Document: EB 2012/107/R.31/Rev.1
Agenda: 14(b)
Date: 13 December 2012
Distribution: Public
Original: English

E

Enabling poor rural people to overcome poverty

Review of the Lending Policies and Criteria

Note to Executive Board representatives

Focal points:

Technical questions:

Iain Kellet
Chief Financial Officer and Head
Financial Operations Department
Tel.: +39 06 5459 2403
e-mail: i.kellet@ifad.org

Kevin Cleaver
Associate Vice-President, Programmes
Tel.: +39 06 5459 2419
e-mail: k.cleaver@ifad.org

Rutsel Martha
General Counsel
Tel.: +39 06 5459 2457
e-mail: r.martha@ifad.org

Dispatch of documentation:

Deirdre McGrenra
Head, Governing Bodies Office
Tel.: +39 06 5459 2374
e-mail: gb_office@ifad.org

Executive Board — 107th Session
Rome, 12-13 December 2012

For: **Approval**

Recommendation for approval

The Executive Board is invited to submit to the thirty-sixth session of the Governing Council the resolution contained in paragraph 36.

Review of Lending Policies and Criteria

I. Background

1. The Lending Policies and Criteria were amended by the Governing Council on several occasions between 1994 and 1998, but the document has not been updated or reviewed since that time. In 2010 the Governing Council instructed the Executive Board to "submit to the thirty-fourth session of the Governing Council in 2011 revised Lending Policies and Criteria that shall take into account all developments since the last revision of the Lending Policies and Criteria in 1998 and express concisely and clearly the broad policies and criteria applicable to financing by the Fund."[1]

2. The Governing Council considered document GC 34/L.8 on the Revision of IFAD's Lending Policies and Criteria at its thirty-fourth session and, on 19 February 2011, decided to defer the adoption of the relevant resolution to the thirty-fifth session of the Governing Council in February 2012.

3. Meanwhile, as part of the Consultation on the Ninth Replenishment of IFAD's Resources (IFAD9), which took place during 2011, Management presented a paper (EB 2011/104/R.61) proposing the introduction of a new "blend terms" product in line with the blend terms product adopted by the International Development Association (IDA). Although the proposal was well received by the Executive Board, it was felt the IFAD would benefit from a broader review of its lending policies and criteria with a view to producing one document which pulled together definitions of criteria governing qualification for different IFAD lending products and the terms and conditions of those products.

4. Guidance was given that IFAD Management, as an overarching principle, should align its products with those of IDA and other comparable International Financial Institutions however due regard should be paid to IFAD's specificity.

5. Accordingly, two working groups were set up: an Executive Board working group to review and recommend a blend terms product and a Management working group to review the other lending products and consider whether they met the above criteria or, if not, whether they should be modified.

6. The output of the Blend Terms Working Group was presented to the Executive Board at the 106th session in September 2012 and approved. This paper represents the conclusions of the management working group and includes the legal instrument for approval to implement the revised policies.

7. At this point in the organization's development, it would be impossible to fully incorporate all pertinent factors governing IFAD's lending terms and criteria into a single document because there are simply too many of them. This paper therefore concentrates on the financial terms of the lending products, and makes reference to other policy documents written since the original Lending Policies and Criteria were compiled which are also relevant to determining IFAD's lending terms and criteria.

[1] Resolution 158/XXXIII

8. This paper, therefore, is a rethink, but not a major revision, of the document on the Revision of the Lending Policies and Criteria (GC 34/L.8) presented to the Governing Council in 2011, and supersedes it. It incorporates the recommendations of the blend terms paper approved by the Executive Board in September 2012 (EB 2012/106/R.29/Rev.1) and does not propose any change to or delegation of authority to approve amendments to IFAD's lending terms.

II. Introduction

9. IFAD's Lending Policies and Criteria is the organization's second most important legal document, after the Agreement Establishing IFAD (the "Agreement"). It was originally adopted in 1978 and has been amended on several occasions, most recently in 1998.

10. The authority for the Lending Policies and Criteria derives from article 7, section 1(e) of the Agreement, which provides as follows:

> "Subject to the provisions of this Agreement, financing by the Fund shall be governed by broad policies, criteria and regulations laid down, from time to time, by the Governing Council by a two-thirds majority of the total number of votes."

11. Paragraph 3 of the Lending Policies and Criteria states that "[t]he policies and criteria outlined in this document reflect only the initial attempt to translate these objectives and policies into concrete criteria and guidelines. These will be reviewed periodically in the light of actual experience."

12. As this document was produced at a time when the Fund had yet to commence operations, it was necessary for the Governing Council to spell out the policies and criteria in great detail. In view of the policies and practices developed by the Executive Board over 34 years of subsequent experience, that level of detail is no longer necessary and the document has been superseded.

13. A review of the Lending Policies and Criteria demonstrates that it no longer fully reflects the Fund's objectives and priorities. Paragraph 21, for example, states that the Fund "will not seek to develop a pattern of country allocations; it will, instead, designate a number of priority countries for programming purposes" – an approach that was abandoned with the adoption of the performance-based allocation system (PBAS) in 2003. Similarly, paragraph 50 states that "IFAD will, from time to time, ask independent agencies to evaluate its completed projects. Such evaluation will normally be the responsibility of an institution in the recipient country." This approach has since been replaced with evaluations carried out by the independent IFAD Office of Evaluation. Annex II hereto explains how the existing document has been superseded by various policies adopted by the Executive Board over the years.

