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To: The Executive Directors
From: The Secretary
Subject: Policy Proposal for Fee-Based Advisory and Knowledge Services at the IDB. Revised version

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Remarks: This revised version contains the modifications agreed by the Policy and Evaluation Committee at its meeting on 12 April 2013. The changes are marked with a line in the right margin.

The Executive Directors are requested to send their comments, if any, via email to Director María Pérez Ribes “**MPEREZRIBES**” with copy to “**SEC-EXE**”, no later than **19 April 2013 at 12:00 noon**. If no comments are received by then, it will be understood that there is agreement within the Committee regarding the above-referenced document, and a record to that effect will be made in the minutes of a forthcoming meeting. The document will be submitted to the Board of Executive Directors for consideration along with the relevant report of the Chairperson of the Committee.

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DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

PUBLIC
SIMULTANEOUS DISCLOSURE

**POLICY PROPOSAL FOR FEE-BASED ADVISORY
AND KNOWLEDGE SERVICES AT THE IDB**

March 14, 2013

This document is being released to the public and distributed to the Bank's Board of Executive Directors simultaneously. The Board may or may not approve the document, or may approve it with modifications. If the document is subsequently updated, the updated document will be made publicly available in accordance with the Bank's Access to Information Policy.

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POLICY PROPOSAL FOR FEE-BASED ADVISORY AND KNOWLEDGE SERVICES AT THE IDB

I. INTRODUCTION

- 1.1 This document presents Management's proposal to increase and diversify the products and services offered by the Inter-American Development Bank (the "Bank") to its member countries and private sector and non-sovereign guaranteed (NSG) clients and partners, by proposing a policy for providing Fee-based Advisory and Knowledge services (AKS) that are not linked to the design and execution of Bank lending operations. The services will be provided by Bank personnel in exchange for fees covering the costs of providing these services.
- 1.2 This proposal includes five sections: section II provides a justification for the proposal; section III describes the purpose of the policy, defines AKS, and delineates the main features of the policy; section IV discusses the proposed policy evaluation; and section V presents the recommendations for the approval by the Board of Executive Directors (the "Board").

II. JUSTIFICATION

A. Context

- 2.1 In the last twenty years, many countries in Latin America and the Caribbean (LAC) have experienced significant economic growth accompanied by poverty reduction, displaying more resilience to the economic crisis than other regions of the world. This economic and social performance has lead most of LAC countries to qualify as middle income countries (MIC)¹. Notwithstanding this encouraging reality, the region still faces numerous development challenges that require diverse, responsive and innovative solutions. The traditional development approach of bundling technical assistance with lending continues to address many of the development challenges facing the region, but Bank clients, both public and private, are now demanding a more diverse menu of instruments from those traditionally offered by the Bank and other multilateral development banks (MDBs). In response, in the last years the Bank has been expanding its instruments, such as contingent products, lending in local currency and diverse financial options to its borrowing member countries and its private sector clients.
- 2.2 One of the main objectives of the Bank's realignment process was to increase the development effectiveness of the Bank's interventions through a greater country focus and deeper sector expertise. The Bank's realignment document (GA-232) clearly states that the Bank needs to move in the direction of becoming a

¹ According to the World Bank classification included in the World Development Indicators for 2011, middle income countries are defined as having annual per capita gross national income of US\$1,026 to \$12,475.

knowledge partner with countries and private entities in the region. In the last years, great progress has been achieved within the Bank, strengthening its engagement with the private sector as well as focusing and increasing its sector expertise and assigning more responsibility and client services to the Bank's Country Field Offices (COF). Achieving a sharper country focus also requires that the development needs of the borrowing member countries be met by providing a more complete set of tools, which includes technical and analytical services. This is particularly the case for MIC where the demand for non-lending products from MDBs has been growing. Both public and private clients are increasingly demanding customized packages of knowledge services not bundled with lending operations. MDBs recognize the growing importance of knowledge as a distinct service for all their clients.

