

Document: EB 2017/122/R.34/Rev.1
Agenda: 10(e)
Date: 12 December 2017
Distribution: Public
Original: English

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Approach to a Transition Framework

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Executive Board — 122nd Session
Rome, 11-12 December 2017

For: Approval

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Abbreviations and acronyms

ACA	Advanced Commitment Authority
AfDB	African Development Bank
AfDF	African Development Fund
AsDB	Asian Development Bank
ALM	Asset Liability Management
DSF	Debt Sustainability Framework
FOD	Financial Operations Department
GNIpc	gross national income per capita
HC	highly concessional
HIPC	Heavily Indebted Poor Countries
IADB	Inter-American Development Bank
IDA	International Development Association
IFI	International Financial Institution
IOE	Independent Office of Evaluation of IFAD
LIC	low-income country
LMIC	lower-middle-income country
MDB	Multilateral Development Bank
MFS	most fragile situation
MIC	middle-income country
OECD-DAC	Organization for Economic Co-operation and Development – Development Assistance Committee
PoLG	programme of loans and grants
RTA	Reimbursable Technical Assistance
SBF	Sovereign Borrowing Framework
SDG	sustainable development goal
SDR	special drawing right
SIDS	small island developing states
UMIC	upper-middle-income country
WBG	World Bank Group

Acknowledgements

This paper has been prepared with the invaluable support of Natalia Toschi (Operational Programming and Effectiveness Unit – OPE), Malek Sahli (Financial Management Services Division), Sylvie Arnoux (Office of the General Counsel – LEG) and Nevenka Addo (LEG). Research was led by Eloisa De Villalobos (OPE) with Raphael Seiwald (OPE) and Manda Sissoko (OPE). Editorial support was provided by Ludivine Valente (OPE).

Executive summary

1. The introduction of a transition framework was proposed by Management as one of the innovations included in the enhanced business model for the Eleventh Replenishment of IFAD's Resources (IFAD11)¹ presented at the second session of the IFAD11 Consultation held in June 2017. Members requested further information about the scope of the transition framework and the proposed timeline, as well as the mechanism for developing the framework. This approach paper provides that information by laying out the main principles of predictability, transparency and sustainability underlying the framework, concrete proposals presented for discussion under each principle, and suggested way forward.
2. The final goal of the transition framework is to establish an adequate package of comprehensive and sustainable support to accompany borrowers on their development journey. To be effective, the support offered by IFAD must be tailored to specific country conditions and challenges, striking the right balance between flexibility and a rules-based approach.
3. The scope of the framework covers both the financial aspects of IFAD's current instruments and proposals for rolling out the framework in conjunction with new policies and instruments.
4. Enhancements in IFAD's current financial practices are intended to avoid abrupt changes in financing terms to reduce uncertainty for borrowers within a single replenishment cycle and to smooth the transition across financing terms with phasing in-phasing out periods. In the policy area, several proposals are brought forward for Members' consideration to provide tailored support to vulnerable countries and to leverage positive performance by countries advancing in their development trajectory. As indicated in the business model, IFAD will strengthen its cofinancing efforts. Country strategies will become the repository of the proposed transition support strategy as a medium-term programmatic tool. The approach paper does not propose a mandatory threshold for graduation but a voluntary one. Graduation represents, in principle, the ultimate success of any transition framework.
5. The proposal is to proceed with implementation of the transition framework in sequence. The amendments to the Policies and Criteria for IFAD Financing will be fast tracked so as to seek approval from the Governing Council at the February 2018 session. The changes will: (i) align IFAD's gross national income per capita thresholds with International Development Association classifications; (ii) leave unchanged the yearly review of financing terms but call for any hardening of terms to coincide with the replenishment period rather than being done annually, with reversals to be implemented annually as per current practice; and (iii) delegate approval of the final transition framework as well as new instruments and tools to the Executive Board.
6. The introduction of any new policies and instruments requires extensive dialogue among Members and Management. Therefore, in line with the feedback received from Members to date, Management proposes that a participatory mechanism be set up, which could be in the form of a dedicated working group of the Executive Board with representatives from all Lists, to finalize the transition framework by end-2018. The working group will be tasked with: (i) analysing the proposals included in the approach paper; (ii) identifying any gap in the proposals; (iii) agreeing on selected areas of intervention; (iv) identifying any needed policy reviews and changes to be undertaken as part of the IFAD11 Consultation; and (v) formalizing the transition framework for presentation to the Executive Board.