14. Against this background, in 2010 the Governing Council instructed the Executive Board to "submit to the thirty-fourth session of the Governing Council in 2011 revised Lending Policies and Criteria that shall take into account all developments since the last revision of the Lending Policies and Criteria in 1998 and express concisely and clearly the broad policies and criteria applicable to financing by the Fund." (Resolution 158/XXXIII.) A working group has developed a draft that seeks to satisfy the Governing Council's requirements.

15. As mentioned, paragraph 3 of the Lending Policies and Criteria states that the document is an "initial attempt" to translate the Fund's objectives and criteria into concrete criteria and guidelines. Since 1978, IFAD has adopted policies addressing, among other issues:

    - Targeting
    - Performance-based allocation system
    - Evaluation
    - Knowledge management
    - Innovation
    - Rural enterprise
    - Rural finance
    - Climate change
    - Engagement with indigenous peoples
    - Improving access to land and tenure security
    - Sector-wide approaches for agriculture and rural development
    - Crisis prevention and recovery
    - Private-sector development and partnership strategy
    - Gender

    These policies set out the "concrete criteria and guidelines" that govern financing by the Fund, and it is these policies, not the Lending Policies and Criteria, that actually guide the President, the staff and the Executive Board in the selection and approval of projects and programmes.

16. These policies, taken as a whole, provide much more detailed guidance than the Lending Policies and Criteria possibly could. They represent the accumulated knowledge and experience developed by the Fund over its more than 30 years of existence. This process of policy development was envisaged in the original document, but unfortunately the Lending Policies and Criteria were never subjected to the periodic review in the light of actual experience prescribed in paragraph 3. The result is that many provisions of the Lending Policies and Criteria are no longer relevant for the Executive Board in conducting the general operations of the Fund.

17. The proposed new draft recognizes this. It is premised on the need to respect the exclusive power reserved for the Governing Council to establish broad policies and criteria while at the same time enabling the Executive Board to conduct the general operations of the Fund. Rather than prescribing detailed policies and criteria, it makes reference to the existing policies cited above, and explicitly delegates to the Executive Board the authority to adopt new policies consistent with the broad guidance set out by the Governing Council and the Agreement Establishing IFAD. The proposed draft therefore acknowledges the fact that a comprehensive set of policies and criteria already exist, and that primary responsibility for setting out the detailed policies governing financing by the Fund rests with the Executive Board.

III. Review of financing terms

Characteristics of IFAD lending terms, including proposed IFAD blend terms

Type	*Maturity periods (years)*	*Grace period (years)*	*Interest*	*Service*	*Concessionality charge (grant element)*[c]
Highly concessional	40	10	-	0.75%	65%
Blend terms (proposed)	25	5[a]	1.25%	0.75%	50%
Ordinary	15-18	3[a]	IFAD reference interest rate (variable)[b]	-	16%[d]

[a] The Executive Board may vary the grace period and amount for each instalment for the repayment of loans on blend and ordinary terms.
[b] As of January 2010, IFAD resets its annual reference interest rate each semester on the first business days of January and July. The IFAD reference rate applicable to loans on ordinary terms is based on a composite SDR LIBOR six-month rate of the four currencies that constitute the SDR basket (United States dollar, Japanese yen, euro, and United Kingdom pound sterling), plus a variable spread. The spread applied by IFAD is a weighted average of the spreads applied by IBRD to its variable lending rate for the same semester.
[c] Calculated using the IDA methodology for concessionality and applying current discount rates.
[d] Ordinary terms have variable interest rates and the IDA methodology cannot be readily applied to calculate the inherent grant element. To calculate approximate comparative figures, the variable interest rate has been converted to fixed rates by applying market-interest-rate swap premiums and aligned to the maturity profile of the IFAD loans plus the current IFAD spread. The grant element for loans on ordinary terms is based on a 15-year maturity.

A. Highly concessional terms

18. IFAD's highly concessional terms, which currently apply to 71 per cent of total loans, comprise a zero per cent interest rate, a 0.75 per cent service charge, 40 years maturity including a grace period of 10 years. There is no commitment fee and repayment terms are straight line from year 10 to 40. These terms are identical to IDA regular terms (see annex II) with the following exceptions: IDA is able to charge a commitment fee, although it may be reimbursable, and has more complex principal repayment terms of 2 per cent per annum for years 11 to 20 and 4 per cent per annum for years 21 to 40.

19. The net present value (NPV) of each set of repayment terms (IFAD and IDA) has been calculated under several discount rate scenarios, and the difference between them ranges up to 3 per cent depending on the discount rate used, with IDA terms being more favourable to the borrower. This does not include the impact of the commitment fee, which would narrow the gap. Any proposed change by IFAD that resulted in more favourable loan terms for the borrower, unless funded by additional contributions from Member States, would result in a reduction in IFAD's programme of loans and grants over the long term. It is therefore proposed that the existing highly concessional terms not be amended.

20. Other institutions considered as possible comparators included the Asian Development Fund (AsDF), the African Development Fund (AfDF) and the Inter-American Development Bank Fund for Special Operations (IDB FSO). All have products that are broadly in line with IFAD's highly concessional terms (see annex III).

