food
Programme

Programa
Mundial
de Alimentos

**Executive Board
Second Regular Session**

Rome, 8–11 November 2010

RESOURCE, FINANCIAL AND BUDGETARY MATTERS

Agenda item 5

For approval



Distribution: GENERAL
WFP/EB.2/2010/5-B/1
6 October 2010
ORIGINAL: ENGLISH

REVIEW OF THE WORKING CAPITAL FINANCING FACILITY

This document is printed in a limited number of copies. Executive Board documents are available on WFP's Website (<http://www.wfp.org/eb>).

NOTE TO THE EXECUTIVE BOARD

This document is submitted to the Executive Board for approval

The Secretariat invites members of the Board who may have questions of a technical nature with regard to this document to contact the WFP staff focal points indicated below, preferably well in advance of the Board's meeting.

Deputy Executive Director and Chief Financial Officer, RM*:	Ms G. Casar	tel.: 066513-2885
--	-------------	-------------------

Deputy Chief Financial Officer and Director, RMB**:	Mr S. O'Brien	tel.: 066513-2682
--	---------------	-------------------

Chief, RMBB***:	Mr G. Crisci	tel.: 066513-2704
-----------------	--------------	-------------------

Should you have any questions regarding matters of dispatch of documentation for the Executive Board, please contact Ms I. Carpitella, Administrative Assistant, Conference Servicing Unit (tel.: 066513-2645).

* Resource Management and Accountability Department

** Budget and Programming Division

*** Budget Service

EXECUTIVE SUMMARY

On-time delivery of food to beneficiaries is a critical success factor for WFP's operations. WFP is using advance financing to improve operational effectiveness and efficiency, and in particular the timeliness of food delivery to its projects.

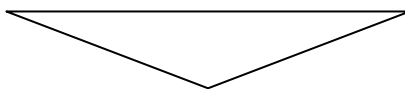
The Secretariat proposes to increase the ceiling of the Working Capital Financing Facility from US\$180 million to US\$557 million. The proposals will eliminate the need for the US\$35.9 million Direct Support Costs Advance Facility. The US\$35.9 million of the Direct Support Costs Advance Facility reserve will be transferred into the operational reserve of US\$57 million to create a single advance financing reserve of US\$92.9 million. The leverage for advance financing would be increased from 3:1 to 6:1 to create a Working Capital Financing Facility of US\$557 million of which US\$407 million is for traditional advance financing and US\$150 million for the Forward Purchase Facility. The Working Capital Financing Facility would continue to make loans to individual operations, based on forecasted income for those operations, and would advance funds for support costs and corporate services.

WFP started advance financing of operations in 1999, when the Direct Support Costs Advance Facility was established. In 2004, the Board approved the pilot Working Capital Financing Facility, using an operational reserve as leverage to advance up to US\$180 million to operations, allowing food to be procured before a contribution to a project had been confirmed. Traditional advance financing has been used by 52 country offices to improve delivery times of 1.2 million mt of food to 70 million beneficiaries. The number and size of such loan requests have increased dramatically since 2004.

In 2008, US\$60 million from the Working Capital Financing Facility was used for a pilot Forward Purchase Facility, to enable WFP to buy food based on estimated aggregated regional needs and funding forecasts to further reduce lead times for the delivery of food. It has been successful in achieving both time and cost savings: estimates based on sample consignments show an average in time savings of 53 days and cost savings of 3 percent. Since the Working Capital Financing Facility was introduced, only one loan – accounting for 0.5 percent of the total advanced – has not been recovered. Requests for loans over US\$10 million are reviewed and endorsed by the Strategic Resource Allocation Committee prior to approval or disapproval. The Secretariat is confident that it has a strong process in place and can manage any risks related to advance financing.

The demand for advance funding has grown significantly in particular since 2008, and the effectiveness of the mechanisms is currently limited by the amounts available. The proposal outlined here implies that 5.4 percent of projected contributions for 2010–2011 be made available for advances to operations and corporate services on the basis of regional needs and forecast income. This would allow WFP to purchase when prices are favourable and to save on lead time.

DRAFT DECISION*



The Board takes note of the “Review of the Working Capital Financing Facility” (WFP/EB.2/2010/5-B/1) and approves:

- i) the transfer of the Direct Support Cost Advance Facility reserve of US\$35.9 million to the Operational Reserve to increase the total Operational Reserve from US\$57.0 million, to US\$92.9 million; and
- ii) the increase of the Working Capital Financing Facility ceiling to US\$557 million, to enable the Executive Director to provide advance financing to projects, the Forward Purchase Facility and other corporate services.

* This is a draft decision. For the final decision adopted by the Board, please refer to the Decisions and Recommendations document issued at the end of the session.

INTRODUCTION

1. WFP operations address emergency prevention, relief and recovery, with a focus on creating conditions for handing over to governments and partners or other sustainable solutions to hunger. WFP has lead roles in the United Nations system in emergency response, logistics, communications, needs assessment and vulnerability analysis.
2. In 2005, the Secretariat completed a Business Process Review (BPR) to improve efficiency and effectiveness by maximizing the utilization of resources allocated to projects and improving the availability of food in-country. WFP continues to refine its operational processes to cater more promptly and effectively address beneficiary needs and to ensure that adequate funding is available at critical times.
3. Demands on WFP continue to increase rapidly – they have doubled since 2004 – but its advance financing capacity has not kept pace and the facilities have reached their capacity for supporting operations effectively.
4. This document seeks the Board's approval for raising the ceiling of the Working Capital Financing (WCF) Facility from US\$180 million to US\$557 million to match the changing and increasing demand. Expansion of the facility would include: i) increasing the amount available for traditional advance financing; ii) expanding the Forward Purchase Facility (FPF); and iii) providing funding stability for corporate services, which are currently provided through the Direct Support Cost Advance Facility (DSCAF).
5. To mitigate the related risks, the Secretariat proposes to transfer the DSCAF reserve of US\$35.9 million to the WFP Operational Reserve of US\$57 million, bringing the total Operational Reserve to US\$92.9 million.

