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EXECUTIVE COMMITTEE OF
THE MULTILATERAL FUND FOR THE
IMPLEMENTATION OF THE MONTREAL PROTOCOL
Twenty-fifth Meeting
Montreal, 29-31 July 1998

PROMISSORY NOTES

INTRODUCTION

1. Several issues were raised on the promissory notes in the discussion on the Treasurer's Report at the 24th Meeting of the Executive Committee in March 1998. The Treasurer anticipated a situation where most of the resources available to the Executive Committee at any given meeting will be in the form of promissory notes rather than cash. Such a shortage of cash funds delayed the transfer of funds to the United Nations (UN) Agencies following the 23rd Meeting approvals because these agencies had not worked out legal arrangements with the Executive Committee to enable them to accept promissory notes as commitable resources. Unless a solution was found, this could cause recurring delays in fund allocations in the future and consequently in project implementation.

2. Another issue related to the management of the promissory note was the impact of exchange rate fluctuations for promissory notes denominated in currencies other than the U.S. dollar. Specifically, the issue is who should be responsible for the consequences of the fluctuations of the exchange rate, the Multilateral Fund or the promissory note issuing Party.

3. As a result, the Executive Committee decided to "request the Sub-committee on Monitoring, Evaluation and Finance to consider the issue of promissory notes." In an effort to assist the deliberations of the Sub-committee on this issue, the Secretariat has worked with the Treasurer and the implementing agencies in preparing this paper.

CASH/PROMISSORY NOTE COMPOSITION OF THE RESOURCES OF THE MULTILATERAL FUND

4. The Executive Committee decided at its 11th Meeting in 1993, that contributions to the Multilateral Fund paid by means of promissory notes constitute commitable resources of the Fund. However since 1996, there has been a significant increase in the proportion of contributions paid by means of promissory notes and the share of promissory notes against cash in the total contributions of the Fund. For example: 40% of the contribution received for 1997 was made in promissory notes. In the future, it is expected that this percentage will increase since the U.S. has indicated that its future contributions to the Fund will use a promissory note modality.

OPERATIONAL IMPLICATIONS OF THE SHIFT IN CASH/ PROMISSORY NOTE COMPOSITION

5. The shift in the composition of the committable resources of the Multilateral Fund impacts the implementing agencies differently due to the difference in the modus operandi and the financial rules and regulations of each agency, as well as their agreements with the Executive Committee. This is discussed separately below.

United Nations Agencies (UNEP, UNDP, UNIDO)

Modus Operandi and Financial Rules

6. The financial rules of UN Agencies normally require that very strict control is exercised when entering into any kind of financial commitments, which are to be kept within the limits of resources available to the organization.

7. Traditionally, resources available for commitment have been defined very narrowly in UN Agencies, and mainly only cash and bank deposits have been considered eligible.

8. Consequently, the agreements concluded between the Executive Committee and the UN Agencies all reflect this requirement. As an example, the Agreement between the Executive Committee and UNDP states: "The Executive Committee shall transfer the agreed amounts for each activity in full, on approval to the UNDP".

9. Due to their financial rules and practices and their respective agreements with the Executive Committee, UNDP and UNIDO in particular find it internally difficult to even commence implementation of any approved project before corresponding cash resources have been transferred to the agency's bank account.

10. Therefore, unless a solution is found, the increase in the proportion of contributions in promissory notes will lead to delays in making cash resources available to agencies for commitment purposes and subsequent delays in implementation of projects.

11. Notable delays in fund transfer to the UN Agencies have already been experienced due to lack of cash after some Executive Committee Meetings and the situation will deteriorate further when most of the Fund's resources will be in promissory notes.

What is being done?

12. In consultation with the Treasurer, both UNDP and UNIDO have internally explored the possibilities of broadening their respective definitions of resources available for commitment to partially include promissory notes held in the Multilateral Fund.

13. The two Agencies now have internal decisions in place to accommodate such new modalities. However, in order to implement these decisions, the current agreements between UNDP and UNIDO with the Executive Committee need to be amended.

14. In accordance with Article G of their agreement with the Executive Committee "Amendments or Termination of the Agreement", both UNDP and UNIDO have proposed draft text amending their agreements with the Executive Committee. The proposed texts are appended to this paper.

15. Once the agreements are amended, both UNDP and UNIDO will make commitments based on notes held in the Multilateral Fund, provided they receive adequate cash transfers to manage actual project disbursements, including provision for disbursement estimates for the next 12 months.

16. UNEP at this point does not feel the need to change its agreement with the Executive Committee, as its commitment needs are relatively small and as it has, due to specific provisions in the UNEP financial rules, some flexibility already allowing partial use of promissory notes as commitable resources.

