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# SmartLessons

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## Findings from the World Bank Due Diligence Pilot on Private Sector TF and EFO Donors

*It is widely acknowledged that the World Bank Group will need to partner in a variety of innovative ways with the private sector to achieve the Sustainable Development Goals (SDGs). Among other things, nontraditional donors are expected to play an important role in leveraging the World Bank's capacity to deliver development finance solutions to client countries. But partnering with such donors can raise complex issues that need to be identified through a process of due diligence. Such issues do not just involve donor integrity—a long-standing concern—but also how to attain “partnership fit” and how to identify and manage the risks arising from the interface of private and public funding modalities. The World Bank's due diligence pilot produced seven interesting findings, which are summarized below.*

### BACKGROUND

While both IFC and MIGA have well-established due diligence processes supporting their engagement with non-traditional partners, the World Bank's approach had been less formal. To test a new approach, in fiscal year 2013, a timely due diligence pilot was launched by the Development Finance vice presidency unit (DFi) through its Partnerships and Trust Funds Department (DFPTF). Its goal was to conduct due diligence on new for-profit and nonprofit donors to trust funds (TFs) and externally funded outputs (EFOs) by applying criteria agreed in a set of due diligence templates.<sup>1</sup>

<sup>1</sup> The pilot was implemented by DFPTF, with collaboration from the Legal Department (LEG) and the Controller's Trust Fund Accounting Clearance Team (TACT). As part of the pilot, DFPTF also shared information about due diligence on TF donors with IFC. The expertise of the World Bank Group's Integrity Office (INT) was called on in cases that related specifically to good governance and anti-fraud and corruption practices.

### Due Diligence Pilot

**A Changing Donor Landscape:** In recent years, private sector partners have shown an increasing interest in working with the World Bank through TFs and EFOs. From 2007 to 2011, the total volume of Official Development Assistance (ODA) through multi-bilateral aid grew from \$11 billion to almost \$20 billion; 22 percent of ODA flowed through the Bank Group in the form of TFs. By FY13, therefore, TFs were perceived as an important World Bank business line, pooling donor funding in support of global, regional, and country-level partnerships. In addition, for those donors interested in making contributions below \$1 million, the EFO was developed to channel individual donor funding contributions to the Bank's budget. Accordingly, a wide range of corporations, corporate foundations, trade associations, international and country-based nonprofits, academic institutions, and even high

net worth (HNW) individuals began to present themselves to the Bank as potential TF and EFO donors. While many were well known, some had little history of prior engagement with the Bank, or had been recently established. Others had specific business agendas of their own, raising questions about strategic alignment and overall partnership fit. In light of these developments, a more organized approach to due diligence was seen as imperative.

**Due Diligence Criteria:** In designing due diligence criteria, DFPTF noted best practices in the financial sector, including the importance of adequate controls and procedures applied by commercial banks and other financial institutions. These best practices are acknowledged by the World Bank Group’s Integrity Office (INT) in its guidance. Specifically, INT refers to “know your customer” obligations, which require properly documented, risk-based due diligence to be performed on “business partners.” After internal consultations, therefore, DFPTF prepared a set of private sector due diligence templates requiring the following:

- **Verification of Partner Eligibility:**

Absence of engagement in activities that are prohibited under the IFC/World Bank Exclusion List;

No sanctionable misconduct (fraud, corruption, coercion, collusion, or obstruction);

No suspension or debarment from working with the Bank Group;

No violation of UN Sanctions;

Vetting of “Politically Exposed Persons” (foreign, domestic, or international), as defined by the Financial Action Task Force Recommendations. (See [Guidance on Politically Exposed Persons](#).)

- **Checking Business Practices, Record of Achievement, and Reputation:**

No red flags with regard to applicable industry sector, leadership, corporate governance, regulatory compliance, social accountability, and environmental stewardship.

Adherence to UN Global Compact Principles.