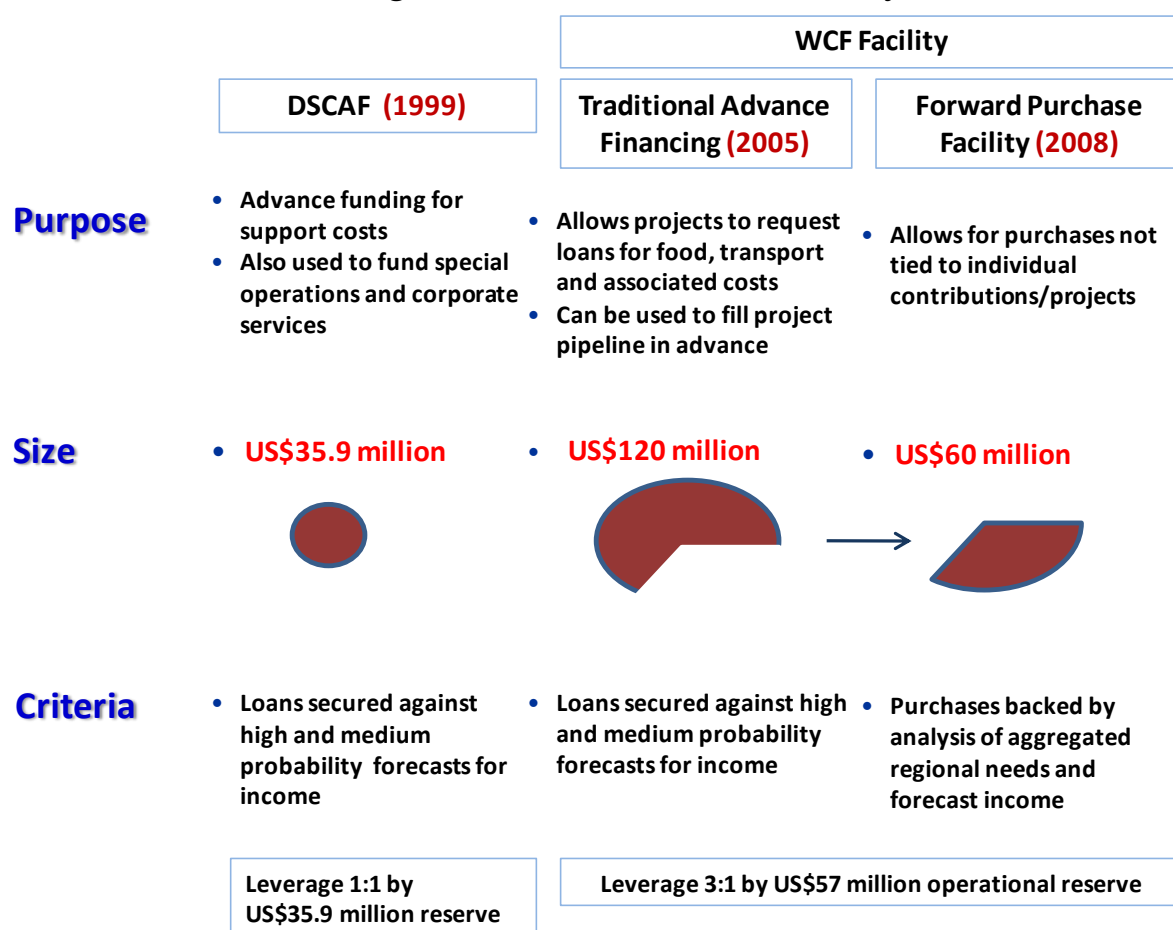
BACKGROUND

6. Advance financing means providing funds to a project using forecast contributions as collateral. Once the collateral contribution is confirmed, the project repays the advance. This enables country offices to reduce the lead time from a donor's expression of interest in contributing to an operation to delivery of food to beneficiaries. WFP's internal advance financing mechanisms are: the Immediate Response Account (IRA), the DSCAF and the WCF Facility.

Immediate Response Account

7. The IRA was established in December 1991. Its original target level of US\$30 million was increased to US\$35 million in 1995 and to US\$70 million in 2004. The IRA is a multilateral fund facility that enables WFP to provide immediate food, non-food and logistics assistance in life-threatening situations. It is a very effective response mechanism.
8. The IRA is also used as a "non-recourse" lending facility in that IRA advances can, in certain circumstances, result in non-repayable loans. Because of this fundamental difference from other facilities, the proposals in this document focus on the DSCAF and the WCF Facility (see Figure 1), and do not affect the IRA.

Figure 1: DSCAF and WCF Facility



Direct Support Cost Advance Facility

9. The DSCAF was established in 1999 as a loan mechanism to provide advance financing for staff and non-staff costs to ensure that projects were not interrupted; 1,200 loans have been approved and recovered through this mechanism. Since 2005, DSCAF has also provided other direct operational cost (ODOC) advances for non-food interventions such as special operations and funding for corporate services; examples are the Global Vehicle Leasing Pool and the Information Technology Special Account. The current ceiling is US\$35.9 million, backed by a US\$35.9 million reserve.

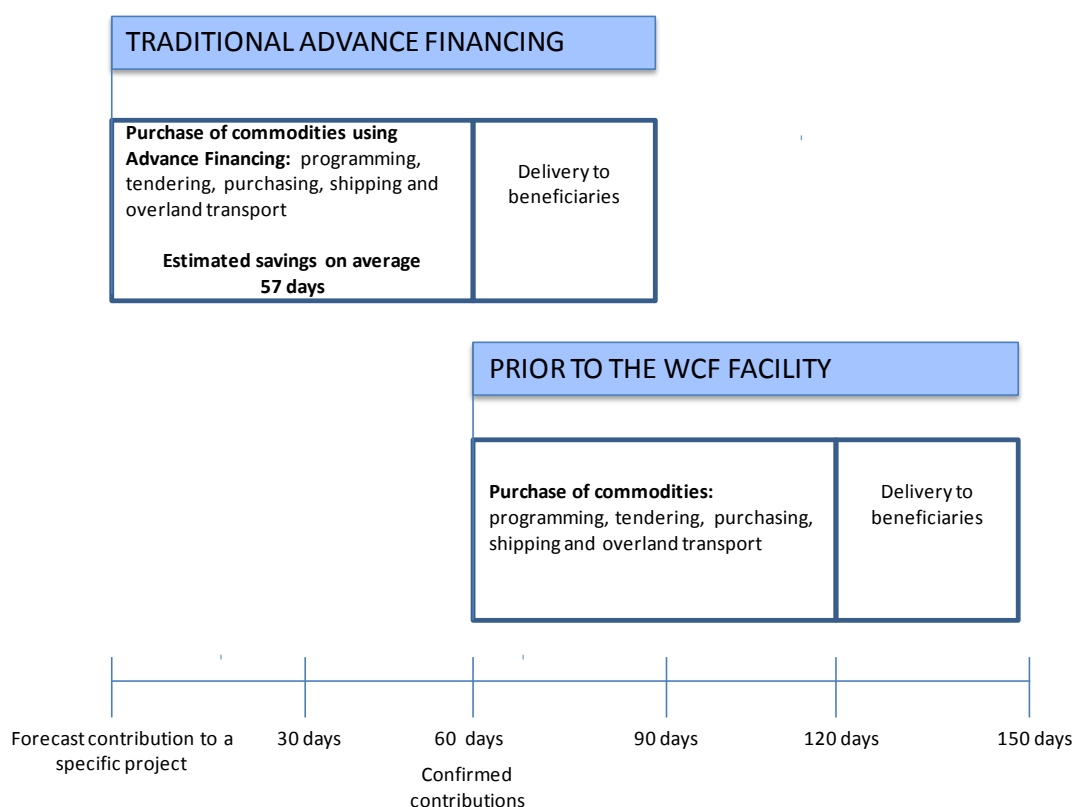
Traditional Advance Financing

10. The BPR conducted between 2003 and 2005 aimed to maximize the utilization of resources allocated to projects and to improve the timely availability of food. The recommendations were tested at the field level in pilot projects starting in January 2004. One of the BPR recommendations was to authorize spending against forecast contributions rather than confirmed contributions to maximize the timely availability of food. The WCF Facility was a major component in achieving the objectives.
11. Following successful pilots, in January 2005 the Board approved a WCF Facility ceiling of US\$180 million, backed by an Operational Reserve of US\$57 million. The WCF Facility enables the Executive Director to ensure the continued advance financing of

projects, pending confirmation of forecast contributions, within established risk-management parameters.