B. Intermediate, hardened and blend terms

21. Currently IFAD offers two loan products that lie between highly concessional and ordinary terms, intermediate and hardened terms, which apply to 16 per cent of total loans. The replacement of these two sets of terms with a single blend terms product is the subject of the paper presented to the Executive Board at its 106th session held in September 2012 (EB 2012/106/R.29 and Corr.1). The recommendation that the Governing Council adopt relevant amendments to the Lending Policies and Criteria contained in that document was approved by the Board and hence is not addressed in this review.

C. Ordinary terms

22. IFAD's ordinary terms currently apply to 13 per cent of total loans. They comprise an interest rate that is set semi-annually based on a six-month SDR LIBOR composite rate plus a 0.28 per cent spread. Maturity is 18 years including a grace period of three years. There is no commitment fee and repayment of principal is straight line between years 4 and 18.

23. The above interest rate is similar to the one applied by IBRD to flexible loans. The flexible loan product allows borrowers to customize repayment terms to meet their debt management or project needs. As long as the weighted average maturity does not exceed 18 years, the final maturity can be up to 30 years including the grace period.

24. Two issues warrant consideration as potential areas of specificity for IFAD, as outlined below.

Use of IBRD spread

25. In 2010 the Executive Board approved the introduction of a rate based on a synthetic SDR LIBOR six-month composite rate, in line with the prevailing IBRD reference rates, and a spread which at the time was 0.24 per cent.

26. A spread represents the increment over the basic interest amount that a bank needs to apply in order to cover its cost of capital. In the case of IFAD, until recently all capital was made available in the form of donations and hence there was no cost of capital and no spread. In 2010 IFAD entered into an agreement with the Government of Spain whereby it received a EUR 285 million loan on broadly commercial terms. Although housed in a separate legal entity, the related loans are consolidated with IFAD loans and so from a financial perspective it would be possible to calculate a spread based on IFAD's now non-zero cost of capital, although this spread would be very small.

27. IFAD is currently undertaking a resource mobilization exercise with the intention of significantly increasing its funding from sources other than member donations. If successful, this exercise will change IFAD's cost of capital and spread. Calculations show that among the feasible outcomes of the resource mobilization exercise could be a range of spreads, from close to 0 per cent to 1 per cent.

28. As there is currently no way of knowing the outcome of the resource mobilization exercise, it is impossible to say which spread figure within this range is more correct. The recommendation of this paper is therefore that the spread should be left as is until such time as there is sufficient certainty to determine an alternate figure.

Grace period

29. The ordinary terms grace period is relatively short at three years. It is not untypical for a project to be still at the implementation stage when repayments begin to fall due. Management has analysed the impact on IFAD of increasing the grace period for loans on ordinary terms. Based on current lending levels, increasing the grace period from three to six years would result in negative resource mobilization of US$24 million over the IFAD9 period, and this negative resource mobilization would need to be offset by increased member contributions or a decrease in the programme of loans and grants.

30. In view of the foregoing, this paper does not recommend an across-the-board increase in the grace period for ordinary loans. However, the Executive Board does have the authority to increase grace periods on ordinary and blend terms loans up

to a maximum of six years in cases where the borrower's debt servicing capacity is a concern.[2]

IV. Other considerations

31. Eligibility criteria set by the Executive Board must adhere to the broad policy on concessionality set out in the revised draft, which generally follows the World Bank approach, taking into account the Fund's special mandate. The Board does not have the authority to deviate substantially from the Fund's existing practice, or from the practice of other international financial institutions.

32. The draft states that concessional loans must be provided on more favourable terms – in terms of interest rate, maturity period, fees, etc. – than the borrower could obtain from the market. In other words, in designing its lending products for concessional borrowers, the Fund can look to the market and offer loans that respond to both a borrower's needs and the changing financial environment – such loans being concessional because they are offered on terms that would not be available to that borrower in the market.

33. The policy on concessionality states that developing Member States having graduated from IBRD may receive concessional loans from IFAD subject to the availability of funds, including funds that IFAD obtains from sources other than replenishment. This approach allows IFAD to coordinate its lending to concessional borrowers with the different sources of funding (e.g. the Spanish Food Security Cofinancing Facility Trust Fund).

34. Naturally, the Governing Council will not be presented with proposals for new loan products unless IFAD Management is convinced that they both respond to a real need and ensure that the Fund remains financially sustainable. It is unlikely that IFAD will create a large number of such products in the foreseeable future; it will, as always, tend to follow the lead of the World Bank and other international financial institutions, taking into consideration its relative capacity.

V. Conclusion

35. The comparative analysis of the existing Lending Policies and Criteria and proposed Policies and Criteria for IFAD Financing presented in this document demonstrates that all of the relevant sections of the existing document have been addressed, either in other policies adopted by the Executive Board or in the current proposal. Therefore, the initial detailed translation of the objectives and policies stipulated in the Agreement into concrete criteria and guidelines is no longer necessary. The new document addresses both tasks set out by the Governing Council in resolution 158/XXXIII: (i) to take into account all developments since the last revision of the Lending Policies and Criteria in 1998; and (ii) to express concisely and clearly the broad policies and criteria applicable to financing by the Fund.