¹ See IFAD11/2/R.3: Enhancing IFAD11 business model to deliver impact at scale.

The design and implementation of the agreed proposals will take place during the IFAD11 period.

7. Certain items currently being discussed within the IFAD11 Consultation, such as the financial model and the composition and size of the programme of work, will be agreed before the transition framework is finalized. This framework is conceived as a living document, to be updated regularly as needed to respond to changes in IFAD and its environment.

Recommendation for approval and transmittal to the Governing Council

The Executive Board is invited to:

1. Approve this Approach to a Transition Framework;
2. Authorize the transmittal of: (a) annex I (Draft report of the Executive Board to the Governing Council: Amendments to the Policies and Criteria for IFAD Financing) as a report for consideration at the forty-first session of the Governing Council in February 2018, including the draft resolution appearing in paragraph [] of such report for adoption by the Governing Council at the same session;
3. Approve the establishment of a working group of the Executive Board tasked with:
 - (i) Analysing the proposals included in the final approach paper;
 - (ii) identifying any gap in the proposals; (iii) agreeing on selected areas of intervention; (iv) identifying any needed policy reviews and changes, to be undertaken as part of the IFAD11 Consultation; and (v) formalizing the transition framework for presentation to the Executive Board.

Additional informal seminars may be held to ensure greater participation.

Approach to a Transition Framework

I. Introduction

1. During the Consultation on the Eleventh Replenishment of IFAD's Resources (IFAD11), Members requested further information on the proposed approach to a transition framework, as a key complement to IFAD's evolving financial architecture and the enhanced IFAD11 business model. The proposed approach draws on research and experience and, although inspired by practices at other international financial institutions (IFIs), is tailored to IFAD's mandate. Unlike other IFIs, IFAD does not have a formal framework in place to govern the graduation of borrowers from one set of financing terms to another to reflect changes in their income and financial capacity.
2. The principal aim of the transition framework is to ensure a smooth, predictable and sustainable transition for borrowers on a fair and equitable basis by providing lending and non-lending support. IFAD's borrowers are generally supported in their transition by other IFIs through a variety of financing instruments and products, additional market-based financial resources, transitional support and capacity-building. In IFAD's case, such options are currently limited, despite recurrent requests from borrowers for more tools and flexibility.
3. Transition refers to the process by which the gross national income per capita (GNIpc) level of a country eligible to borrow from IFAD on more concessional terms increases to a level equal to or above the specified threshold for such terms and/or its creditworthiness improves, thus making the country eligible to borrow from IFAD on less concessional terms. To smooth this transition and avoid shocks and distortions for both borrowers and IFAD, the transition framework will provide for a gradual phasing in of less concessional terms based on objective criteria, taking into account the borrower's demand for concessional funds and calibrated against its development progress.

4. Reversal refers to the process by which the GNIpc level of a country eligible to borrow from IFAD on less concessional terms drops to a level below the specified threshold for such terms or its creditworthiness deteriorates, thus making the country eligible to borrow from IFAD on more concessional terms. The transition framework will provide for such a borrower to benefit from such softened terms promptly.
5. The proposed approach focuses on the IFAD11 period while laying the foundation for IFAD's evolving financial architecture and operational policies in future years. New ways of mobilizing resources under the proposed business model for IFAD11 are expected to facilitate resource allocation and utilization, and respond to borrower's requests for greater flexibility and tailored support. In fact, diversifying IFAD's services and products across its business model is a sine qua non to support transitions.