12. Use of the WCF Facility has grown significantly since its inception in terms of the number of loans granted and the value of funds advanced. Between 2004 and July 2010, 167 advance financing loans were approved through the facility totalling US\$1.2 billion. The only write-off was a US\$5.9 million loan during the early days of BPR implementation, against a protracted relief and recovery operation (PRRO) in the Democratic Republic of the Congo in 2005.
13. Figure 2 shows that advance financing leads to an average 57-day reduction in response time as a result of using forecast contributions as collateral to accelerate the provision of funds to projects and stabilize the delivery of assistance to beneficiaries. Before the advent of the WCF Facility, it took on average 150 days from a donor's expression of interest to the delivery of food to beneficiaries.

Figure 2: Advance Financing from Forecast Contribution to Delivery to Beneficiaries



Review of Advance Financing Mechanisms

14. In 2007, the Secretariat reviewed WFP's internal advance financing processes with a view to improving coordination and management of the mechanisms and to streamline the processes. The review led to a "one-stop shop" approach to advance financing, which included:

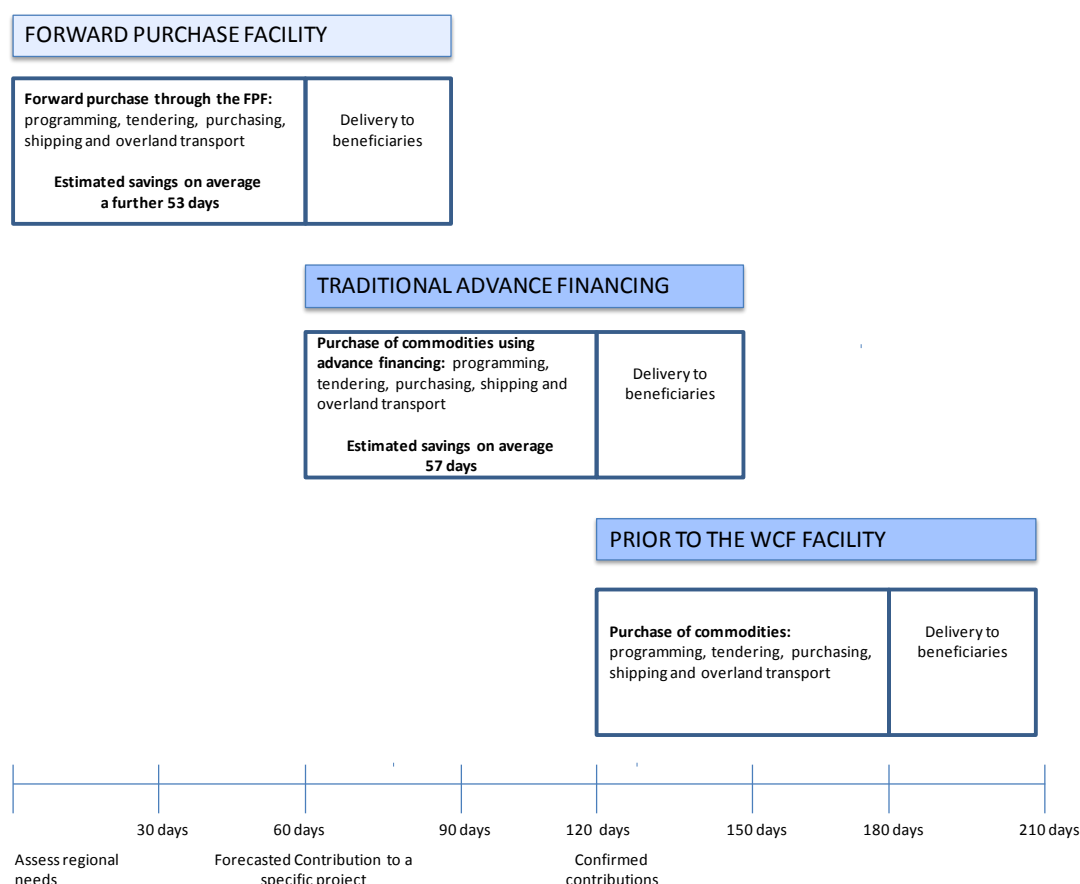
- i) a standard process for requesting and repaying all advance financing loans through the IRA, the DSCAF and the WCF Facility;

- ii) a two-tier approach to approving advance financing to increase efficiency in approving a large number of small transactions while enhancing oversight over high-value transactions; and
 - iii) centralized monitoring of advance financing mechanisms to facilitate a corporate overview of WFP's financial exposure.
15. The review concluded that WFP's advance financing mechanisms must be flexible enough to deal with a large number of requests with low-value transactions and must balance this flexibility with effective risk management achieved through increased monitoring and oversight of high-value transactions.

Forward Purchase Facility

16. WFP established the FPF in June 2008 to accelerate food deliveries to beneficiaries, allocating US\$60 million from the WCF Facility on a pilot basis to a special account to enable forward purchases of food, initially for southern Africa and the Horn of Africa. All purchases through the special account are made in accordance with WFP's purchasing policies and food items are not released to projects until they are backed by specific confirmed or forecast contributions.
17. The objective is to speed up deliveries of food to beneficiaries and exploit favourable market conditions. At the time of purchase, food is not allocated to individual projects: purchases are based on aggregated project needs for a region or sub-region and the related aggregated resource forecasts. This enables WFP to make purchases earlier (see Figure 3), further reducing delivery times. Utilization of the FPF leads to a further 53-day reduction in response times on average.

Figure 3: Forward Purchasing



GROWTH OF WORKING CAPITAL FINANCING

18. Since the WCF Facility was set up in January 2004 it has provided US\$1.2 billion of advance financing. The value of advance financing through the WCF Facility increased from US\$27.1 million in 2004 to US\$272.7 million in the first seven months of 2010. The number of WCF Facility loans approved has increased from 5 in 2004 to 58 in 2008, and 34 in the first seven months of 2010 (see Table 1).

TABLE 1: WCF FACILITY LOANS APPROVED			
Year	Number	Total amount advanced (US\$ million)	Average loan amount (US\$ million)
2004	5	27.1	5.4
2005	10	154.5	15.5
2006	4	36.8	9.2
2007	21	157.3	7.5
2008**	58	324.6	5.6
2009	35	227.1	6.5
2010*	34	272.7	6.7
Total	167	1 200.1	7.9

* Based on actuals up to 31 July 2010.

** FPF established in June 2008, reducing the WCF Facility ceiling by US\$60 million.

19. Since 2008 the demand for WCF Facility funding has grown significantly in line with the increase in WFP's operations, which have doubled since 2004. Advance financing has become a major operational component for stabilizing operational funding. The creation of the FPF combined with increased demand for advance financing has reduced the resources available for traditional advance financing to US\$120 million, a level that no longer meets WFP's needs.

