Risk Management at the World Bank Group

What IEG Evaluation Tell Us

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In recent years, the World Bank Group has come to recognize risk management as a central tenet of its own business strategy as well as an emerging development priority for lower- and middle-income countries. Independent Evaluation Group (IEG) evaluations shed light on both these dimensions of risk management.

Managing Risks to World Bank Group Business

In its everyday business, the Bank Group faces three broad sets of risks — corporate, financial, and operational. Corporate risks concern the Bank's predominant country-based model, its organization, and internal accountabilities. Financial risks affect the Bank's financial capacity including the structure, efficiency, and long-term viability of its various funding models. Operational risks encompass the range of risks factors – fiduciary, governance, social, and environmental -- that affect the relevance and effectiveness of Bank Group operations.

Corporate Risks. Weaknesses in the Bank's matrix organization pose risks to its emergence as a world-class "solutions bank" — one that delivers high-quality services that tailor global knowledge to local needs. Deeper reforms are needed to strengthen the country-based model. The matrix is currently imbalanced. Operational demands in countries and regions - and lending pressures - take priority. The sector side is not succeeding in creating global technical practices with world-class knowledge systems. Multiple quality control layers and diffused accountabilities have not ensured the quality of operations (either at entry or during supervision). IEG has also identified increased risk aversion on the part of operational teams, reduced resources to Regional sector units, disincentives to undertake cross-sector collaboration, and growing dependence on donors to finance core knowledge work. Efforts to modify the matrix (such as the creation of the Sustainable Development Network) have added further stress. Strengthening of institutional and staff incentives, quality and budget processes, and structures are needed to realize the matrix's potential, and strengthen the country-based model (IEG 2012a).

Bank involvement in global and regional partnership programs (GRPPs) is growing along with its exposure to strategic, governance, conflict-of-interest, and reputational risks. Stronger oversight and risk management is needed to ensure coherence and consistency with country programs. As a means of supporting global and regional public goods, the Bank is supporting nearly 85 global and 35 regional programs. GRPPs often entail alternative financing and governance arrangements in which the Bank plays multiple roles (such as convener, trustee, and implementing agency). In addition to giving rise to potential conflict-of-interest and reputational risks, these arrangements can demand a significant amount of senior management time. Their tenuous linkages to country programs may pose operational risks as well. A stronger risk framework would involve an updated GRPP database; guidelines for Bank staff working on GRPPs and serving on their boards; adequate budgetary resources for effective oversight; and regular reporting on involvement in GRPPs (IEG 2011d).

Financial Risks. Key financial risks identified by recent IEG studies include IBRD's limited headroom, limited prospects for a General Capital Increase, and fiscal pressures facing donors in the run-up to IDA17. The magnitude of recent lending, the decline in global interest rates, the use of traditional instruments and their low rates has left the Bank with limited headroom to accommodate further crisis response in middle-income countries should it be needed (IEG 2010c and IEG 2012b).

Trust funds (TFs) are a significant source of concessional financing for World Bank and International Finance Corporation (IFC) business. The priority should be to reduce fragmentation of trust funds and to focus mobilization efforts around funds that complement — rather than substitute — Bank operations. As far as concessional resources are concerned, total trust fund contributions exceeded their International Development Association (IDA) contributions in each of the last three replenishment periods. However, the bulk of this increase was channeled through Financial Intermediary Funds (FIFs) over which Bank has no supervision or oversight. Since funding for FIFs are often financed from the multilateral aid budgets of donor countries, they may risk competing with IDA. The Bank should strengthen its framework for FIFs; and more effectively organize remaining TFs into three channels – multidonor, multi-recipient umbrella facilities; country-specific TFs; and GRPPs (IEG 2011b).

Operational Risks. Despite the attention given to fiduciary risks in recent years, the Bank is still evolving a framework that not only manages risks, but also encourages innovation. Over the years, the Bank's approach to assessing the risks of country public financial management and procurement systems has improved considerably. More recently, under the Governance and Anticorruption (GAC) Strategy, the Bank scaled up the Integrity Vice Presidency's work on investigations, sanctions and debarments, and preventive services. Other units also contributed to GAC-in-projects tools. But these focused mainly on transaction level risks in investment projects rather than on country systems risks such as those used in policy-based lending. Systematic improvements in the use of measures to manage GAC risks in projects (for instance, preventive measures against fraud and corruption) are yet to be achieved. Perceived tensions between GAC goals and lending goals remain. The Bank requires a streamlined approach to assessing systems-level risks across instruments and to setting risk appetites for lending in different settings (IEG 2008a, IEG 2010a, and IEG 2011c).