A. Amendments to the Policies and Criteria for IFAD Financing

6. Although the proposed approach to the transition framework leaves the principles underlying the existing Policies and Criteria for IFAD Financing fundamentally unchanged, it will require several adjustments, described in detail in annex I, to:
 - Align the eligibility thresholds for financing terms with the International Development Association (IDA) to ensure comparability;
 - Following a yearly review of financing terms, make any changes to more concessional terms on an annual basis and any changes to less concessional terms effective for a replenishment period to reduce volatility for borrowers;
 - Reinforce the delegation of authority to the Executive Board to approve a transition framework prior to the beginning of IFAD11, as well as new lending instruments and tools as needed; and
 - Underscore IFAD's strategic prioritization of fragile situations and small state economies.
7. The amendments to the Policies and Criteria for IFAD Financing are expected to be made in February 2018 following endorsement by the Audit Committee and Executive Board in the fourth quarter of 2017, in order to set the parameters for the transition framework to be developed during 2018 in time for the start of IFAD11.

B. IFAD experience with transitions and reversals

8. Changes in per capita income levels and creditworthiness among IFAD's borrowing Member States have occurred frequently in recent years, in both progressive and regressive directions, which has affected financing terms. In fact, 30 low-income countries (LICs) currently borrowing from IFAD have become lower-middle-income countries (LMICs) in the past decade alone. Financing terms are revised on a yearly basis with no support measures, creating uncertainty and shocks for borrowers.
9. Given these frequent changes, lessons learned by Management, in line with the experiences of other development partners, are as follows:
 - Coordination with other development partners is essential given that borrowers compare lending terms and consider support as a single package for planning purposes;
 - Focusing exclusively on lending terms to accelerate transition is insufficient; a full support package is needed with differentiated instruments;
 - Assessing transition requires closer dialogue with borrowers and a clear, longer-term programmatic and strategic vision for IFAD engagement; and

- Policies and procedures need to be reviewed continuously in a rapidly evolving context.

C. Next steps

10. Two informal Executive Board seminars were held on this topic on 11 September and 17 October 2017. Management took the resulting feedback from Members into account in finalizing this document for review by the Audit Committee in November 2017 and submission to the Executive Board in December 2017. The proposed amendments to the Policies and Criteria for IFAD Financing will be submitted to the Executive Board in December 2017 and the Governing Council in February 2018. The Governing Council will delegate authority to the Executive Board to approve the transition framework and to introduce new instruments and tools on a timely basis. The Board will then establish a working group to perform the tasks outlined in the executive summary and recommendation, with the expectation that a transition framework document will be approved by the Board by the end of 2018. This timeline is intended to ensure that the IFAD11 period begins with all underlying elements in place to enable the enhanced business model to operate effectively in the allocation of resources.

II. Vision for a transition framework

11. IFAD's vision through the transition framework is fully aligned with the first two Sustainable Development Goals (SDGs), namely: (i) ending poverty in all its forms everywhere; and (ii) ending hunger, achieving food security and improved nutrition. The aim is for individual countries to transition from one set of financing terms to another in a smooth, predictable and sustainable way with lending and non-lending support. The strategy to achieve this should be anchored in each country's context, sequencing tools and instruments and harmonizing policies with those of other IFIs where relevant.
12. The transition framework is an essential element of the enhanced business model for IFAD11. Together with the performance-based allocation system (PBAS), it will serve as a pillar of resource allocation as it will:
 - Allow resources to be tailored to countries' needs;
 - Respond directly to borrowers' demand for more tools and flexibility in terms of IFAD's support;
 - Enhance resource mobilization by providing incentives for cofinancing and market borrowing; and
 - Help calibrate IFAD's support to Members as the financial architecture and operational implementation evolve.

III. Principles

13. The proposed approach to the transition framework is built on three interlinked principles: predictability, transparency and sustainability. Transition must be predictable to be effective. Predictability requires clear rules that are transparent. Transparency is essential to optimize the use of concessional resources for poor people that need them most. IFAD's borrowers are very diverse in the development challenges they face and in their capacities to meet those challenges, so sustainable transitions call for differentiated approaches that are carefully calibrated against clearly defined principles and processes. An abrupt or ill-conceived transition could complicate economic development and financial planning for borrowers.