BENEFITS OF ADVANCE FINANCING

Benefits of Traditional Advance Financing

20. Since its inception, the WCF Facility has been effective in addressing the needs of beneficiaries: US\$1.2 billion has been advanced to 390 operations to buy 1.23 million mt of food to assist 70–75 million beneficiaries in 52 countries, with an average saving in lead-time of 57 days.

Examples Showing How Traditional Advance Financing Made a Difference

- **Ethiopia.** The WCF Facility was used to support three protracted relief and recovery operations (PRROs). Between 2008 and mid-2010, purchases of 95,000 mt of food valued at US\$70 million (including support costs) were made, benefiting 7 million people at risk from drought, floods, animal diseases, HIV/AIDS and conflict. Advance financing loans for Ethiopia prevented critical pipeline breaks and ensured operational stability.
- **Kenya.** US\$70 million was advanced from the WCF Facility from 2008 to ensure pipeline stability for emergency operation (EMOP) and PRRO projects to meet the

food needs of 3.4 million beneficiaries. The advance financing enabled the country office to fill its pipelines with 74,000 mt of food.

- **The Sudan.** US\$186.8 million in WCF Facility advances were approved to purchase 182,000 mt of food, including delivery and support costs. Crucial pre-positioning of food was completed before the rainy season in Darfur and Southern Sudan, when these areas become inaccessible by land. This secured the food needs of 5 million beneficiaries and avoided expensive airlifts, which cost five times more than land transport.
- **Somalia.** During the third quarter of 2008 and the first quarter of 2010, advance financing prevented 2.8 million beneficiaries from being cut off from assistance for three months because of pipeline breaks.
- **Niger.** The WCF Facility has enabled the country office to purchase 80,000 mt of food in 2010 to respond to the needs of 3.9 million people affected by drought. Of this food, 27 percent was purchased in local markets, 29 percent was purchased regionally in Burkina Faso, Benin, Ghana and Nigeria, and 44 percent was purchased internationally.
- **Pakistan.** The WCF Facility enabled WFP to release an advance of US\$31 million to address the needs of 6 million people affected by floods during the first weeks of the emergency. WFP was able to initiate their response ahead of many other aid agencies.

Benefits of the Forward Purchase Facility

21. The FPF was established in mid-2008 as a pilot initiative to address needs in the Horn of Africa and southern Africa. To enable WFP to gain experience and prove the concept, the parameters of the pilot were simplified to focus on procurement of cereals from South Africa and the Black Sea region. During the initial phase, 315,000 mt of cereals were purchased – much of it during the harvest period – and allocated to operations in southern Africa and the Horn of Africa.
22. Although baseline data was not maintained to track cost and time savings for each consignment of forward purchase, the Secretariat estimated them on the basis of 149,135 mt food delivered through the Facility (see Annex I): the consignments were delivered on average 53 days earlier than normal and saved WFP US\$1.3 million – 3.4 percent of the costs. WFP did not incur additional storage expenditure because the food was delivered to the projects at the right time.
23. WFP seeks to purchase food at favourable times at advantageous prices, but there is no certainty that the FPF will generate savings in food purchases because markets are unpredictable. But savings are not the primary objective of the facility: the aim is to reduce lead times for delivery to beneficiaries at times when food is urgently needed.
24. A major reason for the early success of the FPF pilot was collaboration among country offices, the Southern, Eastern and Central Africa Regional Bureau, the Kampala sub-regional office and Headquarters units for budgeting, programming, procurement, logistics and resourcing, which ensured timely deliveries of food to beneficiaries and reduced the risks for WFP.
25. Building on the pilot projects, WFP expanded the FPF food basket to include rice, pulses, and corn-soya blend in smaller quantities to provide a nutritionally balanced ration. When food was not readily available in a region, the FPF was used to procure it on international markets, which reduced lead times. The FPF was also expanded to

West Africa in early 2010 to help address the Sahel crisis, and to Asia for the forward purchase of rice.

Benefits of the Direct Support Cost Advance Facility

26. The DSCAF enables WFP to respond to unexpected support needs, such as special operations, usually within 72 hours of a request. It is particularly effective during the project start-up for covering immediate staff and non-staff costs. The ODOC portion of the DSCAF is also used to support WFP partners during the same phase, with the same effect.
27. The DSCAF is also utilized for advance financing of cooperate services such as the Global Vehicle Leasing Pool,¹ which saves WFP up to 10 percent compared with normal costs; and the Information Technology Special Account.

Constraints on Working Capital Financing

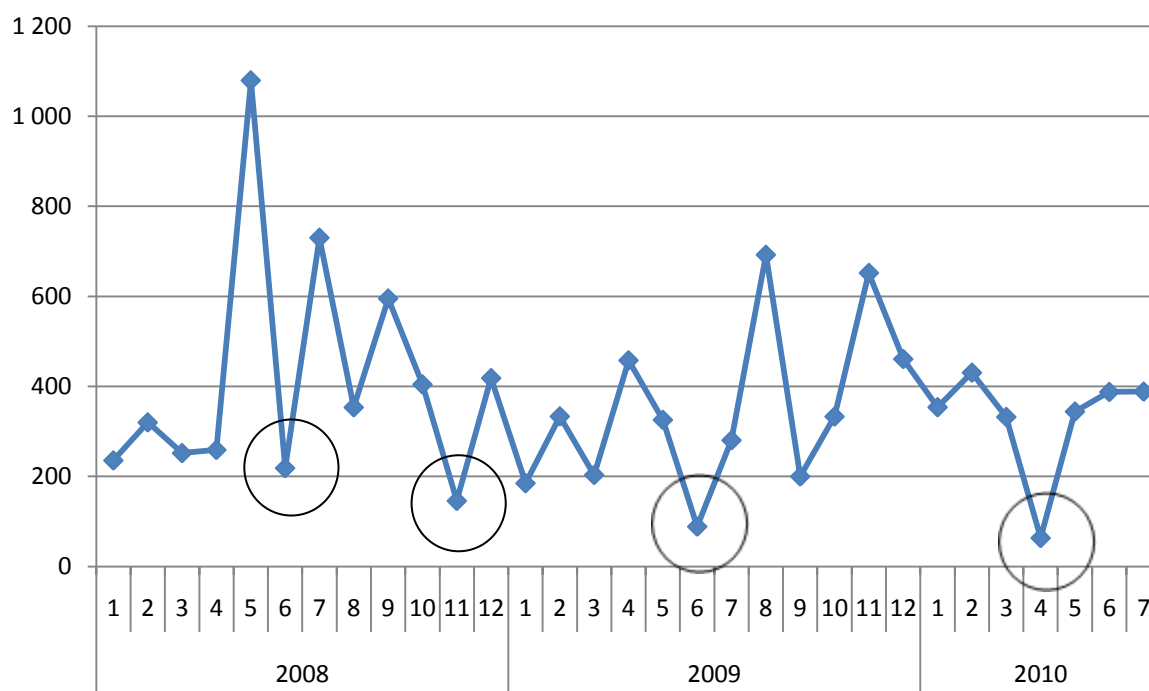
28. Table 2 gives an overview of the utilization of traditional advance financing. From 2004 to 2007 demands on the facility were minimal, allowing for longer advance periods. From 2008 to 2010 the number and size of the requests increased significantly, requiring multiple revolvments.

