AFRICAN DEVELOPMENT FUND

GOVERNANCE STRUCTURE OF THE AFRICAN DEVELOPMENT FUND

ADF-X MID TERM REVIEW
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ADF-X MID-TERM REVIEW: GOVERNANCE STRUCTURE OF THE AFRICAN DEVELOPMENT FUND

I. INTRODUCTION

1.1 The African Development Fund (the "Fund") was established in 1972 by agreement between the African Development Bank (the "Bank") and certain States (the "Fund Agreement"), all of which were non-African States.[1] The Fund was created to assist the Bank in making an increasingly effective contribution to the economic and social development of the Bank's regional member countries (RMCs). Article 22 of the Fund Agreement prescribes the basic organizational and governance structure of the Fund, and states as follows, in pertinent part:

> The Fund shall have a Board of Governors, Board of Directors and a President. The Fund will utilize the officers, staff, organization, services and facilities of the Bank to carry out its functions. (Emphasis added)

1.2 This memorandum has been prepared in response to the request of the ADF Deputies, and outlines the current governance structure of the Fund, as well as recent proposals to improve the formal structure. The memorandum is submitted as part of the working papers for the mid-term review of the Tenth Replenishment of the Fund (ADF-X).

II. The Governance Structure of the Fund

2.1 There is a consistent pattern to the basic structure of international financial institutions, whether their financing is non-concessional (like the Bank) or concessional (like the Fund). These institutions have decision-making organs and allocate voting and representation rights to their members or participants. In this section, the current governance structure of the Fund is outlined and certain unique features are highlighted, for consideration by ADF Deputies.

2.2 Decision-making organs: All the powers of the Fund are vested in the Board of Governors. The Board of Governors consists of the governors and alternates on the Board of Governors of the Bank as well as persons appointed as governor and alternate by State participants in the Fund, that are not members of the Bank and accordingly are not represented on the

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[1] The Bank concluded the Fund Agreement in accordance with Article 29 of the Bank Agreement, which authorized the Bank to conclude general arrangements for cooperation with Governments.

Board of Governors of the Bank.[2] The powers of the Board of Governors, save for certain exclusive powers, may be delegated to the Board of Directors which, generally, is responsible for the direction of the general operations of the Fund.[3] The Board of Directors is accountable to the Board of Governors, in its exercise of its functions. The Board of Directors is composed of twelve (12) directors, six (6) of which are selected by the State participants and the other six (6) designated by the Bank from the members of the Board of Directors of the Bank.[4] The President of the Bank is *ex officio* President of the Fund, is the Chairperson of the Board of Directors, and the legal representative of the Fund.[5]

2.3 Policy decisions as well as decisions pertaining to the general operations of the Fund are taken at the levels of the Board of Governors and the Board of Directors. The general voting majority for these decisions is provided in Article 29(7) which provides that decisions will be taken at the Boards of Governors or Directors by a three-fourths (75%) voting majority of the total voting power of participants.

2.4 <u>Allocation of Votes within Donor Groups:</u> The Fund has a unique voting structure for decision-making, which reflects its organizational antecedents, particularly: (i) the fact that there are two distinct groups of donors, specifically, the Bank and non-African States, (ii) the Fund's relationship with the Bank, and (iii) the fact that the State participants are currently only non-African States. In this connection, the total number of votes of participants in the Fund (the Bank and the State participants) is 2000, and is equally split between the two (2) distinct groups of participants, the Bank, and the State participants.[6] The allocation of votes to each category of participants was fixed as at the time of the creation of the Fund and initial subscription, and is therefore not dependent in any way on future subscriptions. The Bank's 1000 votes, at the level of the Board of Governors, are allocated to each governor of the Fund who is also a governor of the Bank. The 1000 votes of State participants are proportionally allocated to each State participant based on their subscriptions to the Fund.[7] For purposes of voting at the Board of Directors, the 1000 votes allocated to the Bank is allocated by the Bank between the six (6) directors designated by the Bank to represent it on that Board. In order to avoid double counting and to avoid the possibility of a Director representing both a State participant as well as the Bank, Article 29(6) of the Fund Agreement provides that:

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2 See Article 24 of the Fund Agreement. Currently there is only one such country, U.A.E.
3 See Article 26 of the Fund Agreement.
4 See Article 27 of the Fund Agreement.
5 See Article 30 of the Fund Agreement.
6 See Article 29 of the Fund Agreement.
7 Ibid.

> [I]f a State participant shall be or become both a State participant and a member it shall, but solely for purposes of this Agreement, be treated in all respects as if it were not a member.

2.4.1 The above-cited provision ensures that, for purposes of the Fund Agreement, any country that is both a State participant and a member state of the Bank is not legally recognized as member state of the Bank. Accordingly, the Executive Director who is a national of that country cannot be considered for representation on behalf of the Bank on the Board of Directors of the Fund. The provision also preserves the separation in the representation of the two (2) donor groups in the Fund, the Bank and the State Participants.

