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Enabling poor rural people
to overcome poverty

Introduction of IFAD Blend Lending Terms

Some Questions, Comments, Answers and Responses

Note to Executive Board representatives

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For: **Information**

Introduction of IFAD Blend Lending Terms

Some Questions, Comments, Answers and Responses

1. **Question**: What is the place of the proposal on blend/hardened terms in the overall financial package for IFAD9?

   Answer: The financial sustainability of the Fund determines that IFAD cannot rely as heavily in IFAD9 as it did in IFAD7 and IFAD8 on the use of internal resources to expand the resources available for the lending and grants programme. Nonetheless in the first session of the IFAD9 Consultation representatives called upon IFAD to explore areas in which internal resources could be increased. Correspondingly, to maintain and expand the programme of assistance, which is, of course, focused on the poorest countries, IFAD is seeking an increased contribution level for the IFAD9 replenishment and a modest increase in resources that will be available on the basis of loan reflows, not least to counter-balance the financial effects of the fact that IFAD is disbursing money to borrowers much more quickly. The proposed adoption of the blend term lending instrument addresses the contribution of enhanced loan reflows, including the acceleration of reflows to make resources available for commitment sooner.

2. **Question**: What does the proposal mean for borrowing countries?

   Answer: For the large majority of countries already borrowing on highly concessional terms it would mean that more resources are available. It would have no financial cost impact. For countries eligible for the existing intermediate terms instrument (that would disappear under the proposal), the fact that the new blend term instrument would be on a fixed interest basis may offer advantages over the variable interest rates of the existing intermediary terms loan instrument as the reference inter-bank rate rises. Some countries whose last loan was on highly concessional terms may find themselves eligible for the blend term instrument in new loans made under the proposed framework. These countries may have since passed the threshold for highly concessional loan terms, and the relevant reference point in considering the terms of future loans is, therefore, not highly concessional terms, but the existing intermediate terms loan product The ordinary terms lending instrument would remain unchanged.

3. **Question**: When would the proposed change in lending terms be implemented?

   Answer: As part of the IFAD9 financing package, they would be applied from 2013 onwards.

4. **Question**: Would the proposal affect the terms of existing loans?

   Answer: No. The proposed terms would be applied to eligible new loans starting in 2013.

5. **Question:** Why aligning IFAD lending terms with IBRD/IDA? What are going to be IFAD's comparative advantages for borrowers in international lending processes if its terms are as hard as those of other IFIs? [Question provided by List C]

   Answer: IFAD's comparative advantage in in the IFI system is its focus on and successful experience in developing programmes, projects and policies providing support to governments in their efforts to address rural poverty and food insecurity through smallholder development. From the outset, its terms of lending were harmonized with those prevailing in the IFI system as a whole, particularly with the global IFI providing concessional lending for development. IFAD currently has four lending terms (highly concessional, hardened, intermediate and ordinary) and all are aligned with IBRD/IDA and international financial institutions. This alignment is mandated in IFAD's "Lending Policies and Criteria", Chapter IV: Lending Terms and Conditions, and the lending terms offered are also in line with lending terms offered by the regional development banks, AsDB and AfDB.

IFAD's current terms are aligned as follows:

- Highly Concessional: As indicated in Paragraph 31(a)(i) of Lending Policies and Criteria, member countries "having a gross national product (GNP) per capita of USD 805 or less in 1992 prices or classified as International Development Association (IDA)-only countries, shall normally be eligible to receive loans from IFAD on highly concessional terms".
- Ordinary and Intermediate: These loans are provided in line with the "variable ordinary interest rate of international financial institutions" (paragraph 33(a)) which, in the case of Intermediate loans, is applied at 50%.
- Hardened: The Governing Council (February 2010) in its resolution 158/XXXIII gave the Executive Board the authority "to create a category of lending terms similar to the hardened terms offered by the International Development Association (IDA)".

Nevertheless, IFAD does not charge a commitment fee on any of its lending terms (unlike IBRD/IDA) and offers options on grace and maturity periods. (it is worth noting that two members have, in recent months, asked IFAD management if IFAD's terms could be further aligned with IBRD/IDAs to make IFAD's terms more competitive).

As recorded in the Recommendations in the Middle Income strategy paper presented to the EB in May 2011, IFAD would "Develop for each interested MIC a more customized (country-specific) and differentiated menu of policy, project and financial interventions, to be brought to the Executive Board, in response to country needs and within IFAD's mandate". This would give the opportunity to develop new loan 'products', available to all members, more specifically suited to activities in the agricultural sector e.g. value chain development.

6. **Question:** How does IFAD calculate the terms on which a country receive its loans from the Fund? [Question provided by List C]

Answer:: IFAD calculates lending terms for each member country on the basis of the GNI/capita as indicated IFAD's "Lending Policies and Criteria", Chapter IV: Lending Terms and Conditions.

Specific GNI/capita thresholds, initially set at 1992 prices, establish the point at which IFAD member countries progress through the lending terms and which are updated annually using the OECD annual inflation factor. Once these inflation-adjusted thresholds are established they are compared against the GNI/capita for each member country as provided by the World Bank. For 2011, all countries under the $1,337 GNP/capita threshold are eligible for highly concessional loans> For intermediate terms the threshold is $2,169. All countries over that level are eligible to receive loans on ordinary terms.