36. Therefore, the Executive Board proposes the following resolution for adoption by the Governing Council:

"The Governing Council of IFAD

Recalling Resolution 158/XXXIII, in which it decided that upon the proposal of the President, the Executive Board should submit to the thirty-fourth session of the Governing Council the revised Lending Policies and Criteria that shall take into account all developments since the last revision of the Lending Policies and Criteria in 1998 and express concisely and clearly the broad policies and criteria applicable to financing by the Fund;

[2] Subject to maintaining the NPV of the loan.

Having reviewed the proposed Policies and Criteria for IFAD Financing submitted by the Executive Board as contained in document GC ....;

Adopts the Policies and Criteria for IFAD Financing, which shall take effect immediately; and

Tasks the President with maintaining a consolidated text of the policies and guidelines adopted by the Executive Board pursuant to the Policies and Criteria for IFAD Financing hereby adopted".

The amended text to the existing Lending Policies and Criteria is provided in italics.

Policies and Criteria for IFAD Financing

I. Introduction

1. *Article 7, section 2(d) of the Agreement Establishing IFAD (the Agreement) provides that "[d]ecisions with regard to the selection and approval of projects and programmes shall be made by the Executive Board" and that such decisions shall be made "on the basis of the broad policies, criteria and regulations established by the Governing Council."*

2. *In implementation of this provision, IFAD's Governing Council adopted the Lending Policies and Criteria at its Second Session in December 1978. Paragraph 3 of the Lending Policies and Criteria stated that the policies and criteria outlined in the document reflected only the initial attempt to translate the objectives and priorities set out in articles 2 and 7 of the Agreement into concrete criteria and guidelines, and that they would be reviewed periodically in the light of actual experience.*

3. *The Lending Policies and Criteria were amended by the Governing Council several times between 1994 and 1998, but the document was not updated or reviewed thereafter. In 2010 the Governing Council instructed the Executive Board to "submit to the thirty-fourth session of the Governing Council in 2011 revised Lending Policies and Criteria that shall take into account all developments since the last revision of the Lending Policies and Criteria in 1998 and express concisely and clearly the broad policies and criteria applicable to financing by the Fund."*[3]

4. *IFAD has now evolved to the point where it is not possible to set out all of the policies and criteria that guide its work in a single document. The detailed policies adopted by the Governing Council and the Executive Board, mentioned in paragraph 12 below, provide guidance to the staff of the Fund, and to its governing bodies, as they work to achieve its objective. The Governing Council, while retaining its authority to establish the broad policies, criteria and regulations that govern financing by the Fund, acknowledges that the Executive Board has the primary responsibility to set out the detailed policies governing such financing, and adopts these Policies and Criteria for IFAD Financing accordingly.*

5. *The Governing Council, exercising the authority conferred on it by the Agreement, shall monitor the work of the Executive Board in setting out policies governing financing by the Fund, and shall review these Policies and Criteria for IFAD Financing periodically to ensure that they provide a sound framework for the work of the Executive Board.*

II. Objectives and priorities

6. ***Objective.*** *Article 2 of the Agreement states that "[t]he objective of the Fund shall be to mobilize additional resources to be made available on concessional terms for agricultural development in developing Member States."*

7. ***Priorities.*** *Article 7, section 1(d) of the Agreement states that "[i]n allocating its resources the Fund shall be guided by the following priorities: (i) the need to increase food production and to improve the nutritional level of the poorest populations in the poorest food deficit countries; and (ii) the potential for increasing food production in other developing countries. Likewise, emphasis shall be placed on improving the nutritional level of the poorest populations in these countries and the conditions of their lives."*

[3] Resolution 158/XXXIII

III. Policies and criteria

8. *The following are the policies and criteria for financing which shall guide the Executive Board and the President in fulfilling the objective of the Fund:*

9. ***Allocation of resources.*** *The resources of the Fund available for financing for developing Member States shall be allocated in accordance with a performance-based allocation system (PBAS) established by the Executive Board. The Executive Board shall report annually to the Governing Council on the implementation of the PBAS.*

10. ***Programme of work.*** *Projects and programmes submitted to the Executive Board for consideration and approval shall be based on a programme of work proposed by the President and approved each year by the Executive Board in accordance with article 7, section 2 of the Agreement. In developing the proposed programme of work the President is guided by the strategic framework established from time to time by the Executive Board.*

11. ***Country criteria.*** *Projects and programmes submitted for financing by the Fund shall be based as much as possible on results-based country strategic opportunity programmes that provide a framework for making strategic choices about the Fund's operations in a Member State, identifying opportunities for Fund financing and facilitating management for results.*

12. ***Selection of projects and programmes.*** *The projects and programmes financed by the Fund are guided by the criteria set out in the policies and strategies on the following matters as adopted or to be adopted by the Executive Board:*

    - *Targeting*
    - *Knowledge management*
    - *Innovation*
    - *Rural enterprise*
    - *Rural finance*
    - *Climate change*
    - *Engagement with indigenous peoples*
    - *Improving access to land and tenure security*
    - *Sector-wide approaches for agriculture and rural development*
    - *Crisis prevention and recovery*
    - *Private-sector development and partnership strategy*
    - *Gender*
    - *Such other policies as may be adopted in accordance with the broad policies, criteria and regulations established by the Governing Council.*