TABLE 2: TRADITIONAL ADVANCE FINANCING LOANS FROM WCF (US\$)							
	2004	2005	2006	2007	2008	2009	2010*
Total financed	27 051 981	154 461 394	36 793 605	157 303 235	324 580 955	227 092 949	389 593 496
Total ceiling	180 000 000	180 000 000	180 000 000	180 000 000	120 000 000	120 000 000	120 000 000
No. of times revolved	0.15	0.86	0.20	0.87	2.70	1.89	3.25
No. of loans	5	10	4	21	58	35	58

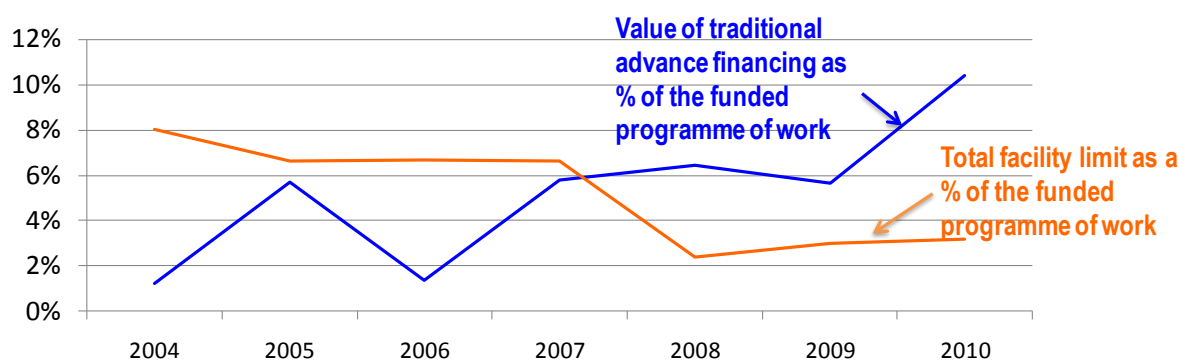
* Estimate for the full year based on 1 January to 31 July 2010 actual data.

29. Because WFP is a voluntarily funded organization, it is difficult to predict the timing and amount of contributions. Figure 4 shows WFP's monthly resourcing trend from 2008 to mid-2010. It is evident that WFP's monthly income is neither consistent nor stable, but the WCF Facility has helped to maintain operational stability. In 2009, 60 percent of contributions were confirmed in the second half of the year. The areas circled in Figure 4 indicate where large WCF Facility interventions were made to maintain operational stability.

¹ WFP/EB.1/2008/6-C/1 "Global Vehicle Leasing Programme and Self-Insurance Scheme".

Figure 4: Resourcing Trends 2008–2010

30. In the second quarter of 2008, WCF Facility availability reached a critically low level as a result of large advances for Kenya, the Occupied Palestinian Territory, Somalia and Zimbabwe, with US\$121 million approved through traditional advance financing. With the outstanding loans of US\$29 million from previous periods, there was a balance of less than US\$30 million remaining from the US\$180 million ceiling.
31. During the third quarter of 2008 the traditional advance financing ceiling was reduced from US\$180 million to US\$120 million to allow for creation of the FPF special account. In the first quarter of 2009, the WCF Facility had an available balance of US\$10 million, with outstanding loans of US\$110 million.
32. The largest quarterly advances were made during the first quarter of 2010: US\$170 million was approved through traditional advance financing for the Sudan, countries in the Horn of Africa and Pakistan.
33. Figure 5 shows the relation between the funded programme of work and traditional advance financing from 2004–2010.

Figure 5: Traditional Advance Financing in Relation to Funded Programme of Work (2004–2010)

34. To accommodate the increasing demand on the advance funding facilities, the Secretariat has:

- i) prioritized loans: some requests were declined or met at a substantially reduced level because funds were not available;
- ii) delayed loans for some projects, thereby delaying project implementation and preventing full realization of the potential benefits of advance financing; and
- iii) recovered some loans earlier than planned, so that contributions not earmarked as collateral were used for payment.

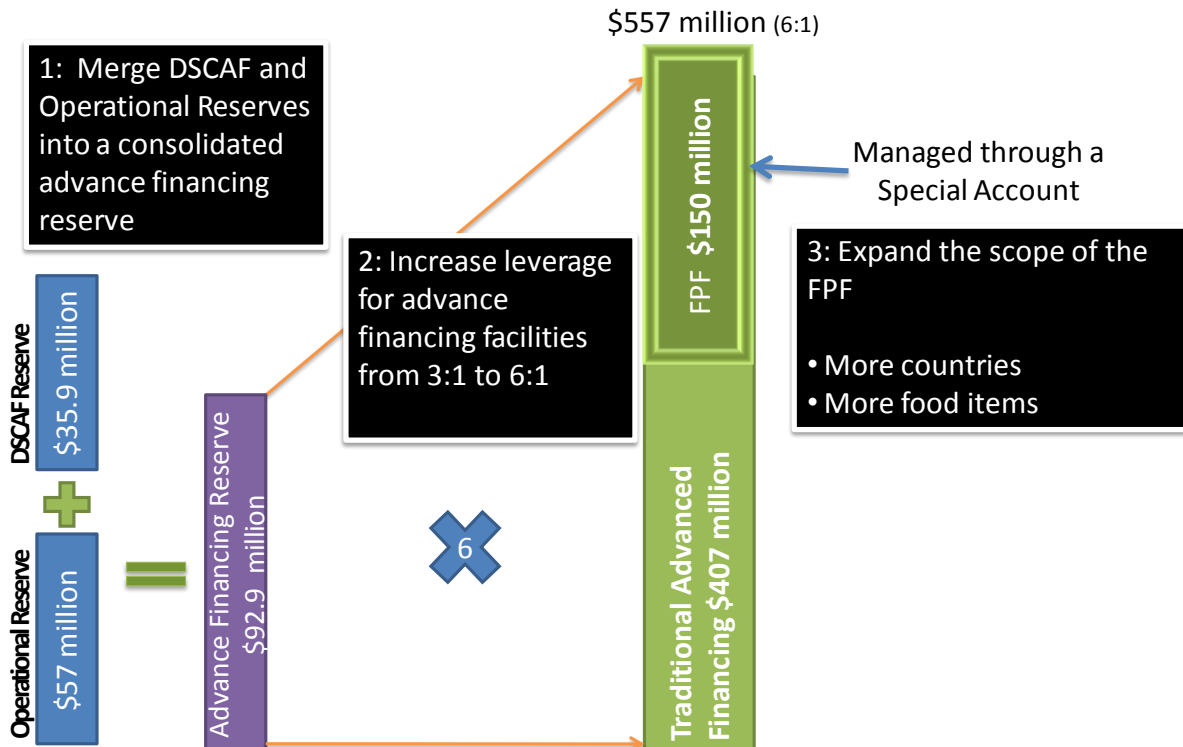
In addition, the uncertainty caused by these actions reduced WFP's ability to plan and thereby reduced project effectiveness.