- **Identification and Management of Risk:**

Confirming that partnership engagement would be structured in ways that do not pose risks to the Bank, such as conflict of interest or unfair advantage, or that raise any insurmountable policy concerns.

**Due Diligence Process:** The new due diligence process had two principal components:

- **Data Gathered and Assessed by World Bank Units.** The task team leaders (TTLs) and resource management staff in Bank-sponsoring units continued to meet with prospective donors and obtain from them the necessary disclosures and other pertinent information. Directors of sponsoring units were accountable for weighing the risks and rewards of engaging with proposed donors and approving the partnership engagement.

- **A Centralized Risk Review.** DFPTF’s role was to clear and to offer advice about the scope of the due diligence itself and the proper identification of risks based on the facts disclosed. DFPTF also made recommendations, as needed. For example, where the risk identified had wide institutional implications, or where there were potential conflicts of interest, DFPTF’s advice to TTLs was to elevate approval from director to vice president (now senior director) level. LEG’s input was on the policy compliance side. Moreover, any risk management plan had to obtain not only director approval but also the concurrence of LEG. Once the process was complete, DFPTF provided a “no objection” to the issuance of a donor code by TACT (Controller’s Office).

**Donors Screened in FY13–FY15:** During FY13–FY15, a total of 74 first-time private sector donors to the World Bank Group were screened under the due diligence pilot. Of these, 30 were cleared to contribute to TFs (including some to IFC TFs), and 40 were cleared as donors to EFOs. Four donor code applications were withdrawn. Cleared donors fell into two groups: 45 nonprofit donors (including corporate foundations), and 25 for-profit donors. These first-time contributions were made across a wide array of sectors and practice areas, including agriculture, health, education, environment & climate change,

finance & private sector development, trade & competitiveness, urban, rural, and social development.

## ***DUE DILIGENCE FINDINGS***

### ***Finding 1: A World Bank directive and procedure should underpin due diligence.***

As required under the Policy and Procedures Framework, the existing due diligence now needs to be retrofitted into a World Bank directive and procedure. These documents would apply to staff in the donor/partner due diligence process and specify the following: 1) the scope of due diligence; 2) how due diligence applies to different types of donors and partners; 3) applicable principles; 4) ways of assessing optimal partnership fit along strategic, operational, financial, and values-based parameters; 5) where accountabilities lie for purposes of the Bank's Accountability Decision Making Framework; and 6) partnership risks and related management strategies. As part of the due diligence pilot, DFPTF reached out to colleagues at UN organizations such as UNDP, UNEP, and UNICEF. In addition, the Multilateral Development Bank (MDB) Roundtable hosted at IFC in November 2014 had a session on due diligence, in which DFPTF was able to gather information about progress made in this area by MDBs. We found that UNDP has a policy as well as a 12-page risk-screening tool that tailors the scope of due diligence to different types of partnership engagement. UNEP also has a relevant policy in place. EBRD is in the process of preparing one, and ADB is preparing guidelines for acceptance of funding from nontraditional partners.

### ***Finding 2: World Bank due diligence should be professionalized.***

Experience with the due diligence pilot indicates that the capacity of Bank units to undertake due diligence on TF and EFO donors varies greatly from unit to unit. Staff are generally not trained to gather and interpret this type of information. Specialized skills will be needed as the range of private sector partners continues to grow and the complexity of private sector instruments interfacing with TFs and EFOs increases. Moreover, best practice and prudent risk management call for the monitoring and regular updating of partner risk profiles, including all donors to TFs and EFOs. While DFi's due diligence pilot is in broad alignment with the due diligence approaches of UN agen-

cies and MDBs, it is noteworthy that many UN agencies have due diligence service providers to overcome institutional capacity constraints,<sup>2</sup> as well as policies in place that mandate continuous risk monitoring on donors and partners. Thus it seems fair to conclude that a professional due diligence service provider could also greatly assist the Bank with generating a more consistent standard of assurance. Cost savings could also likely be achieved by adopting this approach.