13. ***Implementation of projects and programmes.*** *The implementation of projects and programmes financed by the Fund must be consistent with the regulations on the procurement of goods and services to be financed from resources of the Fund adopted by the Executive Board, and in conformity with the policies on corruption, audit and supervision adopted from time to time by the Executive Board. Financing agreements with Member States shall be subject to the General Conditions for Agricultural Development Financing established by the Executive Board. Projects and programmes are supervised by the Fund in accordance with the Policy on Supervision and Implementation Support established by the Executive Board.*

14. ***Evaluation.*** *Independent evaluations of projects and programmes financed by the Fund shall be conducted in accordance with the evaluation policy adopted by the Executive Board.*

IV. Financing terms

15. With due regard to the long-term viability of the Fund and the need for continuity in its operations, the Fund provides financing through loans, grants and a debt sustainability mechanism.[4]

(a) **Loans**

(i) The main objectives of the Fund – to reduce rural poverty, improve nutrition and increase food production – cannot be judged or realized in terms of pure economic indicators, such as food production or agricultural growth rates. Certainly Fund projects must meet reasonable standards of economic viability, but such standards do not suffice either to select future IFAD activities or to evaluate their results. Even attempts to extend the traditional cost-benefit criteria from economic to social objectives, by assigning weights to certain social objectives such as income distribution and employment, fall short of measuring the Fund's broad development objectives – to satisfy the basic needs of people living in developing countries in a self-reliant and positive social environment. The Fund will attempt to develop, over a period of time and in the light of its own experience and that of other agencies, new indicators and analytical techniques that take account of its objectives.

(ii) The Fund will provide loans to developing *Member States on highly concessional, blend and ordinary terms for approved projects and programmes.* The criteria for determining the terms to apply to a specific country shall be as specified in this paragraph.

(1) Those developing *Member States*: (a) having a gross national product (GNP) per capita of US$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. The total amount of the loans provided each year on highly concessional terms shall amount to approximately two thirds of the total amount lent annually by IFAD; *(b) which are eligible for IDA blend terms will be eligible for IFAD blend terms, provided that they are above the IFAD threshold for eligibility for highly concessional terms*; and (c) having a GNP per capita of US$1,306 or above in 1992 prices shall normally be eligible to receive loans on ordinary terms.

(2) For those developing Member States in which there is a significant difference between GNP per capita and gross domestic product (GDP) per capita, GDP per capita shall be used as the criterion for determining the applicable lending terms within the same monetary limits.

(3) The Executive Board shall take account of the impact of the recent devaluation of the CFA franc in determining which lending terms are applicable to the countries concerned.

(4) In allocating resources among countries eligible for loans on the same terms, priority shall be given to those countries characterized by low food security and severe poverty in rural areas.

(5) In determining the lending terms to apply to a country, the Executive Board shall also take into account an assessment by the

[4] Agreement, article 7, section 2(a)

President of IFAD of that country's debt sustainability and its debt-servicing capacity.

(iii) The conditions for highly concessional, *blend* and ordinary lending terms shall be as follows:

(1) Special loans on highly concessional terms shall be free of interest but bear a service charge of three fourths of one per cent (0.75 per cent) per annum and have a maturity period of forty (40) years, including a grace period of ten (10) years;

(*2) Loans granted on blend terms shall be subject to interest on the principal amount outstanding at a fixed rate of 1.25 per cent and shall have a maturity period of 25 years, including a grace period of five years, and in addition a service charge of 0.75 per cent, starting from the date of approval by the Executive Board;*

(3) Loans on ordinary terms shall have a rate of interest per annum equivalent to one hundred per cent (100 per cent) of the variable reference interest rate, as determined annually by the Executive Board, and a maturity period of fifteen (15) to eighteen (18) years, including a grace period of three (3) years;

(4) No commitment charge shall be levied on any loan;

(5) For the purposes of implementing the Heavily-Indebted Poor Countries Debt Initiative, the Executive Board may amend the terms upon which an approved loan is provided to a country.

In determining the grace period, the maturity date and the amount of each instalment for the repayment of loans, the Executive Board shall take into account an assessment of a country's debt sustainability produced under the Heavily-Indebted Poor Countries Debt Initiative;

(6) The Executive Board may vary the grace period and the amount of each instalment for the repayments of loans received on *blend terms* and ordinary terms. In so doing, the Executive Board, on information provided by the President of IFAD, shall take into account a country's debt sustainability and debt-servicing capacity. In submitting a proposal for the lending terms to apply to a country for a loan to the Executive Board, the President of IFAD shall ensure that: (i) the grace period for the loan, which shall be established in relation to the date on which a loan becomes effective and the date upon which disbursement of the loan is to cease, shall not exceed six years; and (ii) the net present value in SDR of the *blend terms* and ordinary terms specified in (2) and (3) above is maintained; and

(7) For the purposes of resolving arrears that may arise from time to time in the payment of interest or service charges and the repayment of the proceeds of loans, the Executive Board may amend the terms upon which an approved loan is provided to a country, including the grace period, the maturity date and the amount of each instalment for the repayment of loans, while securing the original net present value.