The World Bank

Modus Operandi and Financial Rules

17. The World Bank manages its ozone programme on a decentralized system, according to which most of the activities are initiated and implemented by its financial intermediary at the country level. The project authorities are responsible for recruiting, contracting and procurement according to the World Bank rules and procedures and are later reimbursed by the World Bank/financial intermediary against invoices. Under this system, the up-front cash requirement is less pressing than in the case of the UN Agencies.

18. The World Bank agreement with the Executive Committee stipulates that it accepts promissory notes as well as cash as provided that notes are transferable to the Bank. Upon the transfer of notes to the Bank, the rights of the Treasurer as payee are transferred to the Bank and the notes are held in the accounts of the Bank. The drawdown of such notes transferred to the World Bank from UNEP is effected on a need basis with a transmittal of cash request to the government concerned. Usually the Bank follows the encashment schedule set by the payee and implemented by the Treasurer, and a cash flow schedule is submitted by the Bank to the government concerned upon request. The Bank informs the Treasurer of its notes transactions as they occur.

ADMINISTRATION OF PROMISSORY NOTES

Encashment Schedule

19. In accordance with the Executive Committee decision taken at the 11th Meeting in 1993 (UNEP/Ozl.pro/ExCom/11/36 paragraph 128), promissory notes would be encashed on fixed schedule with the option of accelerated encashment on demand by the Treasurer in light of needs on a pro rata basis.

20. The term "needs" here is normally understood to mean project disbursement needs, not up-front cash needs to enable agencies to effect internal commitments.

21. At its 12th Meeting, the Executive Committee decided to adopt an encashment schedule for notes (UNEP/Oxl.Pro/ExCom/12/37 paragraph 31 and Annex II), which requires that a note deposited for a given year is normally encashed in equal installments over the next three years.

22. Some governments adhere quite strictly to this schedule, while other governments have been more flexible and have allowed accelerated encashments even if these were not strictly based on project disbursement requirements, but rather on the need to provide UN Agencies with up-front cash for commitments.

23. Disbursement needs as such have been difficult to demonstrate, as the UN Agencies currently hold substantial amounts of Multilateral Fund cash. For instance, as at 31 December 1997, UNDP held approximately US $134 million and UNIDO about US $72 million, while their annual (1997) disbursement levels were approximately US $50 million and US $35 million respectively. Interest earned on the undisbursed fund balance is credited to the account of the Multilateral Fund.

24. Once agreements are in place for UNDP and UNIDO to accept notes held in the Multilateral Fund as commitable resources, it is not expected that accelerated encashment of notes would be necessary in the near future, and if such a situation would arise, the need would be based on project disbursement requirements, in line with the original intention of the Executive Committee.

Impact of Exchange Rate Fluctuations for Promissory Notes Denominated in Currencies other than the U.S. Dollar

25. The introduction of promissory notes has, as expected, reduced cash build up with the implementing agencies. However, it has also introduced complications of managing promissory notes denominated in currencies other than the U.S. dollar due to the impact of exchange rate fluctuations because the encashment schedule contained in the promissory note could extend the holding of such notes with the Treasurer up to three years. To manage the exchange rate fluctuations of promissory notes denominated in currencies other than the US dollar, the Treasurer submitted a report, entitled The Procedure of Transferring Promissory Notes, to the 17th Meeting of the Executive Committee in 1995 (UNEP/OzL.Pro/ExCom/17/6). The relevant paragraphs are reproduced below.

> (a) The Treasurer would like to inform the Executive Committee also that the promissory notes deposited by Parties in currencies other than the United States dollar will in the books of the Treasurer be recorded only in United States dollars value using the exchange rate indicated by the depositor at the time the Treasurer is notified of the deposit.

(b) In order to ensure consistency between the records of both the Party depositing a promissory note and those of the Treasurer, any shortfall or surplus between the originally intended United States dollar value and the value realized during the encashment should be compensated by either the Parties depositing the promissory notes or the Treasurer. Only in cases of significant exchange rate fluctuations of a permanent nature would there be reason to amend the nominal United States dollar value in the records of both the Treasurer and the Parties in question.

(c) Partial encashments of the promissory notes by the Treasurer will be recorded as cash payments using the actual United States dollar value received. The encashments together with the remaining value of the promissory notes will be maintained at the value of the originally deposited promissory notes. The value of promissory notes transferred to implementing agencies will be recorded in this United States dollar value as maintained by the Treasurer. Upon the final encashment of the promissory notes the United States dollar value realized in the process of encashment will be determined for the purpose of taking the appropriate action of either requesting the Party in question to settle the deficit or the Treasurer paying back to the Party the excess United States dollars value realized.