2.5 The votes allocated to the State participants are exercised proportionally by the six (6) directors representing the State participants, based on the relative subscriptions of the State participants they represent. Although the State participants are grouped in six (6) constituencies, each represented by an Executive Director, the Directors may cast the votes of each of the States they represent separately.[8]

2.6 Allocation of Votes to State Participants that are Regional Members: One of the distinctive features of the governance structure of the Fund pertains to the participation of RMCs. Article 29(3) of the Fund Agreement provides with respect to State participants that are also RMCs, that the total votes to be allocated to this sub-group of State participants shall not exceed one per cent (1%) of the total 1000 votes of the State participants or 0.5% of the total voting power of participants.

2.6.1 It will be recalled that above-mentioned Article 29(3) is a recent addition to the Fund Agreement, which became effective in 2002. It reflected the compromise position at that time, adopted to address concerns expressed against the previous situation where RMCs that were also State participants were prohibited from having any voting rights in the Fund. This was based on previous Article 29(6) which provided as follows:

> 6. Notwithstanding any of the other provisions of this Agreement:
>
> (i) If a **regional member shall be or become a State participant it shall not have or acquire any votes by reason of such participation and if a regional State participant becomes a member it shall cease as of the effective date of such membership to have any votes as a State participant**; and

8 See Article 29(5) of the Fund Agreement.

(ii) If a **non-regional State shall be or become a member it shall, but solely for the purposes of this Agreement, be treated on all respects as if it were not a member.** (Emphasis added).

2.6.2 The Board of Governors of the Fund as well as the participants, after giving careful consideration to the spirit of partnership which guides the collaboration between the RMCs and non-African donors, the need to facilitate resource mobilization for the development of the continent as well as the avoidance, as much as possible, of discriminatory treatment of donors, approved the amendment of the Fund Agreement, by adopting revised Article 29(6) (cited in paragraph 2.3 herein) and revised Article 29(3), which limited the total votes that may be allocated to RMCs that are State participants. The Governors and the participants, however, broadly agreed that the 2002 amendments were only an interim arrangement. It also would be recalled that these amendments were largely driven by South Africa's participation in the Fund, which was approved by Board of Governors Resolution F/BG/98/04 adopted on 29 May 1998.

2.7 Since the adoption of the above-mentioned interim arrangement, the Board of Directors has considered the Report of the Study on the Governance Structure of the Fund (the "Governance Study"), as well as certain proposals by members of the Board of Directors.[9]

III. Proposals to Enhance the Governance Structure of the Fund

3.1 **The Governance Study**: The recommendations of the Governance Study were grouped into the following three (3) categories, further discussed below, (i) Voting Rights; (ii) Representation; and (iii) Institutional:

- **Voting Rights**

  (a) Transform the interim arrangement into a permanent arrangement.

  (b) Expand the voting rights allocated to the RMC State participants pursuant to the interim arrangement, as well as effect a corresponding reduction in the block of votes of the Bank in the Fund by 1%.

9 The Study was conducted by Mr. Andrés Rigo Sureda, Senior Advisor, Fullbright & Jaworski LLP, and former Acting Vice President and General Counsel of the World Bank. Mr. Rigo's Final Report was submitted on May 15, 2002.

(c) Same as above, but reduce the block of votes of the Bank in the Fund by 2% without placing a limit on the voting power of the regional State participants.

- **Representation**

(a) Allocate the votes of the Bank in the Fund to six (6) Directors corresponding to the proportion of shares of groups of specific RMCs that are not State participants.

(b) Increase the number of the members of the Board of Directors of the Fund so that all regional directors on the Board of Directors of the Bank may have a seat on the Board of Directors of the Fund.

- **Institutional**

Revise the Fund structure so that participation is open to all RMCs, whether they are donors or not, and with an option for the Bank to cease participation in the Fund.

3.2 Management considered the recommendations of the Governance Study and provided the Board of Directors with the following guidance on the implications of each recommendation:

3.2.1 <u>Transform the interim arrangement into a permanent arrangement</u>

- This option has the advantage of incumbency in that it has been considered and approved by the Board of Governors.
- However, in the event that contributions by RMCs push the entitlement to voting rights of RMC State participants beyond the 1% ceiling, this option would discriminate against the RMC State participants as additional contributions in excess of the 1% ceiling would not carry any voting rights.
- Once the ceiling of 1% is attained, there is a real possibility that it may re-open discussions on RMC State participation in the Fund.
- This proposal would also have the effect of creating another category of participants in the Fund in the event that the 1% ceiling is exceeded i.e. RMC State participants with no voting rights.

3.2.2 <u>Expand the voting rights allocated to the RMC State participants pursuant to the interim arrangement, as well as effect a corresponding reduction in the block votes of the Bank in the Fund by 1%</u>

- The primary advantage of this option is that it would introduce a balance in the reduction of aggregate voting rights between the Bank and the non-regional State participants.

- On the other hand, this option still retains the inherent disadvantages listed in sub-paragraph 3.2.1, should the ceiling be surpassed.
- This option, furthermore, is contrary to the often-stated (and legal) position that the Bank is a participant in the Fund in its own right and not as a trustee or representative of the RMCs.
- This proposal would also require further amendment to Article 29(1), (3) and (6) (Voting) of the Fund Agreement.

