

**Feasibility Issues For A
Biodiversity Trust Fund For
Madagascar**

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I. Introduction

This report is based on a consultancy visit to Madagascar February 6-23, 2001. During this visit I met collectively and individually with most of the members of the Sustainable Finance Committee that has been established to advise the government on issues related to sustainable finance for the 3rd National Environment Program. I also met with several donor agencies (USAID, World Bank, German Embassy) and representatives of environmental NGOs (WWF, CI). Barry Spergel, WWF/US Director of Sustainable Finance accompanied me to many of these meetings and officers of Investco also attended several meetings. Andy Keck, IRG/PAGE, organized my program and along with Robert LeBlanc provided invaluable assistance to this effort.

Objectives: The purpose of my consultancy was twofold: 1) to identify key feasibility issues related to the possible establishment of a Biodiversity/Protected Areas Trust Fund in Madagascar; 2) to provide options and/or specific recommendations regarding many of these feasibility issues. It is anticipated that the key elements of this report will be incorporated, along with Mr. Spergel's recommendations, into a broader report that Investco will prepare for the Sustainable Finance Committee.

Feasibility issues for a new trust fund can best be reviewed within the context of five broad themes that are traditionally viewed as the five basic aspects of trust funds throughout the world: a) Context and Strategy; b) Governance; c) Program Management; d) Asset and financial Management; and e) Fundraising.

II. Key Issues Regarding Context and Strategy

Issue #1: Scope of a new trust fund

How broad should the scope of a new fund be? Interested parties in Madagascar have introduced several initial concepts:

- A Biodiversity Fund that might encompass many/most elements of the new EP3 program.
- A Protected Areas Fund (that might include protected forests and privately-owned protected areas).
- A National Parks Fund (that might include only the national network of protected areas).

Discussion: Many successful trust funds have started with an activity or program core. Initial donors who provide funds for a new endowment normally insist on financing a very discrete set of program activities rather than a broad range of activities.

After the new trust fund and its program management has been functional for several years and the trust fund has earned a reputation for transparency and solid program management, donors often suggest new and broader responsibilities (“new program windows”) for the trust fund (viz. Peru, Bolivia, Indonesia). These new programs can be absorbed if the original legislation and the articles of incorporation for the new trust fund have been written broadly (“to conserve biodiversity in Madagascar”) rather than narrowly (“to conserve the national park system”).

Initial Recommendation and sources of additional information : Establish the legal objectives of the trust fund in broad, flexible language. But begin trust fund activities focusing on a much smaller “core” program, such as support for the National Park System. Examples of trust funds that have started with a core program and gradually grown larger to take on additional program responsibilities will be visited by the committee during the study tour visits to Costa Rica and Mexico.

Issue #2: Is a trust fund the most appropriate funding mechanism for financing some of Madagascar’s biodiversity needs?

Discussion: Normally donors provide funding for conservation and environment needs via “projects” which have a 4-5 year time span. Projects provide major amounts of capital and technical assistance that are needed to accomplish discrete objectives within the 4-5 year life of the project.

A trust fund is established ONLY where there are much longer-term conservation needs. Typically a trust fund is established for financial needs that will continue for at least 20-30 years. Also a trust fund is normally established when the annual funding needs are much smaller than a typical project - say \$1-2 million/year that would be generated by a well-invested endowment of \$20 million.

The Madagascar system of protected areas has been established to benefit the citizens of Madagascar (and the world) in perpetuity. Protected areas rarely generate sufficient revenue through fees to cover their operating costs, even in heavily visited parks in the United States. Given the global benefits of Madagascar's unique biodiversity, there is a strong rationale for a multilateral donor, such as the GEF, to provide endowment funding that is essential to ensure the long-term sustainability of Madagascar's protected areas system.

During EP1 and EP2, the GEF has helped to create and finance the operating costs of ANGAP and the protected areas system. In EP3- the final phase of this 15-year program- it seems appropriate for the GEF (and other donors) to establish a permanent endowment that would ensure long-term sustainability of the protected areas system by financing a significant portion of annual operating costs. Without such an endowment, the long-term viability of the protected areas system would depend on an endless series of 5-year donor projects and/or GRM budget funds that are not likely to be available until economic conditions improve substantially in Madagascar. The GEF has funded endowments for biodiversity and protected areas in over fifteen countries over the past 6 years and is now the primary source of endowment funding among donors. Typically GEF-funded trust funds established to support national systems of protected areas or national park systems finance a major portion of OPERATING COSTS (not investment costs) for national parks or protected areas.