- 2.3 In this context, the *Report on the Ninth General Increase in the Resources of the Inter-American Development Bank (GCI-9)* (document AB-2764) and the *Agenda for a Better Bank* highlighted the need for the Bank to diversify its menu of products and services in order to deliver nonfinancial value-added products, and to consider the unexplored potential of providing these services through cost recovery options. Pursuant to paragraph 4.10 of document AB-2764, in addition to the Bank continuing to enhance its role as a conduit of external, untied, multi-donor funds for financing non-reimbursable technical cooperation operations, it should also explore providing AKS through a fee-based funding option. Such an option would allow the Bank to effectively satisfy client demand by supplying high-quality, highly relevant customized services in a timely way. As indicated in the *Knowledge and Learning Strategy (2012-2015)*, the Bank is a repository of sector and institutional knowledge and a source of public goods for the countries in their efforts to design, implement, and evaluate policies, programs, and projects for the region's development challenges. This knowledge is invaluable to both public and private sectors in member countries.
- 2.4 OVE's recent evaluation on *How the Bank is Serving Higher Middle Income Countries* sheds more light on the need to improve the Bank's response to the needs of the MICs in the region. The evaluation indicates that some borrowing member countries would like access to AKS from the Bank, unbundled from projects, in the form of fee-based services. OVE acknowledges the potential that a fee-based advisory and knowledge service line could have, particularly for MICs, while at the same time recognizing that its implementation might present challenges, such as availability of overall staffing and alignment with the lending program.

B. Demand

- 2.5 Based on a survey undertaken by the Bank² to estimate the potential demand for fee-based AKS, sixteen borrowing member countries indicated their interest in these services. Fifty percent of the countries had interest in gaining access to services of up to US\$300,000 per AKS while the rest preferred medium or large size services (US\$300,000 to US\$1 million, and over US\$1 million, respectively). Two scenarios were elaborated to estimate the volume of potential demand for AKS. The low scenario assumed small, medium and large size services averaging US\$75,000, US\$300,000 and US\$1 million, respectively. This scenario generated a total potential demand of approximately US\$4 million. The high scenario maintained constant the average size of small and medium size services and assumed an average of US\$2 million for large size services. This scenario generated a total demand of approximately US\$6 million. Therefore, it is expected that in the next five years the demand for AKS will range between US\$4 million and US\$ 6 million.

C. The MDB's Experience in the Provision of AKS and Lessons Learned

- 2.6 The Bank has some experience in the provision of small reimbursable AKS. In 2001 the Bank and the government of Chile signed a Memorandum of Understanding for the provision of AKS. A revolving fund of US\$50,000 was established by the Ministry of Finance to cover the costs of these services. These services were provided by Bank staff for a maximum period of 20 consecutive working days. From 2001 to 2007, seven AKSs were concluded for a total cost of US\$241,587. With two exceptions, the costs per service ranged from US\$8,000 to US\$24,000³ and covered areas related to the formulation, execution, monitoring and evaluation of government policies.
- 2.7 According to the assessment of the AKS program in Chile, the program was successful. Both the beneficiaries of the services and the government unit administering the program gave positive feedback on the quality and usefulness of the AKSs provided, and high performance ratings to the Bank experts that provided the services. The beneficiaries also commended the Bank for its expeditious response to their service requests. In addition, the AKS program strengthened the relationship between the Bank and the government of Chile in those areas covered by the services, and helped to identify new strategic areas of involvement. The provision of AKS services generated four lending operations to be financed by the Bank. Although this was not the intent of the program, as a result of the provision of AKS, the Chilean government recognized the substantial support the Bank had provided in these areas.

² In order to estimate the potential demand for fee-based advisory and knowledge services, Country Departments and Country Offices were provided with a survey questionnaire containing key questions to assess client interest in these services.

³ Chile is at presently interested in services costing more than US\$1 million.

