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Investing in rural people

Revision of IFAD approach to use of cancellation of approved loans and/or grants

Note to Executive Board representatives

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Executive Board — 111th Session
Rome, 8-9 April 2014

For: **Approval**

Contents

Recommendation for approval

The Executive Board is invited to approve that, after due consultation between IFAD and the borrower/recipient, funds cancelled from IFAD loans and/or grants may be reallocated to existing or new programmes of the borrower/recipient in line with guidelines established in paragraphs 14-21 of this document.

Revision of IFAD approach to use of cancellation of approved loans and/or grants

A. Introduction

1. At the request of the Government of India (see appendix 1), the Executive Board, at its 109th session in September 2013, considered an item on the treatment of cancelled project amounts. However, "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."[1] At its December session, the Board agreed to consider a document with options for its approval in April 2014.

2. The Executive Board is now invited to take note of the information presented in this report, including the background, issues and future options relating to this issue.

B. Approach of the World Bank

3. The International Development Association (IDA), as part of its investment lending reform, has taken steps to improve portfolio management efficiency and programme effectiveness. As such, since 2009, to enhance flexibility in the restructuring of ongoing projects and to provide incentives for cancelling IDA operations when necessary, IDA has allowed cancelled balances from ongoing operations to be recommitted within the same country for the purpose of either supplementing ongoing successful operations or supporting new activities that are consistent with its country assistance strategy (see appendix II).

4. In essence, 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 30 June 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 IDA's Debt Sustainability Framework, where financing terms depend 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.

5. Amounts cancelled after the closing date are not eligible for recommitment and are returned to the general IDA pool.

C. Approach of the African Development Bank

6. In May 2011, the African Development Bank (AfDB) Board of Directors approved the Revised Guidelines on Cancellation of Approved Loans, Grants and Guarantees, which includes a detailed set of criteria, procedures and changes in legal provisions. This was seen as "an opportunity for countries and the Bank to re-channel resources to better performing operations". The revised guidelines allow countries eligible under

[1] Paragraph 89 of the Minutes of the 109th session of the Executive Board (EB/109/Rev.1). Progress was shared with the PBAS Working Group, and suggestions made, on 23 October 2013. IFAD initiated a process to run the financial simulations and develop possible criteria and procedures for the use of cancelled funds allocated to project/programmes.

the African Development Fund (ADF) to retain up to 70 per cent of the resources from the ADF operations that have been cancelled.

7. Efforts have specifically been focused on cancelling projects whose annual performance cannot be improved through other measures. The retained amount can be re-used for commitment to ongoing 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 ageing and non-performing operations and the above-mentioned general portfolio clean-up.

9. Previously, these cancelled resources would have flowed back to the general pool of ADF resources and formed part of the internally generated resources (advance commitment capacity [ACC] for the next ADF financing cycle). With the change in the guidelines, only 30 per cent of cancelled amounts flow into the ACC. The September 2013 AfDB replenishment meeting was notified that AfDB internal resources were proportionately reduced due to this new approach.

D. Approach of the Asian Development Bank

10. As indicated in the Asian Development Bank's 2004 performance-based allocation policy, 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. Currently, any cancelled IFAD loan and/or grant amounts 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.

12. Like 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 that the majority (62 per cent) of cancellations take place at loan/grant completion or before the loan has made any disbursements (31 per cent). Only 7 per cent of loan cancellations take place during implementation, and these are usually partial cancellations of loan/grant amounts.

Cancellation period (1 January to 31 December)
(Millions of Special Drawing Rights)

Type of cancellation	*2004*	*2005*	*2006*	*2007*	*2008*	*2009*	*2010*	*2011*	*2012*	*2013*	*Total*	*% of total*
Fully cancelled	10 250.0	-	25 700.0	-	-	-	48 200.0	2 550.0	11 700.0	10 850.0	118 850.0	31.25%
At completion	20 323.7	19 572.2	3 972.1	31 320.1	31 844.2	29 457.9	25 414.7	24 506.3	17 046.8	32 082.2	235 540.6	61.93%
During implementation	-	500.0	5 815.9	50.0	-	-	12 032.1	7 556.0	-	-	25 954.1	6.82%
Total	**30 573.7**	**20 072.2**	**35 488.0**	**31 370.1**	**31 844.2**	**29 457.9**	**85 646.8**	**34 612.3**	**28 746.8**	**42 932.2**	**380 344.7**	**100%**

13. In line with its basic documents[2] and the terms of its financing agreements, IFAD has no obligation to recommit to the same borrower/recipient the resources that have been made available under the terms of project/programme financing agreements, and subsequently cancelled. However, IFAD General Conditions for Agricultural

[2] Article 7, sections 2(d) 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 recipient, 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, with due attention to considerations of economy, efficiency and social equity."