3.2.3 <u>Same as above, but reduce the block votes of the Bank in the Fund by 2% without placing a limit on the voting power of the RMC State participants</u>

- This option eliminates the discriminatory aspect of the previous options. The State participants will also only begin to forfeit portions of their voting rights in favor of new RMC State participants (over and above the 1% level provided for in the interim arrangement) once RMC State participants exceed the 3% mark.
- However, this option also would be at variance with the legal position that the Bank is a participant in the Fund in its own right and not as a trustee or representative of the RMCs.
- This proposal would similarly require amendments to Article 29(1), (3) and (6) (Voting) of the Fund Agreement.

3.2.4 <u>Allocate the votes of the Bank in the Fund to six (6) Directors corresponding to the proportion of shares of groups of specific RMCs that are not State participants</u>

- This proposal would engender a stronger feeling amongst RMCs that they are directly represented on the Fund's Board of Directors.
- Furthermore, this option would not require an amendment of the Fund Agreement but rather an alternative interpretation and application of existing provisions.
- This option would, however, alter the view that the Bank is a participant in the Fund in its own right and independently of its members.

3.2.5 <u>Increase the number of seats on the Board of Directors of the Fund so that all regional directors may have a seat on the Board</u>

- Similar to the proposal discussed in 3.2.4, above, this option would facilitate a greater sense of representation amongst RMCs.
- This option would, furthermore, require amendments to paragraphs 1 and 2 of Article 27 (Board of Directors: Composition) of the Fund Agreement.

3.2.6 Revision of the Fund structure so that membership is open to all RMCs, whether they are donors or not, and with an option for the Bank to cease participation in the Fund

- Under this option, the Bank may or may not remain a participant in the Fund and non-contributing RMCs would be allocated a percentage of voting rights proportionate to their voting rights in the Bank. Should the Bank remain a participant, it would be allocated voting rights equal to its actual subscriptions to the Fund. It should be noted however that, in accordance with Article 40 of the Fund Agreement, withdrawal by the Bank shall constitute a termination of operations by the Fund, and after such termination, the Fund shall forthwith cease all activities, except those incidental to the orderly realization, conservation, and preservation of its assets and settlement of its obligations.
- This option has the advantage of equality of treatment within each potential category of participants.
- However, this option can only be implemented at the expense of the Bank's existing voting rights in the Fund.
- This option would, if the Bank were to cease being a participant, require the withdrawal of the Bank from the Fund in accordance with Article 37 of the Fund Agreement, which would constitute a termination of operations of the Fund, in accordance with Article 40 of the Fund Agreement.
- In addition, there would need to be extensive amendments to the Fund Agreement, in particular to Articles 1 (Definitions), 3 (Participation), Article 4 (Resources), Article 5 (Subscriptions by the Bank), Article 27 (Board of Directors: Composition), Article 29 (Voting) and Schedule B.
- The Board of Governors of the Bank would also need to separately decide on any modification in the interest of the Bank in the Fund.

3.3 **The German Proposal**: Another proposal to enhance the governance structure of the Fund, with regard to the participation of RMCs, was submitted to the Board of Directors, in 2004, by the constituency of State participants, including Germany (the "**German Proposal**").[10] The proposal involves three (3) key steps for implementation: (i) conversion of the 1000 block votes of the Bank to RMC votes ("Regional Votes"), (ii) classifying such shares into two categories, Participation Shares (for RMC participants) and Partnership shares for RMCs that are not participants in the Fund; and (iii) allocation of shares to RMCs on the basis of the above designation.

[10] This constituency includes Germany, the Netherlands, Portugal, and the United Kingdom. The proposal is contained in Document ADF/BD/WP/2004/77.

3.3.1 The Participation Shares will be allocated to RMCs who become participants on the basis of their contribution to the Fund relative to other State participants. The total number of partnership shares will be determined by subtracting the number of Participation Shares from the total number of Regional Shares. Each RMC will have a percentage of the Partnership shares based on their voting power in the Bank and a percentage of the Participation Shares based on their contribution to the Fund. The size of the Board of Directors of the Board will be increased from twelve (12) to eighteen (18) so that all twelve (12) RMC Executive Directors on the Board of Directors of the Bank, will be on the Board of Directors of the Fund. For the non-regional State participants, the 1000 block votes to State participants will only be allocated to non-regional State participants and individual votes of such State participants will be determined on the basis of their proportional contribution to the Fund, relative to the total contribution of Non-regional State participants.

3.3.2 The German Proposal would entail the renegotiation of the Fund Agreement and the conclusion of a new Agreement involving a direct partnership between African and non-African Donors. This proposal requires extensive review and reflection.

3.3.3 In addition, similar to the other proposals that involve the transfer of the Bank's block votes to RMCs, the Board of Governors of the Bank will have to approve such transfer.

IV. THE WAY FORWARD

It is important that the Deputies provide guidance to the Board of Directors, whether to further examine the options outlined in this memorandum or defer further examination until there is persuasive justification for a further amendment of the current governance structure of the Fund. In the meantime, other measures may be considered for improving policy dialogue between donors and recipients, particularly by strengthening the participation of representatives of recipient countries in consultative meetings of the Fund.