- 2.8 With regards to cost recovery, the Bank received all the agreed upon payments. There were some delays due to the fact that the management of the program shifted to a different unit in the Ministry of Finance while responsibility for payments remained in the original unit assigned to manage the program.
- 2.9 On the Bank side there was no centralized management of the AKS program. Each AKS was managed by the specialist assigned to undertake the service. This led to a lack of consistency in the criteria used to administer, bill and evaluate the services.
- 2.10 The World Bank Group has been providing fee-based AKS since the early 1970's. Over the last few years the demand for these services has significantly increased particularly from MICs. In 2012 the portfolio for AKS for the IBRD and IDA was US\$98 million which included US\$11 million for LAC. Between 2000 and 2009 the countries in the region with the largest AKS programs were: Mexico, Chile, Brazil, Honduras, Argentina, Uruguay and The Bahamas. At the IFC, AKS expenditures increased more than tenfold, from US\$24 million in 2001 to US\$260 million in 2010. In 2012 the IFC portfolio of AKS was US\$187 and the LAC program was US\$20.9 million. The countries in the region with the largest number of AKS programs are: Mexico, Peru, Colombia and Brazil.
- 2.11 According to a review of the World Bank's program the AKS "portfolio has grown largely on an ad hoc basis without institution-wide systems for management, reporting and quality control". Although this allowed for flexibility, the treatment across clients has been inconsistent and negotiated on a case-by-case basis. Furthermore, given the rise in complex transactions, it has become more difficult for the World Bank's budgeting and billing systems to handle the program. In conclusion, these issues have resulted in an AKS portfolio that has been difficult to track and monitor.
- 2.12 At the IFC, AKS originated in the mid-1990s as a business development tool. Activities were ad hoc with no central structure, formal organization or quality control. Ongoing efforts have been underway since 2008 to strengthen IFC's AKS business lines and refine product offerings. Today AKS are organized around a few defined business lines underpinned by strategic direction to minimize ad hoc-ness of activities.
- 2.13 With respect to pricing, the option of allowing the World Bank and IFC to contribute to AKSs financing with its administrative budget and net income allocations has provided flexibility. However, reports on AKS implementation have recommended that more formal criteria need to be developed to help staff determine pricing composition. In the absence of formalized criteria, both institutions have experienced varied pricing for similar AKS and limited transparency regarding the factors that lead to price variations.

III. OPERATIONAL POLICY FOR FEE-BASED ADVISORY AND KNOWLEDGE SERVICES

D. Objective

- 3.1 The objective of the proposed policy is to respond to the changing needs of the Bank's member countries and private sector and NSG clients and partners, whose development challenges, institutional capacity and technical assistance needs increasingly require AKS not linked to Bank lending operations. Engaging in the provision of these services will also benefit the Bank in that it will generate new knowledge and lessons learned which could be applied to strengthen the development effectiveness of Bank lending operations as well as AKSs. In addition, Bank participation in AKS will also serve to foster greater south-south cooperation and the generation of regional goods.

B. Definition and Main Features

- 3.2 Fee-based AKS are defined as analytical, technical and advisory activities not linked to the Bank's lending operations. They are requested by external clients (Clients) and provided by the Bank's personnel, in exchange for a fee covering the costs to the Bank of providing the service. The fee is paid to the Bank directly by the Client receiving the service, or by a third party on behalf of the Client, provided that the third party is acceptable to the Bank. However, if the Bank deems necessary that its personnel be complemented by external individual consultants, it may hire consultants and supervise their work in accordance with Bank's policies and procedures.⁴

1. *Clients*⁵

- 3.3 The Bank may provide AKS to the following clients⁶:
- (i) National governments and public sector entities;
 - (ii) Subnational governments;
 - (iii) State-owned entities (national or sub-national);
 - (iv) Private sector entities;
 - (v) NGO's or other non-profit private sector entities; and
 - (vi) Multilateral institutions and regional organizations.

⁴ In general, consulting firms will not be considered except for AKS to be provided by INDES.

⁵ AKS provided to entities other than national governments will be subject to legal status and financial considerations, such as status to enter into agreements with the Bank and financial capacity to make the corresponding payments to the Bank.

⁶ This Client list contemplates both sovereign and non-sovereign entities.

2. *Strategic Alignment*

- 3.4 AKS are not simply ad-hoc activities to be carried out by the Bank at the request of a Client. These services are imbedded in the Bank's institutional strategy as another way to achieve innovative solutions to development challenges of the region. Thus, the AKS provided by the Bank needs to be aligned with the Bank's IDB-9 strategic priority areas. If it is not aligned with the Bank's IDB-9 strategic priority areas, then it would need to be aligned with the priority or dialogue areas established in the Country Strategy document of the host country in which the service is requested.