Equally important are efforts to avoid or mitigate large-scale social and environmental risks in projects financed by the World Bank Group through safeguards and sustainability policies. To date, categorization of risks has not been consistent and monitoring of results has not been thorough. A compliance-based approach is less effective as the Bank's portfolio evolves beyond traditional investments. Greater emphasis on ownership among sovereign and private sector clients can yield results. Bank policy frameworks should also harmonize thematic coverage across the institution; enhance relevance to client needs and capacities; and strengthen montoring and evaluation (M&E), disclosure, and redress (IEG 2010b).

The Bank has ramped up its assessment of policy economy and governance risks on its own projects. Similar assessments of policy reforms should be done more systematically and disclosed. Over the 2008-10 period, the Bank saw a systematic increase in the number of projects in which it supported political economy analyses (PEA). IEG's evaluation of the GAC strategy confirmed a positive correlation between the use of PEA and evaluators' assessments of 'goodness of fit' to country context. Uses of PEA in policy dialogue are still varied. More systematic assessment and disclosure of policy economy incentives for reforms — while sensitive — can serve to enhance the Bank's credibility as an impartial broker of public dialogue on policy reform (IEG 2011c).

Helping Countries Manage Developmental Risks

There is growing recognition of the need to help countries manage development risks and promote sustainability. The food, fuel, and financial crises, as well as natural disasters in the 2000s underscored the importance of responding rapidly in the short-term to macro- and micro-economic shocks. In the years following the crisis, the Bank responded quickly — with unprecedented levels of financial support — to help countries respond to macro-shocks through effective sovereign risk management and countercyclical policies. The efficacy of Bank Group responses was a function of adequate financial headroom, sufficient risk appetite, and prior knowledge of countries' economic circumstances (including poverty and distributional issues). Equally important were social safety net (SSN) programs that provided much needed liquidity and short-term employment. When institutionalized, SSNs can also discourage negative mechanisms for coping with setbacks. In natural disasters, the Bank has most frequently relied on loan reallocations — and more recently standby loans and insurance pools — to meet short-term liquidity needs (IEG 2010c, IEG 2011a, and IEG 2006)

Over the long-term, countries can become resilient to shocks by securing the economic and social fundamentals of sustainability: for instance, fiscal and debt sustainability, structural reform and a robust investment climate, investment in human development and infrastructure, state building, and environmental sustainability (IEG 2010c and IEG 2012b). For instance:

- The Bank has made progress in integrating climate vulnerability into country assistance strategies, but there is still need to incorporate climate risks (both current risks and increased risks from climate change) into project design and appraisal. Ultimately, such resource allocation decisions need to be climate-aware and rational in the face of potential climate risk and able to respond when those risks materialize. There is also a need to ensure that there is sufficient capacity and support to populate and sustain institutions and appropriate technologies for long-term adaptation planning and implementation. The Bank is still searching for financial products that better manage catastrophe risks.

- Ultimately, the only way to address fiduciary and governance risks in countries is to help build institutional capacity, particularly in Africa and in fragile states. Support for public financial management systems improved, but priority should be given to reducing sectoral bottlenecks. Low civil service pay is a pervasive problem that urgently requires pragmatic solutions. Efforts to remove administrative bottlenecks to the investment climate expanded, but need to be systematically monitored. There is scope for innovation of the Bank's support modalities to civil society (IEG 2011c; IEG 2008b).

The Bank's guarantee and insurance instruments are meeting growing demand for risk mitigation in diverse contexts. These instruments, which promote private investment, should be strengthened with clearer mandates, improved marketing, and enhanced awareness. The Multilateral Investment Guarantee Agency fills a gap in privately provided political risk insurance (with $17 billion in guarantees issued to date). The Bank's partial risk guarantee has supported large and complex public-private partnership infrastructure projects in high-risk countries. Its partial credit guarantees have introduced countries to commercial markets or reintroduced them following a crisis. IFC guarantees have led its entry in the market for local currency finance and have helped improve access to finance for underserved market segments. Taken together, these instruments can be better integrated with traditional Bank lending to meet the needs of clients.

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