For 2012 the thresholds have been updated and are $ 1,355 for HC and $2198 for Intermediate.

7. **Question:** In the paper, reference is made to expectations of growth in certain countries for 2012, and 2013. Which figures did the Fund use, taking into consideration that the final estimate for the World Bank on growth for 2012 is still not available? [Question provided by List C]

Answer: The document for review by the Executive Board entitled Introduction of IFAD Blend Lending Terms does not include growth projections (see paragraph 4 of that document). Lending terms to be embodied in specific loan agreements will reflect actual published national income figures.

8. **Question:** Are there differences in the criteria used by IFAD and IDA for the transition of countries lending terms from highly concessional to intermediary (hardened terms)? If so, which are they? [Question provided by List C]

   Answer: In general, IFAD member countries, as per IFAD Lending Policies and Criteria, progress to IFAD intermediate or hardened terms if the country is no longer IDA only eligible, in line with IDA member countries. As IFAD also applies a GNI/capita threshold of $1,337 in 2011 (based on the OECD inflator) there may be some countries e.g. India, that remain classified as highly concessional by IFAD yet have moved to hardened terms with IDA. This difference in thresholds between IDA and IFAD is due to a fine-tuning produced by using the OECD inflation index rather than the Worlds Bank index and this is usually harmonised within 1-2 years.

9. **Question:** The process related to the definition of lending conditions for each country takes into account it's GNP/capita. On the other hand,
   it considers also particular cases of countries that have just emerged from conflicts, particularly those which generated a significant degradation of infrastructure and social nets. By aligning its lending terms to IDA/IBRD, IFAD will continue to consider these aspects? [Question provided by List C]

   Answer: The IBRD/IDA (and the regional development banks) does not address post conflict status through lending terms but through increasing country allocations in their respective PBAS systems. IFAD follows this approach and, where determined by the IDA post-conflict assessment, will increase PBAS allocations by up to 100%. Where countries are assessed as being at risk of not being able to sustain loan repayments by the IMF/World Bank their lending terms are categorised as 'grant only' under the Debt Sustainability Framework (DSF). IFAD also applies this to its financing terms.

10. **Comment**: According to the IFAD's recently proposal, there will be only three lending terms from mid-2012 onward that are: highly concessional (HC) blend (or blend/hardened), and ordinary. Therefore, if one country is no longer be eligible for HC term (no longer a low-income countries), they can only borrow from IFAD on Blend term/or Ordinary term.

    For those countries that just recently achieved the status of middle-income countries, but at a lower level (their GNP per capita just a little above 1000 $ only), the status of middle-income countries is quite fragile and not sustainable. Therefore, if they are not receiving further concessional loans from international community, the on-going projects including those funded by the IFAD in the country will be negatively affected and consequently they are risky of falling back into the low-income countries category. [Comment provided by List C]

    Response: IFAD does not use low income or middle income status to establish lending terms. As noted above, the 2011 threshold for IFAD HC terms is a GNI/capita of $1,337. Those countries moving out of highly concessional terms, in any of the IFIs, would move first into blend terms before, ultimately, moving to ordinary/IBRD status. The transition is progressive and if the country's economic growth falters (or is affected by broader external events) then the GNI/capita may well be revised downwards by the World Bank.

    The majority of IFAD member countries receive financing from IFAD either on highly concessional terms or on grant terms (through the DSF process).

11. **Comment**: On the other hand, even though IFAD has already recognised the need to offer more varied lending products to its members, the new proposal consists of a decreased number of options for borrowing countries, if both current intermediate and hardened terms become blend/hardened terms.

Response: IFAD's existing intermediate terms and the proposed blend terms are similar but, as noted above, following the Executive Board approval of IFAD's Middle Income strategy , the possibility now exists to consider creating new type of lending products both for MIC and for all other member countries.

12. **Comment:** Therefore, some list C Members suggest that IFAD maintain the current applied lending terms (HC, intermediate, hardened, and ordinary) to ensure the transitional periods for those countries just jumped out of low-income category to enable them to achieve a sustainable poverty reduction. On the other hand, this will allow more time to study on the possible impacts of the new proposed lending terms. [Comment provided by List C]

Response: The introduction of hardened terms in 2010 was linked directly to the terms and eligibility conditions used at that time by IDA. IDA has, since July 1st 2011, ceased to offer the 'hardened' terms that IFAD had also introduced, and has replaced them with the blend/hardened terms. Several member countries have already accepted loans from IDA on the new blend/hardened terms, and it is anticipated that the respective Ministries of Finance have been able to make an initial analysis of the impact of the new terms, recognising that the terms still remain concessional compared to IBRD/ordinary terms.

The inclusion of the 'intermediate' term at IFAD's inception recognized the need to have a transition for member countries as they progressed from highly concessional to ordinary terms. The earlier blend and hardened terms introduced by IDA were a reflection of the same objective. The eligibility criteria that have been consistently maintained by IDA, the need to have a GNI/capita above the highly concessional threshold for two or more consistent years, reflects this: a country's GNI/capita needs to move through the threshold for more than two consecutive years to be eligible for the blend/hardened term. If there is not this evidence of a consistent change in a country's economic position, the new terms are not, and would not, be applied.