Initial recommendation and sources of additional information

A endowed trust fund is the most appropriate mechanism for ensuring the long-term sustainability of the Madagascar national parks system. The GEF is clearly the most likely source of funding for a new Madagascar trust fund. Indeed, GEF may be the ONLY donor who could provide the large amounts of funding needed (min. \$20 million). Given GEF's history in Madagascar and the evolution of the EP program, the GEF should be predisposed to consider a request from Madagascar. However, GEF funding will be contingent on Madagascar meeting the preconditions that the GEF typically requires prior to releasing funds for a new trust fund endowment.

During the study tour visit to Washington, the committee will have an excellent opportunity to discuss the possibility of a new trust fund with GEF and World Bank leaders and task managers, and to discuss the typical preconditions required by the GEF.

Issue #3: Location of the new endowment: Should it be combined with Tany Meva or established as a new trust fund?

Discussion: What are the advantages and disadvantages of co-locating a new Biodiversity trust fund with an existing “grants fund” such as Tany Meva. Mexico is a successful example where a new “parks” fund was funded by the GEF/World Bank and was co-located with a very strong and well respected “grants fund”. In Brazil, however, a new biodiversity trust fund (Funbio) was co-located with the existing Getulio Vargas Foundation that managed a diverse program. After three years, a “divorce” occurred when it became apparent that the two institutions had very different and incompatible objectives.

Normally combining a new trust fund with an existing trust fund would be expected to provide advantages of scale (e.g. use of the same staff or the same board members) and provide the benefits of the experience of the older trust fund. Would this occur if a new “biodiversity/parks” fund were placed under the same managerial “roof” as Tany Meva? What advantages would Tany Meva bring to the “marriage”?

	New Fund	Tany Meva
Context/Strategy	Fund Objective: Sustain “parks and Pas” Large in scope, a major national institution	Stimulate small NGOs/CBOs Small in scope, modest ambitions expressed
Governance	Largely private board with valuable govt. participation Board selected based on personal Board interest and focus must be PAs	Private board with only one govt. representative Much of Board “represents” attributes regions or interests Board interest to date has been NGOs/CBOs
Asset Management	Endowment in foreign exchange, invested outside of Madagascar, managed by investment firm, directed by board “investment sub-committee”	Endowment in FMG, invested largely in Madagascar. Very limited experience with use of investment firm. No investment sub-committee
Program Management	Must focus initially on Protected Areas management	Focus on NGO/CBO small grants. No PA experience.
Fundraising	Must focus on raising large-scale endowment from GEF and perhaps counterpart funds from other sources	No successful fundraising from major donors to increase endowment since initial USAID funding received

Initial Recommendation and sources of information: Per the above analysis Tany Meva would bring little relevant experience to the “marriage” and few economies of scale. The potential donor(s) for a much larger new trust fund (that will be focused on very different objectives than Tany Meva) will likely insist on establishment of a new and independent organization.

The committee can review the experience in Mexico and discuss GEF preferences during the study tour.

III. Key Issues Concerning Governance

Issue #1: Can the traditional trust fund governance structure - a Private Sector Dominated Board of Directors with limited government control - be established and function effectively in Madagascar?

Discussion: Donors typically provide endowment funds for environment/conservation programs to benefit the “people” of a nation, or a “nation”. The trust fund is expected to outlast many, many changes of government. Funds placed into a “perpetual” trust are managed by citizens who are not government officials. Most boards include only 2-3 government representatives among 15-20 board members. The few trust funds that have “failed” (i.e. Bolivia and Peru) were government dominated and lost credibility and program coherence when successive governments attempted to change the objectives of the trust fund. These two trust funds have now been reconstituted with majority private sector boards of directors and both are now flourishing.

Tany Meva’s board of directors is predominately private, with only one government representative (from the Min. of Finance). This representation is less than normally expected.

