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Enabling poor rural people  
to overcome poverty

## **Revision of IFAD approach to use of cancellation of approved loans and grants**

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Executive Board — 110<sup>th</sup> Session  
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**For: Information**

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## **Revision of IFAD approach to use of cancellation of approved loans and grants**

### **A. Introduction**

1. The Executive Board is invited to take note of the information relating to the background, issues and options going forward following the Executive Board request to review IFAD procedures following the letter received from Government of India (see attached Annex I) and the Minutes of the Board decision:

“Noting the complexity of any proposal related to this issue, it was agreed that Management would review this matter through the Performance-based Allocation System (PBAS) Working Group, and submit a proposal for the Board’s consideration in December 2013.

### **B. Approach of World Bank**

2. IDA, as part of their investment lending reform, aims to improve portfolio management efficiency and programme effectiveness. As such, since 2009, to enhance flexibility in the restructuring of ongoing projects and to give incentives to cancellation of IDA operations, where applicable, cancelled IDA balances from ongoing operations may be available for recommitment to other purposes in the same country, either to supplement ongoing successful operations or for new activities that are consistent with the Banks, country assistance strategy (CAS), see Annex II.
3. The cancelled funds are to be used for recommitments in the same countries within the same fiscal year., In all cases, this should occur before June 30 of the last year of the IDA replenishment cycle within which the cancellation occurs i.e. cancellations in one replenishment cycle cannot be carried forward to a subsequent replenishment cycle. PBAS allocations are not altered by this process. Consistent with the implementation of the Debt Sustainability Framework, where financing terms depends on the degree of debt distress, cancelled funds would be available for recommitment on terms (grants or loans) for which the country is eligible in the year during which the funds are recommitted.
4. Amounts cancelled after the closing date are not eligible for recommitment and are returned to the general IDA pool.

### **C. Approach of African Development Bank**

5. In May 2011, the AfDB Board of Directors approved the Revised Guidelines on Cancellation of Approved Loans, Grants and Guarantees (attached) which included a detailed set of criteria, procedures and changes in legal provisions. This is seen as “an opportunity for countries and the Bank to re-channel resources to better performing operations” and allows ADF-eligible countries to retain up to 70 per cent of the resources from ADF operations that have been cancelled.
6. Efforts have specifically been focused on cancelling projects whose annual performance cannot be improved through other measures. As a result, the volume of cancellations has increased from U\$16 million in 2009 to U\$147 million in 2011.
7. The retained amount can be re-used for commitment to on-going operations or new activities consistent with the Country Strategy Paper. These resources are available to countries in addition to their PBAS allocations.
8. According to AfDB, this new provision has been a useful tool in stimulating cancellation of aging and non-performing operations and the above-mentioned general portfolio clean-up.
9. Previously, these cancelled resources would flow back to the general pool of ADF resources and form part of the internally generated resources (Advance Commitment

Capacity for the next ADF financing cycle). With the change in the guidelines, only 30 percent of cancelled amounts flow into the ACC. The recent September 2013 AfDB Replenishment meeting was notified that AfDB internal resources were proportionately reduced due to this new approach.

#### D. Approach of Asian Development Bank

10. As indicated in the Asian Development Fund (ADF) performance based allocation (PBA) policy, 2004, all proceeds from loan savings and cancellations will be retained within the originating operations group. This is intended to provide a direct incentive for improved portfolio management.

#### E. Current IFAD practices

11. IFAD's current practices for the use of any loan/grant amounts cancelled are returned into IFAD general resources and are therefore available to be committed for new loans and grants, and through the PBAS allocation, are assigned to individual countries. On average, annual cancellations are assessed at 13 per cent of approved amounts and this is the figure currently built into the IFAD model. However, as indicated below, the majority (63 per cent) of cancellations take place at loan/grant completion or before the loan has made any disbursements (30 per cent). Only 7 per cent of loan cancellations take place during implementation and these are usually partial cancellations of loan/grant amounts.
12. A reduction in the cancellation rate (of all types of cancellation) would generate an impact on IFAD cash flow, resulting in additional out-flow needs in the short/medium term to provide for the necessary disbursements. Given the importance of internal resources to the calculation of the final Programme of Loans and Grants generated by any given Replenishment process, a careful assessment of financial implications would be required.
13. Similar to other financial institutions, IFAD has also used cancellation as a portfolio management measure in non-performing projects/countries. In this regard, the table below shows loan cancellation during implementation together with the cancellations more regularly carried out after loan completion.