Development Financing (section 12.02 Cancellation by the Fund and section 12.03 Cancellation by the Borrower/Recipient) regulate the possibility, after mutual "consultation", of cancelling in full or in part the unwithdrawn financing. Therefore, to exercise the same flexibility as adopted by IDA, IFAD would need to ensure that its internal guidelines provided the operational framework for use of loan and/or grant cancellations.

F. An IFAD approach

14. 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 has examined how such an approach could be adopted. An IFAD approach would be dependent on the interaction of and emphasis on two aspects:

- Management of internal resources; and
- Management of programme portfolios and initiatives for improved portfolio performance.

15. **Management of internal resources.** A reduction in the cancellation rate (of all types of cancellation) would generate an impact on the IFAD cash flow, resulting in additional outflow needs in the short/medium term to provide for the necessary disbursements. IFAD's minimum liquidity level is set, as per the IFAD Liquidity Policy,[3] at 60 per cent of annual gross disbursements (and potential additional requirements due to liquidity shocks). This constraint ensures that a certain level of programme of loans and grants (PoLG) is judged to be sustainable based on the sustainable cash flow (SCF) approach. IFAD's financial model considers all the parameters to maximize the PoLG on a SCF basis.

16. It is difficult to forecast the impact that this policy change will have on IFAD's overall level of cancellations. However, should this policy result in an ongoing reduction in that level from the current forecast average of 13 per cent, then, in the absence of other balancing factors, the minimum liquidity threshold may be breached and projections would need to be revised accordingly to forecast the impact on IFAD's liquidity, long-term financial sustainability and PoLG. It would therefore require that proposed reallocations from cancellations be assessed on a case-by-case basis in relation to anticipated regular cancellations at completion or during implementation to remain within the SCF parameters. To avoid possible additional liquidity "shocks" to those already identified in the liquidity policy, the forecast of the timing of the cash outflows would need to be assessed to simulate the impact on the liquidity threshold.

17. **Management of programme portfolios and initiatives for improved portfolio performance.** Improved portfolio performance has been, from an operational perspective, an important part of the approach to cancellations followed by IDA and AfDB. Nevertheless, as highlighted by the AfDB, cancellation of approved loans and/or grants should be the last resort, used only when all other measures have failed to yield the desired adjustment in performance and development impact. Similarly, any new approach that IFAD took 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 the light of IFAD9 targets) in an efficient and cost-effective manner.

18. Therefore, as implemented by IDA, cancelled loan and/or grant balances from ongoing operations would be available for recommitment to other purposes in the same country, either to supplement ongoing operations or for new activities that are consistent with IFAD's country strategic opportunities programme, i.e. reallocated funds could be used in the same country to finance second phases of well-performing

[3] IFAD Liquidity Policy, document EB 2006/89/R.40, November 2006.

projects, or to scale up project activities through a thematic and/or geographical expansion of activities. Extensions of programme/project completion and financing closing dates would be considered, subject to existing procedures. However, while the opportunity to cancel loan and/or grant funds from the existing portfolio and reallocate to other, or new, projects in the portfolio would be open to all countries, the fact that only 27 per cent of countries in IFAD's current portfolio have more than four ongoing projects would likely limit uptake of the initiative.

19. With regard to incentives and portfolio management, there are several risks that would need to be managed. The most evident is the risk that both governments and IFAD would put less effort into "turning around" poor performance if the alternative was simply to reallocate funds to other projects. To mitigate this risk, no cancellations would occur in projects that had less than one year left before completion. Second, a minimum cancellation of US$1.0 million would be needed for the overall process to be initiated.