Initial Recommendation and sources of additional information: Parks fund boards dominated by private citizens have functioned well in many Latin American countries that have not had a tradition of non-paid boards of directors acting in the public trust (Mexico, Jamaica, Peru and Bolivia in recent years). There is no reason to believe that concerned private citizens cannot be found to serve as board members for a new trust fund in Madagascar. The Malagasy government, including ANGAP, should be represented on the board with 2-3 members among 15-20 in order to ensure that the government’s views are well represented.

The committee should carefully study the experience of the Mexico Parks fund to see how it’s board of directors and sub-committees function.

Issue #2: Is Madagascar’s “Law on Foundations”, established to enable the creation of Tany Meva, acceptable for a new Biodiversity Trust Fund or are amendments needed?

Discussion: My non-legal reading of the Foundation Law indicates that three broad areas of the existing law need thorough study, and possible changes: 1) limitations in the law on how trust fund assets may be invested and how proceeds may be used; 2) absence of tax-credit incentives for fundraising within Madagascar; 3) very detailed language in the law on the governance of a trust fund - language that is normally left for each trust fund to determine as part of its by-laws. Barry Spergel and Investco are providing more in-depth comments on the Foundation Law based on their legal expertise. A summary of specific concerns with the existing law is found as

Attachment A. (*andy, please add my email to investco on the law - I don't have access to it here*).

Initial recommendation and further sources of information: A thorough review of the Madagascar Foundation Law in comparison with similar laws in other countries with well-functioning trust funds (e.g. Costa Rica, Mexico) is desirable. Amendments to the existing law might be proposed as part of the broader legislative approval requirements for the EP3 program. Positive changes in the legislation would ensure that a new trust fund can be feasibly established in Madagascar. They would also benefit Tany Meva.

Issue #3: Should the new trust fund be established outside of Madagascar?

Discussion: There are very few examples of trust funds/foundations that have been established outside of the beneficiary country. As one example, Switzerland is the legal home of the Eastern Carpathians Fund that encompasses the territory of three Eastern European countries. A new fund for the Democratic Republic of Congo is being considered with its legal headquarters and board of directors located outside of the politically turbulent borders of the Congo.

The concerns that might lead a donor to insist that a new trust fund be established outside of Madagascar would be: a) absence of strong non-government citizen involvement in the design and eventual management of a new trust fund (e.g. government dominance); b) concerns about fiscal probity and the transparency of asset management and financial management; c) absence of Madagascar government agreement on establishment of a new fund that meets donor conditionality.

Initial recommendations: The first two concerns are very serious issues that must be addressed directly in the design of the new trust fund. The participation of non-government citizens in conceptualizing and designing the new trust fund has not yet begun, but needs to begin soon. Regarding fiscal probity, Tany Meva has an unblemished track record to date. However, the government's management of various "redevances" (fishing, tourism, national forest fund, road tax, mining fee) is reportedly not at all transparent and funds are not being used to meet stated objectives.

IV. Key Issues For Program Management

Issue #1: What kinds of program funding are typically provided by a trust fund and are they appropriate for Madagascar?

Discussion: Throughout the world trust funds that provide financing for protected areas or national parks typically finance a portion of “core” park operating costs - sometimes 50%, sometimes a higher percentage of these operating costs. The remainder of the operating costs is expected to be provided as “counterpart funding” by government, other donors or via cost-recovery mechanisms. This approach limits total park dependency upon the trust fund and encourages diversification of revenue sources for a park.

In Mexico, Peru and Jamaica, “parks trust funds” typically agree to finance parks costs such as core staff (the park director, conservation chief, administrator and guards), and basic operational costs (electricity, water supply, gas and vehicle maintenance). Funding agreements are usually multi-year. The trust fund typically agrees to a 3-4 year park management plan, and an overall budget. The trust fund then agrees to provide funds to parks each quarter as agreed upon in the plan. These funds are provided privately, and do not depend on government revenues or government expenditure decisions. The park manager and staff can be certain that the funds will arrive on schedule and they can plan program expenditures rationally.

Three major park system expenditures are typically NOT funded by a trust fund and must be covered from other sources: a) the remainder of operating costs; b) investment or capital expenditures to improve park trails, bridges, etc. and c) expenditures of the park system headquarters.