(iv) The Executive Board shall:

(1) Determine, on the basis of the variable ordinary interest rate of international financial institutions concerned with development, the reference rate of interest for application in IFAD, which shall provide

the basis for the review and revision prescribed in sub-paragraph (2) below; and

(2) Decide, annually, the rates of interest to be applied to loans on ordinary terms. For that purpose, it shall review annually the rates of interest applicable to loans on ordinary terms and revise such rates, if necessary, on the basis of the reference rate of interest in effect on 1 July of each year.

(v) Notwithstanding anything to the contrary in Resolution 77/2 of the Governing Council on the delegation of power to the Executive Board, the Executive Board is hereby vested with the authority to carry out the responsibilities specified in sub-paragraph (iv) above on the basis of the principles laid down in this document.

(vi) The composition of the Fund's lending operations on various terms of concessionality stated above, shall be related to the economic and financial capacity of the countries to which the Fund *lends*. The financial position of the poorest countries makes it imperative that the largest portion of the Fund's resources should be on highly concessional terms and should be concentrated on the poorest food-deficit countries.

(vii) Loans to countries which are not eligible for loans on highly concessional terms will be on *blend* or ordinary terms. In respect of these countries, justification for the degree of concessionality proposed will be provided in every project submitted to the Executive Board. The dominating criterion shall be the country's economic and financial situation. However, the Board might, in appropriate cases, consider the nature of the project to be financed in determining the degree of concessionality.

(viii) The Fund's grant assistance, apart from technical assistance, shall be used exclusively for the financing of projects in the absolute poorest food-deficit countries with the most severe development problems. Taking account of the very limited resources available for this type of assistance, the Executive Board will approve grant financing only for high-priority projects in countries with very severe budgetary constraints; these considerations will apply in particular to those cases where the revenue-generating effects of projects are considered unimportant but where the project still constitutes an essential element of the Fund's programmes in the country.

(ix) Technical assistance, particularly for activities *to strengthen the technical and institutional capacity essential for agricultural development*, will normally be provided on a grant basis. However, when technical assistance for feasibility studies leads to a loan provided by the Fund, the Executive Board may include the cost of such technical assistance in the loan. In addition, the Fund may provide, in cooperation with other agencies, grants for suitable activities of international, regional and national research institutions.

(b) ***Grants.*** *Grants may be provided to: (i) developing Member States; (ii) intergovernmental organizations in which such Member States participate; and (iii) other entities which the Executive Board determines to be eligible pursuant to article 8 of the Agreement. Grants are provided in accordance with a policy for grant financing established by the Executive Board.*

(c) ***Debt sustainability mechanism.*** *Financing under the debt sustainability mechanism is provided to eligible Member States in the form of grants or a combination of a grant and a loan on highly concessional terms, in accordance with arrangements for implementation of a debt sustainability framework at the Fund established by the Executive Board.*

16. **Arrears.** For the purposes of resolving arrears that may arise from time to time in the payment of interest or service charges and the repayment of the proceeds of loans, the Executive Board may amend the terms upon which an approved loan is provided to a *Member State*, including the grace period, the maturity date and the amount of each instalment for the repayment of loans, *provided, however, that no amount of principal may be forgiven and that similarly situated Member States will also be able to receive equal treatment. Other policies applicable in the case of arrears are set out in a policy framework for managing partnerships with countries in arrears established by the Executive Board.*

V. Leveraging the Fund's resources

17. The Fund *shall* attempt to multiply the impact of its own resources by undertaking projects jointly with other multilateral and bilateral agencies, *and by mobilizing resources for investment in agricultural and rural development in the developing Member States for the public and private sector*, while ensuring the realization of the Fund's own objectives and *preserving* its own independent identity in the process.

VI. Implementation

18. ***Policies.*** *The Executive Board shall establish from time to time other policies for financing that may be required or may be appropriate in order to fulfil the objective of the Fund.*

19. **Operational guidelines.** The Fund *shall* formulate, in the light of experience, more detailed operational guidelines on various policies and criteria outlined above.

20. **Implementation and review.** The Executive Board *shall* interpret and implement these policies and criteria with the necessary flexibility provided for *herein* and will review them at a future date in the light of actual experience.

VII. Reporting

21. The Executive Board shall:

    (a) Report periodically to the Governing Council on the exercise of the authority vested in it above; and

    (b) Review periodically these *Policies and Criteria for IFAD Financing* in the light of changing circumstances and, if it *so* deems necessary, recommend to the Governing Council such modifications thereto as may be appropriate.

Comparative analysis of the existing Lending Policies and Criteria and the proposed Policies and Criteria for IFAD Financing