PROPOSED IMPROVEMENTS TO WORKING CAPITAL FINANCING

35. In view of the positive results achieved with advance financing over the past six years and to keep pace with the growth in WFP's level of activity and achieve greater efficiency and effectiveness, the Secretariat proposes to revise the level of the ceiling of the WCF Facility to US\$557 million, consisting of:

- i) US\$407 million for traditional advance financing and corporate services currently funded by DSCAF; and
- ii) US\$150 million for FPF advances (see Figure 6).

Figure 6: Proposed Improvements to WCF Facility



Proposed Traditional Advance Level of US\$407 million

36. Table 3 shows the current WCF Facility limit as a percentage of the resource level. WFP's levels of funding and operational requirements have increased considerably since

the WCF Facility was introduced, but the WCF Facility ceiling has remained unchanged. The creation of the FPF has also reduced availability for traditional advances by US\$60 million. These factors have led to a reduction in the value of the ceiling for traditional advances as a percentage of the resource level from 5.0 percent in 2004–2005 to 2.1 percent in the current biennium.

37. The proposed revised level of US\$407 million for traditional advance financing would increase advance availability to 5.4 percent of forecast income. The increase would bring the level up to a percentage comparable with that in place at the inception of the facility (see Table 3). The percentage would be consistent with the ceiling envisaged when the facility was created.

Table 3: Traditional Advance Financing Ceiling as a Percentage of the Biennial Programme of Work

	Funded programme of work (US\$ million)	Available from advance facilities DSCAF+WCF-FPF (US\$ million)	Advance facility loans available as % of programme of work
2004–2005	4 810	240	5.0
2006–2007	5 230	215.9	4.1
2008–2009	8 710	155.9	1.8
2010–2011	7 500	155.9	2.1
PROPOSED 2010–2011	7 500	407	5.4

- \$60m
for FPF
in 2008

38. Increasing the traditional advance financing component of the WCF Facility to US\$407 million will enable WFP to:
- feed more people on time with the same resources;
 - improve project continuity;
 - improve pipeline management, leading to better planning with partners;
 - utilize donor contributions more quickly;
 - finance corporate services through existing special accounts; and
 - continue to provide finance for corporate services such as vehicle leasing and other special accounts.

Proposed Forward Purchase

39. The amount requested through the FPF, at US\$150 million is conservative when compared with the volumes purchased by WFP in 2008 and 2009. In 2008, WFP purchased 2.8 million mt of food valued at US\$1.4 billion; in 2009 it purchased 2.6 million mt valued at US\$965 million. The ceiling of US\$150 million requested for the FPF is sufficient to meet about two months of WFP's food procurement requirements.
40. The proposed increase of the FPF ceiling to US\$150 million will enable WFP to:
- expand the FPF to other geographical areas;
 - expand food provided through the facility to include a wider range of foods;
 - purchase larger quantities of food at optimal times;
 - purchase and ship large quantities at favourable prices;
 - improve planning and programming;

- vi) reduce the need for large in-country stocks;
 - vii) reduce the number of advance financing requests; and
 - viii) allow for a reduction in the loan request period.
41. The Secretariat also encourages donors to make contributions to the special account at the global and/or regional level, which would allow WFP to expand the size of the facility without incurring additional risk.
42. In addition to the proposals in this paper, the Secretariat plans to explore the forward purchase concept further by purchasing smaller volumes of non-cereal foods, including new nutritious products, and employing alternative procurement approaches. WFP will work with experts from the World Bank with support from the Government of Canada, which has contributed US\$19.4 million over two years to establish a separate revolving fund for forward purchases and provide capacity support in the Secretariat.

RESERVES AND RISK MITIGATION

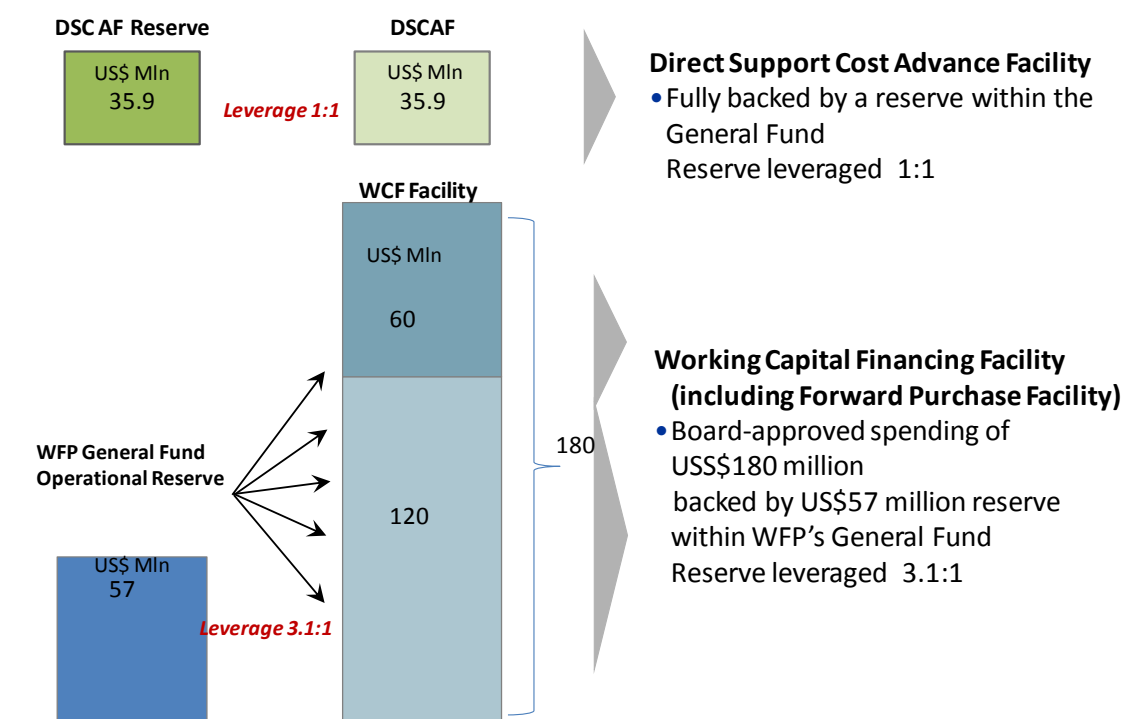
43. There are unavoidable risks associated with advance financing. These include:
- i) forecast contributions not materializing or being less than forecast;
 - ii) contributions being unusable for repayment, for example because of donor-specific bag marking requirements, specific purchase locations or contribution validity dates; and
 - iii) adverse changes in exchange rates between the time of purchase commitment and receipt of the donation.

Track Record

44. WFP has a successful track record in managing advance financing risks since the WCF Facility was established. This is the result of developing and implementing step-by-step procedures and defining roles and responsibilities clearly.
45. Since the DSCAF was established in 1999, no amounts have been written off. When the WCF Facility was in its pilot stage, one loan of US\$5.9 million was written off because the contribution did not materialize, but the amount was used to meet beneficiary needs. Since the finalization of the pilot stage of the WCF Facility, a further US\$1.02 billion has been advanced with no further write-offs. Since the establishment of the FPF in 2008, 448,000 mt of food have been purchased, all of which was eventually funded from projects.