Finally, most trust funds are not sufficiently large to provide operating costs for ALL of the protected areas or national parks in their PA system. Therefore the park service must prioritize which parks should receive trust fund support and which parks will be financed from other revenue sources. Some trust funds (e.g. Mexico) try, over time, to “graduate” specific parks from their support, so that they can provide funds to more fragile parks.

Initial recommendation and sources of further information: ANGAP and GRM leadership should work with consultant assistance to determine the likely level of donor funding for a new trust fund endowment and what level of counterpart funding will be required by the most likely donor(s). They also will need to prepare realistic options for trust fund financing of national parks. For example, if the most likely level of endowment funding is \$20 million, one might assume an annual rate of return from endowment investments of approx. 8-10%. Once trust fund administrative expenses (15-20% of investment return) are subtracted from the gross investment return, one might estimate, for example that \$1,300,000 would be available for parks each year.

ANGAP might prioritize the use of these funds for a) category A parks; b) a combination of category A&B parks; or for a few specific parks that are most needy.

Issue #2: What Program Management Options Might be Considered during program design?

Discussion: Successful experience in other countries should encourage Madagascar to consider a variety of options for “extending” the impact of trust fund resources. For parks that are well-known internationally for their “flagship” or “emblematic” species (such as lemurs), international NGOs such as Conservation International and the Worldwide Fund for Nature might raise a dollar in private donations in Europe and the United States to “match” each dollar provided by the trust fund for these parks.

Similarly, for parks with special eco-tourism potential, the trust fund might require a “match” of one dollar from eco-tourism fees for each dollar provided by the trust fund for these particular parks. In examples such as these, realistic, innovative program management can “extend” the value of each dollar a trust fund provides.

Initial recommendations and sources of information: The sustainable finance committee should carefully review innovative sources of matching funds for trust funds in Costa Rica and Mexico and should discuss other trust fund models with GEF specialists and World Bank task managers in Washington.

V. Key Issues For Asset Management

Issue #1: Where should the endowment be invested - in Madagascar or abroad?

Discussion: The objectives of managing a trust fund's endowment (or its "assets") are normally to balance maximizing the annual income and capital growth from its investments with minimizing the investment risk associated with investing the assets in a variety of investment instruments (e.g. in an investment portfolio of bonds, stocks, etc.).

The trust fund's board of directors normally wants to disburse enough funds each year to obtain important conservation objectives, but it also must balance these needs with prudent asset management and protection of the endowment assets.

The greatest variety of financial instruments and the most sophisticated financial managers are typically associated with hard currency, international markets. Most funds have invested their assets in these international markets with a goal of achieving an annual investment return of at least 6% above the level of U.S. inflation. Many funds achieved returns substantially higher than this during the 1990s - from 8%-16%.¹ Most donors, especially the GEF, insist that the endowment they provide in hard currency be invested in hard currency in international markets. They also insist that professional asset managers be hired by the trust fund to manage these assets. Most trust funds develop a multi-year investment strategy, with the help of board members with professional investment expertise, and then negotiate an investment management contract with a professional asset manager or "portfolio manager" to achieve specific investment objectives. This manager is responsible for managing the portfolio to achieve those objectives working within the investment limitations (or guidelines) established by the board. If he does not achieve "benchmark" objectives, normally his fee (or profit) is reduced and his contract may be terminated.

Endowment assets provided in local currency, e.g. through debt swaps, are sometimes invested by trust funds in domestic capital markets, even very small markets such as Madagascar, if government regulations prohibit their transfer into hard currency. Typically these investments are more likely to be negatively affected by high rates of inflation and the uncertainties associated with oscillating small capital markets and low levels of economic growth.

Initial recommendation and sources of information: If GEF funds are provided for the endowment, the GEF will certainly insist that these funds be invested internationally and that the

¹ Experience with Conservation Trust Funds, GEF, Evaluation Report #1-99, p 34.

generally accepted asset management procedures of the GEF and the World Bank be followed by the trust fund.

If debt forgiveness or debt for nature funds is available from bilateral donors, these funds are likely to be provided in local currency. The new trust fund (and the donor) should encourage the Ministry of Finance to allow these funds to be transferred immediately into hard currency for investment abroad, in order to allow maximum flexibility for this new institution. Otherwise, the history of very modest returns from Tany Meva's domestic investments is likely to be repeated.