3. *Type of services*

- 3.5 The AKS will include, but not be limited to, economic and sector work, research services, good practices in the formulation and evaluation of public policies, institutional strengthening, training, PPP advisory and financial structuring, fostering sustainability and shared value opportunities among private entities, and design and implementation of impact evaluations. Subject to appropriate safeguards and risk management, the Bank may provide AKS to support the preparation, implementation and supervision of projects not financed by the Bank. These services will be provided to the extent that there is available capacity without affecting Bank's core services and activities.

4. *Duration of Services*

- 3.6 The duration of each AKS will be agreed between the Bank and the Client on a case-by-case basis, and it will depend on the nature of the activities defined in the Terms of Reference (TRs) for the service, as well as the availability of the personnel assigned.

5. *Implementation and Quality Assurance*

- 3.7 All requests for AKS will undergo an internal review to determine whether the Bank has the resources to respond to particular requests. The Client's written request and a draft of the TRs will be submitted to the Bank. Once the Bank has determined its ability to partake in the provision of the AKS, the Bank and the Client will proceed to agree on the final TRs for the service and sign the service agreement. The Bank, at its discretion, will select the personnel or group of personnel that best meets the skills required, considering the workload of the Division/Unit involved. Personnel can be selected from any of the Bank's Vice-Presidencies, Departments, Divisions/Units or Country Offices.
- 3.8 The Bank and the Client will agree on the timing and frequency of contact in order to ensure the quality and timeliness of the deliverables. At completion of the service, the Client will provide the Bank with an evaluation on the quality, relevance and timing of the products provided by the AKS.

- 3.9 For those AKS involving the preparation and execution of projects not financed by the Bank, consistency with Bank safeguards and policies will be required. In addition, they must also be subject to Bank practices that ensure quality. If during the provision of the AKS, it is determined that the consistency with Bank safeguards and policies no longer exists, the Bank will proceed to terminate the AKS service agreement.
- 3.10 In providing AKS, the content of the Bank's advice will be consistent with the Bank's own safeguards and policies, if applicable. In addition, those services must also be subject to Bank applicable practices to ensure the quality of the products delivered. The Bank will not provide AKS and/or will terminate an existing AKS service agreement in those cases in which the Client requests services that are inconsistent with the applicable Bank safeguards and policies.

6. *Cost Recovery Mechanism*

- 3.11 The provision of AKS by the Bank is based on the principle of cost recovery. The Client will reimburse the Bank for all expenses incurred by the Bank to provide the AKS, including personnel salary and benefits, travel costs, per diem, consultancy costs (if any) and overhead expenses of Departments/Offices deemed relevant⁷. These costs will be determined during the appraisal of the AKS. Bank policies will apply regarding travel costs and per diem of the personnel and consultants assigned to the advisory service.
- 3.12 If the Client is delayed in its reimbursements to the Bank, a late fee will be charged on the amount overdue. Requests for new AKS from a Client in arrears will not be processed until all reimbursement payments due are received by the Bank.

7. *Risk Management*

- 3.13 Three main risks are identified for the implementation of the policy.
- 3.14 First, some borrowing member countries may concentrate their demand solely on AKS at the expense of other Bank products. This may generate an imbalance in the portfolio composition amongst members of the cooperative. To minimize this risk, the Bank will gradually roll out the provision of AKS to its borrowing member countries and will closely monitor the Bank's portfolio composition.
- 3.15 Second, the operational risks involve possible delays in the delivery of the AKS products and cost overruns. To minimize these risks the following mitigation measures will need to be put in place: a) adequate coordination, programming and monitoring mechanisms of all activities and timetables; b) specific TRs and

⁷ Payments received from Clients will be distributed to Bank Departments and Offices that provide services and incur other expenses associated with the AKS in accordance with criteria to be approved by Management, and such payments shall complement resources allocated to such units as part of the Administrative Budget.

service agreements for the AKS that include clearly defined activities and deliverables, timelines, persons responsible for supervising the AKS, quality control mechanism and associated budget; c) a clear definition of the parties responsible for the quality and timeliness of the AKS at the Bank and by the Client; and d) Bank personnel and external consultants, if any, needed to follow the operational guidelines of AKS.