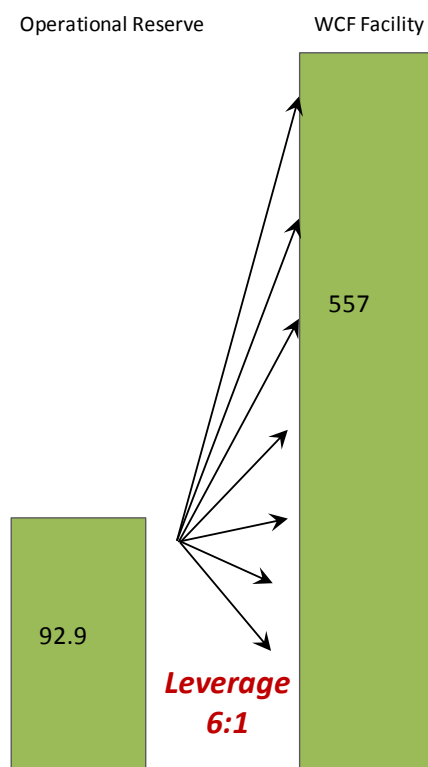
Reserves

46. The DSCAF is fully backed by a reserve of US\$35.9 million. The WCF Facility is backed by the Operational Reserve of US\$57 million (see Figure 7).

Figure 7: Current Reserves for DSCAF and WCF Facility

47. To consolidate risk management and leverage resources, the Secretariat proposes to transfer the DSCAF reserve of US\$35.9 million to the WFP Operational Reserve of US\$57 million, bringing the total Operational Reserve to US\$92.9 million (see Figure 8). The increased WCF Facility ceiling would provide a leverage ratio of 6:1 against the Operational Reserve.

Figure 8: Operational Reserve as WCF Facility Leverage (US\$ million)



48. In exceptional cases – where i) the forecast contributions do not materialize; or ii) other contributions to the project do not materialize to repay traditional advance financing loans from the WCF Facility – the Operational Reserve would absorb the write-off, in line with Financial Regulation 10.6. Write-offs will be considered only after financial closure of a project. Before using the Operational Reserve, the Secretariat will look at all possibilities for repaying loans. The Secretariat contends that this level of risk is justified by the operational efficiency gains that will be achieved and resulting improvements in delivery of food to beneficiaries.

MEASURING THE LEVERAGE OF WFP'S ADVANCE FINANCING MECHANISMS

49. WFP's advance financing mechanisms operate like those of a bank: loans are approved up to a limit determined on the basis of forecast contributions, which are used as collateral. There are, however, differences between the way banks work and the way in which WFP's advance financing mechanisms operate:

- i) Banks establish the limit to be loaned in terms of the number of times that capital can be leveraged; WFP's advance financing mechanism establishes a monetary figure as the limit.

- ii) Loans approved through WFP's traditional advance financing have reduced risk in comparison with bank loans and they may be applied to a broader range of uses. The WCF Facility allows all projects to submit loan requests: these are approved provided that the appropriate level of collateral is forecast. The WCF Facility can be used to purchase food through the FPF, which can be allocated to any project with funding from confirmed contributions or advance financing.
 - iii) Banks have much higher default ratios.
50. The advance financing mechanisms are more conservative and sounder than those of banks in terms of making loans. To demonstrate this, the Secretariat compared the soundness of its advance financing mechanisms with a banking method called "capital adequacy", which is based on the Basel Capital Accords from the Bank of International Settlements (see Table 4).
51. As shown in Table 4, the WCF Facility has an assigned capital of US\$57 million that functions as a reserve to cover loans. The WCF Facility can grant a maximum of US\$180 million in loans, which means that the WCF Facility's capital can be leveraged 3.16 times and that its reserves cover 31.7 percent of the loans. In the case of the DSCAF, loans may not exceed reserves. Taking the combined capital and maximum risk outstanding of both facilities, their capital can be leveraged only 2.32 times and 43 percent of the loans are covered by reserves.

TABLE 4: APPROXIMATION TO A CAPITAL RATIO OF THE ADVANCE FINANCING MECHANISM				
	Current situation			
	WCF	DSCAF	Total	Proposed leverage
Reserve assigned (A) (US\$ million)	57.0	35.9	92.9	92.9
Maximum amount of loans to grant (B) (US\$ million)	180.0	35.9	215.9	557.0
Leverage (B/A)	3.16	1.00	2.32	6.00
Capital ratio (%)	31.7	100	43.0	16.7

52. The proposed merger of the WCF Facility and the DSCAF would increase the maximum amount of risk from US\$215.9 million to US\$557 million and increase to six the number of times the capital can be leveraged, with capital covering 16.7 percent of loans. A comparison of these figures with those of the banking sector shows that the proposal is conservative.
53. A stress test of 91 European banks² showed that their leverage limit was between 9.71 and 10.87, compared with the limit of 6.0 proposed by WFP. Their equity covers a smaller proportion of the loans – between 9.2 percent and 10.3 percent; WFP's proposed allocated capital covers 16.7 percent of loans. A sample of 19 United States banks³ showed that their leverage limit was 9.34 and that their equity covered 10.7 percent of loans (see Table 5).

² Aggregate outcome of the 2010 European Union stress test coordinated by the Committee of European Bank Supervisors in cooperation with the European Central Bank, issued 23 July 2010.

³ See: Board of Governors of the Federal Reserve System. 2009. *The Supervisory Capital Assessment Program: Overview of Results*. Washington DC.

TABLE 5: LEVERAGE COMPARED WITH EUROPEAN AND UNITED STATES BANKS

	WFP's proposed advance financing mechanisms	Sample of 91 European banks	Sample of 19 United States banks
Reserve assigned (A) (<i>US\$ million</i>)	92.9	92.9	836.7
Maximum amount of loans to grant (B) (<i>US\$ million</i>)	557.0	557.0	7 814.8
Leverage (B/A)	6.00	9.71 – 10.72	9.34
Capital ratio (%)	16.7	10.3 – 9.2	0.1

54. These figures show that the proposal to increase the ceiling of the advance financing mechanisms and merge the WCF Facility and the DSCAF is conservative and that it would help WFP to provide the flexible funding to respond rapidly to emergencies and changing needs.

Risk Mitigation

55. The Secretariat has developed step-by-step procedures that identify the roles and responsibilities involved in advanced financing. This has helped to improve oversight and mitigate process risk. An overview of the WCF Facility approval process is provided in Annex II.

56. Among the factors contributing to effective management of advance financing are:

- i) centralized monitoring and reporting;
- ii) improved donor forecasting through improved dialogue with donors, upgraded information technology systems and staff training;
- iii) the introduction of more robust business processes; and
- iv) enhanced oversight of advance financing requests.

57. The oversight process includes review of:

- i) the purpose of loans;
- ii) impact – number of beneficiaries, improvement in delivery time;
- iii) risk factors for WFP;
- iv) detailed donation forecasts;
- v) strength and suitability of collateral; and
- vi) project planning – income and commitment alignment.