Current Lending Policies and Criteria paragraph reference	*Comments*
I. Introduction	
1	The paragraph is retained in the revised draft. *Over the three decades since its establishment, IFAD has refined the purpose and use of IFAD resources to reflect changing needs. The changes are broadly in line with article 2 of the Agreement.* *In recent years, IFAD's overall development objective and specific strategic objectives have been periodically reviewed and agreed to by the Executive Board in the medium-term strategic framework as well as in the triennial reports on consultations on the replenishment of IFAD's resources.*
2	The paragraph is retained in the revised draft. *The Executive Board has over time adopted new eligibility criteria and guidelines for development programmes and projects in the form of strategic frameworks, country strategic opportunities programmes (COSOPs) and project guidelines, which have superseded the initial guidelines set in the Lending Policies and Criteria.* *The actual allocation of IFAD resources to each eligible country is moreover determined by the performance-based allocation system (PBAS) approved by the Executive Board, which may be adjusted from time to time. There is therefore no need to cover these issues in detail in the revised document.*
3	This paragraph gives broad authority to the Board and the Governing Council to adjust lending objectives and priorities in line with evolving needs. *This has taken place in practice with the adoption of various policies over the years. The net impact of the policies adopted by IFAD over three decades is to make many of the provisions in the current Lending Policies and Criteria obsolete.* *This is the fundamental reason for revising the existing document and making it more succinct while referring, as appropriate, to the various policies adopted by the Board to cover eligibility, criteria, objectives of programmes and projects, etc.*
4	This paragraph contains general guidelines on the objectives of IFAD projects, the need for cofinancing, approaches to project design, etc. *These have been superseded by strategic frameworks and COSOPs, other policies such as the IFAD Policy on Targeting, and important quality processes such as quality enhancement and quality assurance.*
5	The paragraph restates the general principle that development is chiefly the responsibility of developing countries. In addition, it states that the Fund's target groups are small and landless farmers. *Relations with countries are dealt with in the strategic framework, and IFAD has developed a more comprehensive targeting policy that has superseded the policy on targeting set out in this paragraph*.
6	This paragraph is a general statement regarding IFAD's limited financial capacity and the need for cofinancing. *The general principle is reflected in the revised draft*.

Current Lending Policies and Criteria paragraph reference	*Comments*
II. Objectives	
7 -12	These paragraphs contain general statements regarding the need to focus on the production of low-cost foods, create employment opportunities and higher incomes for low-income people, and raise productivity through new technology; as well as the need for support services, partnership, land tenure reform, financial services, institutional strengthening, and a country-driven approach. *General development objectives are currently stated in much greater detail in the context of the strategic framework, the various IFAD policies and COSOPs. These paragraphs are therefore superseded.*
13-19 Poverty and Nutrition	These paragraphs are general statements on the importance for IFAD to focus on nutrition and small farmer development, assist the landless, promote agrarian reform and capacity development, and take into account country priorities. *These issues are now broadly dealt with in the strategic framework and various policies at the organizational level, and in COSOPs at the country level. There is therefore no need to include them in the Policies and Criteria for IFAD Financing.*
III. Lending Criteria	
20	This paragraph contains general criteria relating to: (i) the principle of flexibility; (ii) country requirements; and (iii) project appraisal standards. *While the principle of flexibility will necessarily be retained – and indeed the revision of the Lending Polices and Criteria is intended largely to enable IFAD to quickly respond to changing needs and circumstances – country requirements are now provided for in much greater detail in the PBAS. With respect to appraisal standards, the many lessons learned from IFAD's experience over three decades are now reflected in the Programme Management Department operational guidelines.*
21-24A Country Criteria	These paragraphs provide general guidance on country targeting, allocation principles, the need to consider the general economy, agricultural and administrative policies and practices in eligible countries; and the need for the Executive Board to periodically review the allocation of IFAD's resources. *In line with these provisions, IFAD has now developed a highly refined system – the PBAS – which is periodically reviewed by the Executive Board. The criteria indicated are therefore obsolete, and the reference in the revised draft to the PBAS is adequate.*
25-30 Project Criteria	These paragraphs provide general guidelines on the types of projects that IFAD should finance. *Over the last three decades, IFAD has adopted a number of policies and guidelines to provide guidance on project design. The general guidelines provided have therefore been superseded and are replaced by a general reference to the new policies in the revised draft.*
IV. Lending Terms and Conditions	
31-41	*These paragraphs contain the operational content of the lending terms and conditions. The recommended changes are included in Annex I, paragraph 15, with regard to the introduction of blend terms.*
V. Project Preparation, Appraisal and Monitoring	
42-44	These paragraphs provide general guidelines on project preparation and appraisal. *These provisions have been superseded by much more detailed operational guidelines and policies regarding project preparation and appraisal. There is therefore no need to include them in the revised draft*.
45-51 Monitoring Arrangements	These paragraphs provide guidelines on project monitoring arrangements and evaluation arrangements. *Monitoring arrangements are now guided both by the operational guidelines and by the requirements of IFAD's results measurement framework (RMS).* *The evaluation of IFAD projects is covered by the Evaluation Policy, which led to the establishment of the IFAD Office of Evaluation. These guidelines have therefore been superseded and are referenced in the revised draft.*

Current Lending Policies and Criteria paragraph reference	*Comments*
Annex: A Framework for Sector/Sub-Sector Allocation: Principles Revisited (added in 1995)	The annex provides additional guidelines on sector and subsector resource allocation including, inter alia, a shift from large-scale to small-scale irrigation; the need to focus on well-identified poverty groups, including poor rural women; the importance of knowledge-sharing among international financial institutions, cofinancing, collaboration among the Rome-based agencies, income diversification, policy dialogue, partnerships, rural financial services and cost-effective research and extension. *In all the areas dealt with in the annex, IFAD has developed policies and operational guidelines in addition to the strategic framework and COSOPs. There is therefore no need to deal with these issues in the lending policies and criteria. Reference to the policies and guidelines in the revised document is considered adequate.*