- 3.16 Third, underlying reputational risks to the Bank could arise resulting from: a) the integrity/reputational risks associated with the Client; and b) the nature of the decisions taken at the discretion of the Client based on the AKS. To minimize this risk (a) Integrity checks and due diligence will be carried out on NSG entities and third parties' funding AKS provided to Clients, when appropriate; and (b) appropriate provisions that limit the Bank's responsibility will be applied and special emphasis will be put on the quality of the services delivered. As a general rule, indemnification provisions and other relevant protections to the Bank will also be included in the agreements with Clients.

8. *Sources of funds*

- 3.17 The costs of the AKS can be covered by the Client's own funds, or funds of third parties channeled through the Client.⁸ Under exceptional circumstances, the Bank may also, via its own administrative budget, cover a portion of the total cost of the AKS delivered to the Client. In those cases, management will ensure that these contributions are consistent with pre-existing budgetary mechanisms to transfer funds between various units of the Bank.

9. *Intellectual Property*

- 3.18 As a general rule, the intellectual property (IP) rights of the new materials prepared under the advisory service agreement will belong to the Client. However, the Bank's pre-existing IP rights will be adequately protected. Normally, the Bank will require that the Client grants the Bank to have a universal, non-exclusive, perpetual, and free license that gives the Bank the rights to use, copy, display, distribute, publish and create new knowledge derived from all or part of the materials generated by the AKS, without having to seek further consent of the Client, but subject to the limitations on the disclosure of confidential information and the rights of third parties recognized by the Bank.

10. *Representation of the Bank's views and use of the Bank's names, trademarks and logos*

- 3.19 The Client will not make or permit assertions regarding the views of the Bank's personnel, nor will it use or permit the use of the name, trademarks and/or logos of the Bank without the written consent of the Bank. The Bank and the Client will

⁸ Third parties making payments on behalf of the Client must be acceptable to the Bank.

include, in the material delivered as a result of the AKS, the appropriate attribution and the provisions limiting Bank's responsibility regarding its personnel's opinions, in accordance with applicable Bank's policies and practices.

11. Agreements

- 3.20 The Fee-based Advisory and Knowledge service agreement between the Client and the Bank will include all necessary provisions required in connection with this policy, such as provisions regarding confidentiality, intellectual property, and use of the knowledge generated by the AKS by those involved. Reasonable efforts will be made to standardize the agreements used for AKS; however, the Bank will have the flexibility, within the framework of this policy, to adapt such agreements to particular circumstances and requirements on a case-by-case basis.

C. Operational Guidelines

- 3.21 The provision of AKS will be guided by the terms and conditions set forth in this document as well as in the respective Operational Guidelines for eligible Clients under the proposed policy and defined in paragraph 3.3 of this document to be approved by Management, which may be amended from time-to-time.

IV. EVALUATION OF THE ADVISORY AND KNOWLEDGE SERVICES POLICY

- 4.1 This is a new area for Bank intervention that will need to be closely monitored and assessed in order to cover topics such as: demand for the services; the resource costs of these services to the Bank and the Clients; implementation of the policy; and the quality and usefulness of each of the AKS provided.
- 4.2 Management will monitor the provision of AKS on an annual basis. The results of this monitoring will serve as a key input for the evaluation of the policy and to elaborate a midterm report of the implementation of AKS to be presented to the Board for information. An evaluation by Management will be conducted three years after the approval of this policy. If there is a significant number of AKS contracted before this time, so as to permit sufficient and relevant data, this evaluation will be carried out before the three years. The assessment would include recommendations, if any, for modifications of the AKS policy and future actions regarding the provision of the services. Results of the assessment will be presented to the Board for information along with any requests for approval of modifications to this policy.

V. RECOMMENDATIONS

Management recommends that the Board of Executive Directors approve the Policy for Fee-Based Advisory and Knowledge Services at the IDB in accordance with the terms and conditions established in this document and authorizes the President of the Bank, or such the representative as he shall designate, to enter

into such agreements and take such other measures as may be necessary for its implementation.