Cancellation period (1 October to 30 September)  
Millions of Special Drawing Rights

Type of cancellation	03 to 04	04 to 05	05 to 06	06 to 07	07 to 08	08 to 09	09 to 10	10 to 11	11 to 12	12 to 13	Total	% of total
Fully cancelled	(10.2)	(9.6)	(25.7)	0	0	0	(42.3)	(8.4)	(11.7)	(10.8)	(118.8)	30%
At completion	(17.1)	(24.0)	(19.1)	(29.2)	(17.8)	(22.2)	(28.5)	(21.7)	(36.4)	(30.4)	(246.8)	63%
During implementation	0	(4.6)	(1.7)	(50.0)	0	0	(8.5)	(10.9)	0	0	(25.9)	7%
<b>Total cancellations</b>	<b>(27.3)</b>	<b>(38.3)</b>	<b>(46.5)</b>	<b>(29.3)</b>	<b>(17.8)</b>	<b>(22.2)</b>	<b>(79.4)</b>	<b>(41.0)</b>	<b>(48.1)</b>	<b>(41.2)</b>	<b>(391.6)</b>	<b>100%</b>

14. Currently, IFAD does not have an instrument which would enable it to exercise the same flexibility adopted by the IDA or AfDB with relation to loan or grant cancellation. IFAD has no obligation, in line with its basic documents<sup>1</sup>, or in the terms of its financing agreements, to recommit to the same Borrower the resources which have been made available under the terms of project/programme financing agreements, and subsequently cancelled. As such, as in the AfDB, the IFAD Executive Board would need to approve a new framework for use of loan cancellations.

<sup>1</sup> Article 7, Sections 1(e) and (f) of the Agreement Establishing IFAD (AEI) specify respectively that decisions with regard to the selection and approval of projects and programmes shall be made by the Executive Board and that the loan agreement shall be concluded in each case by the Fund and the Borrower, which shall be responsible for the execution of the project or programme concerned. Moreover, Article 7, Section 1 (c) of the AEI states that the Fund shall make arrangements to ensure that the proceeds of any financing are used only for the purposes for which the financing was provided.

## F. Options for IFAD

15. Given the recent changes introduced, in particular, by both the World Bank (IDA) and AfDB in support of portfolio management and effective use of financial resources at country level IFAD is considering, if and how, IFAD could adopt such an approach. Nevertheless, The options for how IFAD would proceed would be dependent on the need to strike a balance between the interaction and emphasis on these three aspects:
  - generation of internal resources;
  - incentives for improved portfolio performance; and,
  - management of non-performing portfolios.
16. Generation of internal resources: Implications for levels of internal resources are an important factor in the analysis. IFAD will need to run financial simulations using the existing rate of 13 per cent annual cancellations. Simulations would apply different levels of cancellations retained by the country or returned to general resources (as in AfDB). While It doesn't make any financial difference if cancellations are retained in country or returned to general resources, what does makes a difference is the timing of the cancelled resources being redeployed into new projects. An additional aspect of the analysis is the number of countries with projects under implementation for which cancellation and reallocation is a viable initiative.
17. Support for improved portfolio performance: Improved portfolio performance has been, from the operational perspective, an important part of the approach to cancellations followed by IDA and AfDB. Similarly, any new approach of IFAD would need to ensure that the purpose of allowing use of cancelled allocated funds to a different project loan within the same country is to enhance the outreach, results and impact of IFAD-financed projects (particularly in light of IFAD9 targets) in an efficient and cost-effective manner. Reallocated funds could be used in the same country to finance second phases of financing well performing projects, or to scale-up project activities through a modular thematic and/or geographical expansion of activities.
18. Management of non-performing portfolios: With regard to incentives and the management of the portfolio there are several risks that would need to be managed, e.g. the risk of reducing efforts by both governments and IFAD to 'turn-around' poor performance if the alternative is simply to reallocate to other projects. One option, still under internal discussion, is that one way to minimize these risks and distortions would be for Government to pay for any costs of re-designing from the proceeds of the cancelled financing.
19. Establishment of Guidelines: There would need to be set of procedures and processes (modelled on World Bank and AfDB) that provide clear criteria and guidelines to governments and staff to implement revised criteria and procedures for the sue of cancelled allocated funds. Such guidelines would need to regulate the approval of cancellation and reallocation of financing for existing projects, provide definitions and purpose of the proposed initiative, eligibility conditions, time/ stage when such changes can be approved, ineligibility and limits for approval, business process to be followed, documentation requirement, responsibility for review, and the streamlined procedure for submitting the proposal for loan/grant cancellation/reallocation.

## G. Next Steps

20. Currently, IFAD is preparing and to run the financial simulations and will be developing possible criteria and procedures for the use of cancelled allocated funds to project/programmes. Progress was shared with the PBAS working group, and suggestions made, on 23 October. Subsequently, a document with options for consideration by the Executive Board for 'approval' would be prepared for the April 2014 Executive Board.

## Letter from Government of India

**SHAKTIKANTA DAS, IAS**  
Additional Secretary



D.O. No. 10/9/2010-FB.VII

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August 27, 2013

Dear Mr. Paolo Ciocca,

This is regarding the 109<sup>th</sup> Executive Board Meeting, scheduled to be held on 17-19<sup>th</sup> September at Rome, Italy.