All loans above US\$10 million require endorsement by the Strategic Resource Allocation Committee (SRAC).

58. Because advances from the WCF Facility are made on the basis of forecast contributions to projects, the first recourse for repayment is from confirmed contributions. WFP classifies contribution forecasts as high, medium or low according to the probability of their being confirmed, using the criteria in Table 6.

TABLE 6: CRITERIA USED TO CLASSIFY CONTRIBUTION FORECASTS	
High Probability	There is a clear indication of donor support.
Medium Probability	The contribution history shows a steady trend and is supported by positive political and financial developments in the donor country.
Low Probability	There are some possibilities for attracting additional funding. Typically includes potential funding to new emergencies and potential contributions over and above the expected. Used to establish funding targets rather than forecasts.

59. Where there is a high probability that a contribution will be confirmed, the Secretariat normally allows up to 75 percent of the contribution amount to be loaned in the form of advance financing. For contributions with a medium probability of confirmation, 50 percent of the amount may normally be loaned. Low-probability forecast contributions are not used as collateral for advance financing.

The Way Forward

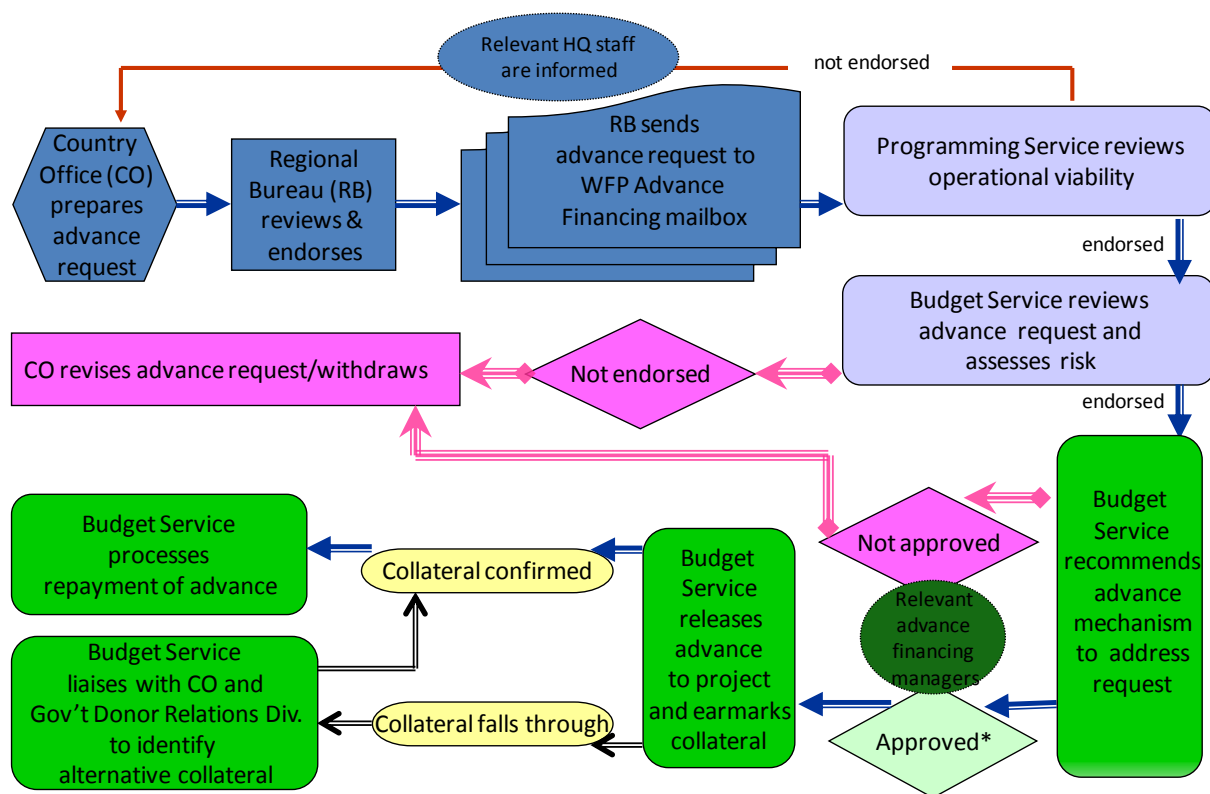
60. The Secretariat will continue to provide updates on the status of WFP's advance financing mechanisms through the Biennial Management Plan and updates to it.

ANNEX I

COMPARISON OF MAIZE PURCHASES FROM SOUTH AFRICA USING THE FPF COMPARED WITH FORECAST CONTRIBUTION							
Purchases through FPF	Recipient country	Prog. category	Country allocation	Price per mt - FPF	Revised price per mt - WCF Facility	Savings/losses	Days saved
Dec-08	Zimbabwe	PRRO	5 200	269.00	279.76	55 952.00	33
Dec-08	Kenya	EMOP	14 646	269.00	279.76	157 590.96	51
Dec-08	DR Congo	PRRO	1 639	269.00	279.76	17 635.64	63
Dec-08	Zimbabwe	PRRO	10 000	274.80	285.79	109 900.00	32
Dec-08	Zimbabwe	PRRO	1 950	274.80	285.79	21 430.50	33
Dec-08	Kenya	EMOP	1 550	274.80	285.79	17 034.50	54
Dec-08	DR Congo	PRRO	9 485	277.00	287.99	104 240.15	65
Dec-08	Kenya	PRRO	5 515	277.00	287.99	60 609.85	53
Dec-08	Zimbabwe	PRRO	3 150	281.00	292.24	35 406.00	34
May-09	Kenya	EMOP	10 000	290.00	275.50	- 145 000.00	61
May-09	Somalia	EMOP	8 532	290.00	275.50	- 123 714.00	63
May-09	Kenya	PRRO	9 941	290.00	275.50	- 144 144.50	52
May-09	DR Congo	PRRO	1 527	290.00	275.50	- 22 141.50	63
Jul-09	Kenya	PRRO	15 000	199.00	222.80	357 000.00	53
Oct-09	Somalia	EMOP	14 721	212.51	242.26	437 949.75	61
Oct-09	Kenya	PRRO	15 279	212.51	242.26	454 550.25	54
Oct-09	Somalia	EMOP	5 000	398.00	453.72	278 600.00	59
Nov-09	Somalia	EMOP	15 000	234.00	208.26	- 386 100.00	58
Oct-09	Somalia	EMOP	1 000	400.60	456.68	56 080.00	61
GRAND TOTAL			149 135			1 342 879.60	

ANNEX II

Advance Finance Process Overview



*Advance request over US\$10 million requires endorsement from SRAC.

ACRONYMS USED IN THE DOCUMENT

BPR	business process review
DSC	direct support costs
DSCAF	Direct Support Cost Advance Facility
EMOP	emergency operation
FPF	Forward Purchase Facility
IRA	Immediate Response Account
ODOC	other direct operational costs
PRRO	protracted relief and recovery operation
SRAC	Strategic Resource Allocation Committee
WCF	Working Capital Financing