### ***Finding 3: Due diligence should precede negotiations with donors.***

Early screening of donors to rule out eligibility problems is essential. Obtaining a good sense of the business practices, record of achievement, and reputation of donors would also strengthen the Bank's position in any partnership negotiation. Yet the pilot showed that Bank staff begin in-depth discussions and even negotiations with private sector donors before undertaking even the most basic due diligence. Specifically, DFPTF encountered examples where partnership launch dates were agreed without much knowledge of donor intentions. Failure to conduct necessary due diligence caused negotiations to break down in at least one high-profile case. The resulting damage to the Bank's reputation could have been avoided.

### ***Finding 4: Donations from HNWI individuals should be carefully considered.***

During the due diligence pilot, TTLs have sometimes informed DFPTF that HNWI individuals are personal friends or business acquaintances of prominent philanthropists or former colleagues of Bank Group senior management and, on that basis, should be accepted as donors and partners to TFs or EFOs. However, neither the Bank nor IFC has accepted HNWI contributions to date because of the difficulty of monitoring such individuals and the associated risk exposure. Instead, the practice has been to encourage contributions via existing foundations, assuming the latter have been cleared through a process of due diligence. While some UN agencies do accept contributions from HNWI individuals through their fundraising arms, a very limited donor profile and scope of engagement is offered in return for the provision

2 UN organizations rely on an external due diligence service provider. In 2014, the UN Global Compact facilitated joint due diligence service provider arrangements for UN organizations, resulting in substantial cost savings.

of such funds. Any risks to UN agencies are, therefore, highly diluted. To date, neither EBRD nor ADB accepts contributions from HNW individuals.

***Finding 5: Operating by waiver of World Bank policies is not sustainable.***

The goals and organizational cultures of the World Bank and its for-profit/nonprofit donors must be somewhat compatible if partnerships funded through donor contributions are to succeed. In some cases, however, donors find Bank TF and EFO policies to be burdensome—perhaps with some justification. On occasion, the Bank has been asked to waive its own policies. While the Bank’s flexibility may be appreciated by individual donors, providing waivers on an ongoing basis is not sustainable from a risk management standpoint. If such waivers are pursued, the Bank’s reputation will suffer, since its TF and EFO business lines will be perceived as not on a level playing field. It is preferable to pursue donors’ concerns with Bank policies through a wider policy-harmonization agenda than in the ad hoc way encountered in the pilot.

***Finding 6: Risks need to be better identified and managed.***

The due diligence pilot identified and documented in a transparent manner examples of various types of risks involved in engaging with private sector donors. Risk management solutions were developed in the course of the pilot, pursuant to consultations with LEG and sometimes INT. Some of these cases should be discussed more widely to facilitate future risk identification and management and to develop institutional best practices. In particular, those risks to do with conflict of interest<sup>3</sup> were frequently encountered and require institutional attention. While conflict of interest is a recognized risk in the Bank’s Risk Taxonomy, the due diligence pilot seems to indicate that staff could benefit from wider dissemination of guidance on conflict of interest management in the partnership area. (See Box 1.)

<sup>3</sup> A conflict of interest can occur when a person’s ability to exercise judgment in one role is impaired by his obligations in another role or by the existence of an interest. An “interest” can be loyalty, concern, emotion, or influence that has the power to sway a person’s judgment in the partnership context. Financial or career interests, family connections, friendship, and enmity are some of the “subjective” tugs on judgment. See *Guidance Note on Partnership Conflict of Interest*, Sophia Drewnowski, CFPTO 2007.