Summary of comparative lending terms

	Type of loan	*Interest rate*	*Service charge for credits*	*Maturity*	*Grace period*	*Commitment fee*	*Currency*	*Principal repayment terms*
IFAD	*Highly concessional terms:*	NA	0.75 per cent per annum	40 years	10 years	NA	SDR	6 monthly
	Blend terms:	1.25 per cent	0.75 per cent per annum	25 years	5 years	NA	SDR	6 monthly
	* Grace period may be increased up to six years by exception for ordinary terms.							
	Regular: Countries with a high risk of debt distress (red-light) receive 100 per cent of their allocation in the form of grants and those with a medium risk (yellow light) receive 50 per cent in the form of grants. Grants are not subject to repayment fees, but carry a 20 per cent volume discount on the country's allocation.	NA	0.75 per cent p.a. of disbursed and outstanding credit balance	40 years	10 years	0 - 0.5 per cent of the undisbursed balance. Reviewed annually. Often fully or partially waived.	SDR	6 monthly - Year 11-20: 2.0 per cent - Year 21-40: 4.0 per cent
IDA	*Blend:* Countries with GNI per capita above the operational cut-off for more than two consecutive years	1.25 per cent	0.75 per cent p.a. of disbursed and outstanding credit balance	25 years	5 years	0 - 0.5 per cent of the undisbursed balance. Reviewed annually. Often fully or partially waived.	SDR	6 monthly - Year 5-15: 3.3 per cent - Year 16-25: 6.7 per cent
	Hard-term lending: Countries receiving loans on blend terms are eligible for hard-term credits.	Fixed interest rate set on an annual basis as the fixed rate equivalent of IBRD interest rates less 200 bps	0.75 per cent p.a. of disbursed and outstanding credit balance	25 years	5 years	0 - 0.5 per cent of the undisbursed balance	SDR	6 monthly - Year 5-15: 3.3 per cent - Year 16-25: 6.7 per cent
	(IDA credits include an acceleration clause providing for doubling of principal payments from creditworthy borrowers where per capita income remains above eligibility thresholds.)							

	Asian Development Fund						
AsDF	*Sovereign or sovereign-guaranteed borrowers*	1.5 per cent p.a. of disbursement and outstanding credit balance	40 years	8 years	0	SDR	6 monthly
AfDF	*African Development Fund*	0.75 per cent p.a. - Project loan - Line of credit	 50 years 20 years	 10 years 5 years	0	SDR	Equal instalments of principal. Frequency: semi-annually for US$, EUR and JPY, quarterly for ZAR

Summary of lending terms – II

	Type of loan	*Interest rate*	*Maturity*	*Grace period*	*Commitment fee*	*Currency*
IFAD	*Ordinary terms:*	Variable reference interest rate determined semi-annually	15 - 18 years	3 years *	NA	SDR
	* Grace period may be increased up to six years by exception for ordinary terms.					
		Spread over reference interest rate:				
IBRD	Flexible loan. Fixed Spread (6 month LIBOR) US$*	Average maturity 12 years or less: 60 bps Average maturity 12 to 15 years: 80 bps Maturity 15 to 18 years: 105 bps	Average 12 - 18 years. Final maturity 30 years max.		Commitment fee 0.75 per cent p.a. Front end fee 1 per cent	US$, Euro, Yen
	Flexible loan. Variable spread (6 month LIBOR) US$*	Average maturity 12 years or less: 29 bps Average maturity 12 to 15 years: 39 bps Maturity 15 to 18 years: 49 bps	Average 12 - 18 years. Final maturity 30 years max.		Commitment fee 0.75 per cent p.a. Front end fee 1 per cent	US$, Euro, Yen
	* Loans also offered in EUR and JPY< for which spreads vary. Reference rate for Euro-denominated loans is EUROIBOR.					
AsDB	*LIBOR-based loan*					
	Sovereign or sovereign-guaranteed borrowers	- Floating lending rate consisting of a cost-base rate (6-month LIBOR for US$ and JPY, 6-month EURIBOR for EUR) plus an effective **contractual spread** (40 basis points) and a maturity premium (10 basis points for loans with a maturity period of 13 - 16 years, 20 basis points for loans with a maturity period of 16 - 19 years) - Fixed lending rate: fixed-rate funding cost of the ADB for the relevant maturity payable by ADB under the related hedge swap transactions	19 years		15 basis points on flat amounts of undisbursed balances	EUR, JPY, US$, and other currencies in which ADB can efficiently intermediate
	For floating-rate loans the lending rates will be reset every 6 months. The floating lending rate may be converted to a fixed rate, or vice versa, for the residual maturity of the loan or part thereof.					

AfDB	*Sovereign-guaranteed loan*	Base rate (floating: 6-month LIBOR for US$ and JPY, 6-month EURIBOR for EUR, 3-month JIBAR for ZAR/ Fixed: calculated as the swap market corresponding to the principal amortization schedule of a particular tranche of a loan) + funding margin (the Bank's cost of borrowing relative to LIBOR, resetting every 6 months) + lending margin (60 basis points)	20 years	5 years	Time-dependant graduated commitment fee for policy-based loans	US$, EUR, JPY, ZAR
IDB	*Ordinary capital*	Rate based on 3-month LIBOR, automatically fixed when the outstanding loan balance reaches 25 per cent of the financing or US$3 million	30 years	6 years		US$