The sustainable finance committee will have an excellent opportunity to discuss GEF and World Bank asset management guidance during the study tour visit to Washington.

Issue #2: Who makes investment and financial decisions for a trust fund?

Discussion: The responsibility for making the key investment and financial decisions for a trust fund lies with the Board of Directors of the fund. For that reason, normally a strong board includes 2-4 board members who are bankers or financial professionals. These professionals usually also serve as members of a "investment sub-committee" of the board that makes investment recommendations to the full board.

The investment sub-committee doesn't carry out the detailed work of managing the trust fund's investment portfolio. It sets financial objectives, financial limits, and recommends approval of an investment management firm ("portfolio manager") that has day-to-day responsibility for buying and selling assets in a way that will ensure that the overall investment objectives of the trust fund are met. In some cases, an independent international consultant is hired for 1-2 weeks each year to assist the sub-committee in reviewing the performance of the investment management firm and to recommend modifications in investment objectives and guidelines.

Another major trust fund responsibility is prudent financial management of the trust fund's program and operating expense monies. This is typically the responsibility of a staff-level controller who reports to the executive secretary of the trust fund. Trust fund financial management must be "squeaky clean". The financial records of trust funds are subjected to international audit each year and financial records are published in the annual report of the trust fund. Transparency and financial probity are generally essential preconditions if a trust fund hopes to raise additional assets through international fundraising.

Initial recommendations and sources of information: Bankers, investment specialists and other financial specialists should be approached to serve as board members for the new trust fund. Models of trust fund guidelines for asset management as well as models of operational procedures for trust fund financial management can be obtained from well-respected trust funds.

VI. Key Issues For Initial Fundraising

Issue #1: What funds need to be raised externally or found locally to establish a viable trust fund? What are the most likely sources?

Normally funds need to be raised abroad or found locally for four requirements:

- a. **The Endowment:** A very large donation of capital is typically needed to “endow” a new trust fund. A minimum of \$20 million appears to be needed to support even a portion of the national park system.
- b. **Counterpart Funds:** Most donors require the host country to provide counterpart funds to demonstrate the serious commitment of the host country and host government. GEF normally requires a 1:1 match. The counterpart can be provided from a wide variety of sources (domestic and foreign).
- c. **Planning and project preparation funds:** Modest funding is needed to finance the legal and consultancy costs of preparing a trust fund proposal, the costs of broad consultations throughout Madagascar with environment/conservation organizations and others, the costs of initial training for trust fund board members and staff and all other costs essential to establishing a trust fund. Only after a new trust fund is legally established and has developed its by-laws, operational guidelines, and management structure, does the endowment donor provide the endowment funds.
- d. **Start-up Costs:** Many new trust funds have solicited and received grant financing from a donor to cover the start-up and operating costs of a new trust fund for the first 2-3 years of operation. Without these start-up funds, a new trust fund is obliged to use up all the investment returns from its asset investments. If start-up funds are available, the initial endowment is left to grow for the first 2-3 years of trust fund operation. For example, a \$20 million endowment would grow to about \$24 million (or by 20%) over three years at a conservative 6% rate of return on investment.

Possible sources of funding:

Very preliminary discussions with each of these donors indicates their interest in supporting a new trust fund that would support the national parks system. Levels of funding that will probably be needed are in parenthesis.

Endowment (\$20-40 million): GEF is the only feasible donor to provide this level of endowment funding. The overall GEF program is being reduced because member countries have not made

planned contributions to the GEF. Nevertheless, Madagascar is a high priority country for the GEF and an endowment would consolidate the positive results of its previous support for ANGAP.

Counterpart funds (\$20-40 million): Sources of counterpart funds could include German government debt forgiveness, GRM budget allocations, park entrance and other fees, contributions from private donors via CI or WWF, and the national petrol tax. Trust fund planners need to quickly determine how flexible the GEF might be in how it defines counterpart funds for this proposed endowment.

Planning and project preparation: (\$1-2 million): USAID grant funds via IRG/PAGE are already being used for this purpose and might be extended and expanded to allow IRG/PAGE to continue this work beyond June, 2002. Other possible sources of planning and project preparation funds include grant support from the MacArthur Foundation, IBRD loan funds from EP II, and in-kind technical support from WWF, CI and other international environment NGOs.