20. **Establishment of guidelines.** The basic guidelines to be followed would be based on those implemented by IDA:

    (a) Cancelled funds would be used for recommitments in the same countries within, normally, the same (calendar) year, either to supplement ongoing operations or for new activities that are consistent with IFAD's country strategic opportunities programme. This should occur before 31 December of the last year of the IFAD replenishment cycle within which the cancellation occurs. This means that cancellations in one replenishment cycle cannot be carried forward to a subsequent replenishment cycle;

    (b) PBAS allocations are not altered by this process;

    (c) 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; and

    (d) Amounts cancelled after the closing date are not eligible for recommitment and are returned to IFAD accounts.

21. IFAD will develop clear guidelines, for both governments and staff, on the revised procedures for using cancelled funds, which will be based on those already prepared for the additional financing of ongoing projects. Such guidelines will regulate the approval of cancellation and reallocation of financing for existing projects, eligibility conditions and criteria, time/stage when such changes can be approved, ineligibility and limits for approval, business process to be followed, documentation requirement, responsibility for review, and a streamlined procedure for submitting the proposal for loan/grant cancellation/reallocation.

Clarification was requested on several issues raised during the 131st meeting of the Audit Committee, held on 28 March 2014, with regard to revision of the IFAD approach to the cancellation of approved loans and/or grants.

1. Loan/grant cancellations that occur after the formal loan closing date (as specified in the relevant financing agreements) are excluded from the proposed approach to loan cancellation. This is the approach followed by IDA and African Development Bank. Similarly, loans or grants that were fully cancelled before any disbursements were made may not be considered for reallocation. The only cancellations eligible for consideration are those occurring during implementation and, as noted in paragraph 19 of the document (AC 2014/131/R.5), such cancellation must occur at least one year before loan closing. This currently accounts for 6.8 per cent of all cancellations.

2. Currently, 13 per cent of approved loan and grant amounts are cancelled annually, principally at the time of loan closure. These cancelled funds are returned in their entirety to IFAD accounts. These funds make a significant contribution to internal resources, and thereby provide an important source of financing for subsequent programmes of loans and grants. Therefore, the assumption of a 13 per cent annual cancellation rate has been included in the IFAD financial model as a key modelling parameter. While the current number of loan cancellations occurring during implementation is relatively low, it still forms a small part (6.8 per cent) of the total cancellations included in the financial model. Therefore, it would be regarded as financially prudent to examine, on a case-by-case basis, any proposal for loan cancellation and reallocation, to ascertain if there are implications for the sustainable cash flow model.

3. As is the case at the IDA and AfDB, the practice of a partial loan cancellation would only take place during implementation, in the context of improving country portfolio performance. Projects whose loan was reduced would have the amortization schedule revised (therefore reducing future repayments of loan principal) while projects receiving additional funds would have their amortization schedule adjusted to repay increased amounts. The financing agreement of the respective projects would be amended, as per normal practice, and the borrower informed. If there were changes in project scope or coverage, the financing agreement would be amended per normal procedures. If the changes could alter the project description and financing significantly with respect to that previously approved by the Executive Board, then, as per existing procedures, the Board would be asked to reapprove the project.

4. No additional charges for project preparation would be introduced, and any additional costs would be met by the existing budget for loan and grant administration.

Letter from the Government of India

SHAKTIKANTA DAS, IAS
Additional Secretary

सत्यमेव जयते

D.O. No. 10/9/2010-FB.VII
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August 27, 2013

Dear Mr. Paolo Ciocca,

This is regarding the 109th Executive Board Meeting, scheduled to be held on 17-19th 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,

27/8

(Shaktikanta Das)

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World Bank: Cancellation and Recommitment of IDA resources

OpMemo - Cancellation and Recommitment of IDA Resources

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. **Operational Memorandum**

File with OP/BP 13.05; OP/BP 13.30; OP/BP 13.50

DATE: December 3, 2009

TO: Staff Recipients of the Operational Manual

FROM: Jeffrey S. Gutman, Vice President and Head of Network, Operations Policy and Country Services

EXTENSION: 80454

SUBJECT: **Cancellation and Recommitment of IDA Resources**

1. Investment lending reform 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.

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.

3. **Recommitments**. 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 recommitted funds should be noted in the project documentation submitted to the Board.

4. **Applicable IDA Terms**. 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 recommitted 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).

5. **Cancellations after the Closing Date of the Credit**. 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.

6. **Monitoring**. 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 CFPIR of any cancellations that are to be used

for recommitments (see attached sample Memo).

7. **Contacts**. Staff may contact their Regional Operations Advisor or 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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