**Box 1: For Discussion—Examples of Risks Encountered and Their Management**

- **Fraud and Financial Risk.** A long-standing corporate donor to an existing IBRD TF wanted to transfer its contractual obligations to its parent company under a novation agreement. Since the parent company did not have a donor code, due diligence was conducted. In checking internal databases, the program manager found that the parent company was being investigated for fraud by INT. A fraud investigation renders a company ineligible to partner with the World Bank Group. The program manager, whose program was dependent on continuing contributions to the underlying IBRD TF, informed the corporate donor that its parent company could not become a donor to the IBRD TF. What lessons can be learned here about the need to conduct and update due diligence on the beneficial owners of donor entities?
- **Tax Evasion and Criminal Investigations.** Due diligence on a corporate foundation, a potential TF donor, indicated that there was very little separation between it and the corporation. Notably, its officers were also those of the corporation. Some of the officers had been extradited to the United States on tax-evasion charges. The corporation was also the subject of criminal investigations in several jurisdictions. The Bank asked the corporate foundation to make a contribution to another charitable organization with an existing donor code. In turn, that charitable organization would make a TF contribution. Does this recommendation sufficiently protect the Bank’s reputation? Should the Bank seek to harmonize due diligence standards among its partners so as to promote a public good?
- **Financial Risk.** A corporate donor signed an EFO agreement to pay its funding contribution to the Bank in several tranches. After paying one tranche, the donor has not responded to the Bank’s requests for further payment. What steps should be taken to protect the Bank besides canceling the donor code?
- **Conflict of Interest.** A director who was previously associated with a prospective TF donor recused himself from approving due diligence on that donor in order to manage a potential conflict of interest. A then vice president approved the donor and the terms of the partnership engagement. How should productive business synergies be distinguished from conflicts of interest?
- **Conflict of Interest.** Staff on leave from the World Bank accepted an appointment with a corporation and proposed to approve an EFO to support a work program in their former department at the Bank. Staff intended to return to that department and to seek a promotion. The EFO was deemed unacceptable, and the conflict of interest risk was avoided. Should a formal rule cover this type of situation?

### Box 1 (continued...)

- **Conflict of Interest and Unfair Advantage.** A number of private sector consulting firms offered to provide EFOs for outputs related to programs they were managing on behalf of sovereign government agencies. At the same time, the firms wanted to bid on Bank projects. To avoid the appearance of conflict of interest and unfair advantage, the consulting firms were asked to respect the “cooling-off” provisions applicable to EFOs. How should this cooling-off period be monitored and enforced in individual cases?
- **No Value-Based Fit.** A corporation offered a small EFO to prepare a paper on marine pollution in connection with a newly established partnership. The corporation had a poor environmental record, with repeated violations of environmental laws. The funding was turned down, because the narrow business interests of the prospective donor were not reconcilable with the Bank’s own development goals and values. Are there other ways to engage this type of entity while protecting the Bank’s reputation?

### *Finding 7: Due diligence can clarify partnership fit and donor-added value.*

When performing due diligence, staff should seek to understand the diverse incentives that drive donors to provide funding to TFs and EFOs and to partner with the World Bank. While in the past the Bank engaged with corporations mainly through their corporate foundations that were focused on corporate social responsibility, the current thinking is that the core business expertise of corporations should be harnessed in support of SDGs. However, there needs to be careful examination of what this entails with regard to legal and financial structures. Staff should ask what measurable added value will be provided to the SDGs besides the funding contribution itself, and whether the private sector modalities that interface with TFs and EFOs support or detract from the Bank’s strategic

objectives. In a significant number of cases, the due diligence pilot served to open a constructive conversation with donors about “good partnership fit” along strategic, operational, financial, and value-based dimensions. In a few cases, TTLs withdrew donor code applications, having decided, after consulting with DFPTF, LEG, and management, that the proposed donors were not appropriate partners, or at the very least should not be engaged in that particular context.

### **CONCLUSION**

It is hoped that these findings can inform the future establishment of a formal, Bank-wide due diligence directive and procedure. This will help the Bank identify the right donors and partnership arrangements, which in turn will contribute to the success of Bank initiatives supporting the SDGs.



#### **DISCLAIMER**

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