Start-up Costs and continuing technical assistance (\$4-5 million over three years): USAID, MacArthur Foundation, possibly other bilateral donors might provide these funds.

VII. Summary Of Feasibility Issues

This report identified many key issues that must be addressed in establishing a new trust fund in Madagascar. None of these issues, however, appear to be insurmountable if endowment funding is available from the GEF.

A concerted effort will be required over the next 18-24 months to address these issues in a carefully planned manner. The ultimate objective will be for the trust fund to be funded and operational by the beginning of EP III so that there is no hiatus in funding for the national parks system.

A first step appears to be for the Sustainable Finance Committee to strongly recommend that the establishment of a new Biodiversity Trust Fund should be the GRMs highest Sustainable Finance program priority in planning for EPIII. Other sustainable finance programs may well be desirable and feasible, but they are likely to be smaller in size and impact than a new trust fund.

A subsequent step should be to encourage the involvement in planning the new fund of Malagasy citizens who are not government officials - and the establishment of a mixed commission (non-govt/govt) that will take the lead in developing the new trust fund. Normally this commission would also hold informational meetings throughout Madagascar to introduce and debate the concept of the new trust fund. This process hopefully will lead to the greater involvement of non-government individuals and organizations throughout the country in the planning and development of the new trust fund.

Meanwhile the more technical requirements for meeting GEF preconditions and for establishing the new trust fund can proceed with donor technical assistance. The calendar for achieving milestones in establishing the new fund will depend primarily on the requirements of GEF, as the primary donor. Madagascar can benefit from the previous experience of other trust funds (esp. Mexico, Peru, Bolivia and Indonesia) and may want to use these successful trust funds as operational models for this new fund.

Annex A: Concerns with the Law on Foundations

Here are the main problems in the Madagascar Law on Foundations as pointed out to me by Tany Meva in July, 2000 and per my reading. They relate primarily to taxes and investment of capital.

- a. Chapter IV --the term “a tres haut risque reconnue comme tel pour le milieu financier”. Does this mean that the Malagasy financial community will be judging whether a Wall Street investment is of very high risk? The language would appear to apply to investments in Madagascar.
- b. Chapter V -Taxes: I’m not clear about the relationship of this chapter to the Code General des Impots. What taxes must be paid and what taxes might not be paid if certain conditions are met by the foundation? Have these conditions been met to date by Tany Meva and allowed by the Min Finance?
- c. Article 32: Deductibility of Contributions: Again, I’m not clear if this language does enough to encourage private contributions to a foundation. Has it led to any personal contributions to Tany Meva that have been tax- deductible in Madagascar?
- d. Article 38 (4): This seems to limit the duration of a grant made by the foundation to 3 years. This might be a useful norm, but it should permit exceptions. This is an example of where this legislation is too prescriptive regarding the governance and operations of a foundation. This is better left to the By-laws.
- e. Art 38 (6): Inflation: This would appear to refer to inflation in Madagascar, but it isn’t clear. As written this language would seem to require that dollars in the endowment invested in the U.S. would need to be set aside, say at 10% of the foreign exchange value, if inflation in Madagascar was 10%. Obviously this is perverse. Tany Meva has successfully interpreted this language to refer to inflation in the country where the investment has been made.
- f. Title 111:Investment of capital: Article 57: This is very directive and is probably out of date. It also appears to be referring to the Madagascar market, rather than considering the variety of investment options now available on the international market.
- g. Art 57 (5): What stock markets qualify as a “bourse” recognized by the Malgache state? Is this, for example, a bourse where the central bank invests its own money? How should it be defined? Is the New York Stock Exchange “recognized” by the Malgache state?

- h. Title V: Fusion: We need to look carefully at this language in case it is decided to “marry” the new foundation to an existing institution, such as Tany Meva.
- i. Chap V, Art 24: The legal reserve requirement (5% of investment return must be applied annually until an amount equivalent to 10% of the total endowment is set aside in a reserve for possible dissolution) duplicates the objectives of other provisions of the law that prevent any reduction of the endowment capital. No other foundation that I have reviewed must follow such a “reserve” restriction.

Perhaps some of these issues will be clarified via a reading of the law in Malagasy.