2. In IDA (World Bank), the amounts cancelled in projects are re-allocated to the same country within a replenishment cycle. Such reallocated amount can be used for either existing projects or for new projects. However, in the case of International Fund for Agricultural Development (IFAD), cancellations, if any, are not reallocated to the same country.
3. It is felt that consequent upon cancellations, reallocation of savings (within a defined cycle), to the same country will help all countries to manage their portfolio effectively.
4. India would like this suggestion to be discussed in the Executive Board meeting.
5. We request you to get the matter examined for being placed before the Executive Board for discussion.

With regards,

Yours sincerely,

*Shaktikanta Das* 27/8  
(Shaktikanta Das)

Mr. Paolo Ciocca  
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## World Bank: Cancellation and Recommitment of IDA resources



Ext Opmanual - OpMemo - Cancellation and Recommitment of IDA Resources

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<ul style="list-style-type: none"> <li>Table of Contents</li> <li>OPs</li> <li>BPs</li> <li>OpMemos</li> <li>By Series</li> <li>Definitions</li> <li>Archived Statements</li> <li>Print Manual</li> </ul>	<h3>OpMemo - Cancellation and Recommitment of IDA Resources</h3> <p>These Operational Memoranda were prepared for use by World Bank staff and are not intended to be a complete treatment of the subject. They should be read together with the OP/BP to which they relate. <span style="float: right;">Operational Memorandum</span></p> <p style="text-align: right;">File with OP/BP 13.05; OP/BP 13.30; OP/BP 13.50</p> <p><b>DATE:</b> December 3, 2009</p> <p><b>TO:</b> Staff Recipients of the Operational Manual</p> <p><b>FROM:</b> Jeffrey S. Gutman, Vice President and Head of Network, Operations Policy and Country Services</p> <p><b>EXTENSION:</b> 80454</p> <p><b>SUBJECT:</b> Cancellation and Recommitment of IDA Resources</p> <ol style="list-style-type: none"> <li>1. <b>Investment lending reform</b> aims to improve the efficiency and effectiveness of investment lending and pays special attention to development effectiveness and implementation support. An important component of this reform aims to facilitate project changes and restructuring, making adaptation to changing circumstances easier and faster. Facilitating project restructuring is expected to help countries use their scarce resources more effectively.</li> <li>2. To enhance flexibility in the restructuring of ongoing projects and to give incentives to cancellation of IDA operations, where applicable, cancelled IDA balances from ongoing operations would be available for recommitment to other purposes in the same country, either to supplement ongoing successful operations or for new activities that are consistent with the CAS instead of returning back to the general IDA pool for future redistribution as is currently the case.</li> <li>3. <b>Recommitments.</b> The cancelled funds will normally be used for recommitments within the same fiscal year, and in all cases before June 30 of the last year of the IDA replenishment cycle within which the cancellation occurs. The following are not eligible for recommitments: (a) IDA graduates, (b) countries eligible for IDA on an exceptional basis, (c) balances cancelled from regional projects, and (d) cancellations due to: (i) suspension; (ii) misprocurement; and (iii) fraud and corruption. The recommitment funds should be noted in the project documentation submitted to the Board.</li> <li>4. <b>Applicable IDA Terms.</b> Consistent with the current IDA grants system, where grant eligibility depends on the degree of debt distress, cancelled funds would be available for recommitment on terms (grants or credits) for which the country is eligible in the year during which the funds are recommitted. For example, if a country's degree of debt distress is high (i.e. "red light" country) in the year of approval of recommitment funds, the cancelled funds would be available on grant terms (even though the original cancelled project may have been on credit terms). Similarly, if a country's degree of debt distress is low ("green light" country) in the year of recommitment, the cancelled funds would be available on credit terms (even though the original cancelled project may have been on grant terms). For countries with a moderate degree of debt distress ("yellow light" countries), recommitment would be on a 50:50 mix of grants and credits. For funds that were originally on credit terms but are now being recommitted on grant terms because of changes in a country's debt position (or traffic light), there will be no grant discounting (to keep the monitoring of funds as simple as possible).</li> <li>5. <b>Cancellations after the Closing Date of the Credit.</b> Cancellations must occur prior to the Credit closing date. However, if the closing is the result of restructuring effort, the cancelled funds are eligible for recommitment. Amounts cancelled after the closing date are not eligible for recommitment and will be returned to the general IDA pool.</li> <li>6. <b>Monitoring.</b> Cancellations and recommitments will need to be monitored to ensure that they are not treated as new commitments that utilize the country's IDA allocations. Consequently, it is important that the country director, in collaboration with LOA, notifies CFP/IR of any cancellations that are to be used</li> </ol>
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<http://web.worldbank.org/WBSITE/EXTERNAL/PROJECTS/EXTPOLICIES/EXTO...> 04/10/2013

for recommitments (see [attached sample Memo](#)).

7. **Contacts.** Staff may contact their Regional Operations Advisor or [OPCShelpdesk@worldbank.org](mailto:OPCShelpdesk@worldbank.org) for more information.

8. **Timing.** This change is effective for cancellations made on or after October 23, 2009.

Attachment

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