26. Since the report from the Treasurer to the 17th Meeting was submitted as information to the Executive Committee and the issue was again raised at the 24th Meeting of the Executive Committee, it is advisable that the Executive Committee adopt a decision to provide clear guidance to the Treasurer in managing the promissory notes.

RECOMMENDATIONS

I. The proposed amendment to the agreement between UNDP and UNIDO with the Executive Committee should be considered by the Executive Committee.

II. Considering the significant shift in the composition of cash and promissory notes in the resources of the Multilateral Fund and the operational need, the Treasurer should have the flexibility to implement the Executive Committee decision on accelerated encashment on need, provided that any accelerated encashment is done on a pro-rata basis across all the promissory notes received by the Treasurer to provide fairness and with a reasonable period of time of advance notice.

III. Contributing parties which issue promissory notes in currencies other than U.S. dollar should be responsible for the up or downward movement of the value of their promissory notes due to exchange rate fluctuations. The variance between the value of the note when it is deposited and the value of the note when it is cashed should be credited or debited to the account of the note issuing party and reflected in the contribution due from the party in the following year.

AMENDMENT TO THE AGREEMENT BETWEEN THE
EXECUTIVE COMMITTEE OF THE (THEN INTERIM) MULTILATERAL FUND
FOR THE IMPLEMENTATION OF THE MONTREAL PROTOCOL AND THE
UNITED NATIONS INDUSTRIAL DEVELOPMENT ORGANIZATION,
SIGNED 22 OCTOBER 1992

1. For purposes of making commitments in respect of agreed activities, UNIDO shall consider as resources at its disposal:

(a) Contribution payments in cash transferred to UNIDO by the Executive Committee through the Treasurer of the Fund (UNEP), and

(b) Subject to confirmation by the Treasurer of the Fund in accordance with paragraph 2 below, resources allocated to UNIDO by the Executive Committee and held by the Treasurer on behalf of the Executive Committee in irrevocable promissory notes.

2. Resources held and allocated to UNIDO by the Treasurer of the Fund shall be considered by UNIDO to be available for purposes of making commitments after UNIDO receives written confirmation to this effect from the Treasurer.

3. Cash transfers shall be made by the Executive Committee through the Treasurer to cover the disbursement requirements of agreed activities. These will be based on periodic cash flow estimates submitted by UNIDO.

4. The Executive Committee shall ensure, through the Treasurer of the Fund, that adequate cash is made available to UNIDO in advance to cover at least one year's estimated disbursement requirements for agreed activities, provided cash flow estimates for any given period are submitted well in advance by UNIDO (preferably three months).

5. The details related to cash flow estimates and cash transfers will be agreed between UNIDO and the Treasurer of the Fund.

6. This amendment supersedes those relevant stipulations of the agreement which relate to commitments and transfers of contribution payments.

Signatures

For the Executive Committee　　　　　For UNIDO

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Date:　　　　　Date:

AMENDMENT TO THE AGREEMENT BETWEEN THE EXECUTIVE COMMITTEE OF THE (THEN INTERIM) MULTILATERAL FUND FOR THE IMPLEMENTATION OF THE MONTREAL PROTOCOL AND THE UNITED NATIONS DEVELOPMENT PROGRAMME (UNDP), SIGNED ON 21 AUGUST 1991

1. For purposes of making commitments in respect of agreed activities, UNDP shall consider as resources at its disposal:

   a) contribution payments in cash transferred to UNDP by the Executive Committee through the Treasurer of the Fund (UNEP), and

   b) resources allocated to UNDP by the Executive Committee, held by the Treasurer on behalf of the Executive Committee in irrevocable promissory notes.

2. Resources held and allocated to UNDP by the Treasurer of the Fund shall be considered by UNDP to be available for purposes of making commitments after UNDP receives written confirmation to this effect from the Treasurer.

3. Cash transfers will be made by the Executive Committee through the Treasurer to cover the disbursement requirements of agreed activities. These will be based on periodic cash flow estimates submitted by UNDP.

4. The Executive Committee shall ensure, through the Treasurer of the Fund, that adequate cash is made available to UNDP in advance to cover at least one year's estimated disbursement requirements for agreed activities, provided cash flow estimates for any given period are submitted well in advance by UNDP (preferably three months).

5. The details related to cash flow estimates and cash transfers will be agreed between UNDP and the Treasurer of the Fund.

6. This amendment supersedes those relevant stipulations of the agreement which relate to commitments and transfers of contribution payments.

Signatures

For The Executive Committee	For UNDP
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Date:__________________.	Date:__________________