A. Predictability

14. Predictability is the commanding principle of the proposed approach to the transition framework. In this context, the provision of IFAD's loans and grants to

countries is predictable when borrowing members can be confident about the amounts, timing and pricing of resources allocated to them. Research has shown that unpredictability devalues aid through its negative impact on growth and public financial management, thereby undermining donors' and partner countries' efforts to achieve development results, including the SDGs.

15. Aid predictability is highlighted in the Paris Declaration on Aid Effectiveness (2005), the Accra Agenda for Action (2008) and the Fourth High Level Forum on Aid Effectiveness (2011). They emphasize that greater predictability in the provision of aid flows enables developing countries to effectively plan and manage their development programmes over the short and medium term to make the transition to a higher level of development.

Transition across lending terms

16. Transition of development status is a process that extends over several years. Currently, however, IFAD reassesses lending terms on an annual basis. Annual changes cast doubt over the sustainability of such changes, and have in IFAD's case yielded numerous reversals as the underlying economic factors are not robust (see annex II).
17. A more gradual transition methodology, involving a phasing out-phasing in period of appropriate length, will be developed on the basis of objective criteria for countries moving from more to less concessional terms. This approach, in use at the African Development Fund (AfDF), allows marginal changes in the base criterion (i.e. GNIpc) to stabilize before lending terms are revised. Under this new approach, financing terms for each country will be revised formally once for each replenishment cycle. Reversals from less to more concessional terms will continue to be applied on an annual basis.
18. Table 1 illustrates how phasing in less concessional terms over a three-year period would work. For example: during 2018, a country's financing terms change from highly concessional to blend terms. According to current practice, the country would borrow the entire PBAS allocation on blend terms as of 2019. Under the proposed approach, the change would be more gradual. If the financing programme (PBAS allocation) amounts to US\$60 million, IFAD would offer the country the following financing terms:
- If the project is submitted to the Executive Board during 2019, 67 per cent on highly concessional terms and 33 per cent on blend terms;
 - If the project is submitted to the Executive Board during 2020, 50 per cent on highly concessional terms and 50 per cent on blend terms;
 - If the project is submitted to the Executive Board during 2021, 33 per cent on highly concessional terms and 67 per cent on blend terms.

Table 1
Example of phased approach to transition

Year of replenishment period	Financing terms		Numerical example: financing of US\$60m	
	Highly concessional / Blend	Blend / Ordinary	Old financing terms	New financing terms
Year 0 (Prior to start)	Discussions with borrower			
Year 1	67%	33%	US\$40m	US\$20m
Year 2	50%	50%	US\$30m	US\$30m
Year 3	33%	67%	US\$20m	US\$40m

19. Phasing in the new financing terms across the replenishment period also provides an incentive for earlier use of PBAS allocations in the initial years of the replenishment.

Borrower-tailored approach

20. A cross-departmental transition task force will be set up to undertake annual assessments of countries' transition status and identify extraordinary circumstances that may require more tailored support. IFAD's experiences described above, and those of other IFIs as shown in annex III, suggest that transition cannot be driven solely by a mechanical formula.² Management will pay close attention to countries that are approaching eligibility towards the end of a replenishment period, and hence on the cusp of a transition, so that discussions with borrowers and other stakeholders can be both meaningful and timely. This said, it is important to preserve the guiding principle of fair and equitable access for all borrowers on a consistent basis, so flexibility is limited to exceptional circumstances to be agreed on a case by case basis.
21. IFAD will endeavour to work closely with other IFIs to achieve a coordinated or common approach where feasible, especially in cases of prolonged arrears or unsustainable debt, fragility and small state economies. This will address the issue of making resources available to the borrower in the short and medium term.
22. In line with the proposed IFAD11 business model, and based on the comparative table presented in appendix II, there is potential for updating lending products to better serve different member segments. IFAD lending products have not kept pace with changes in the global economy and at other IFIs. The limited set of options on offer compromises the sustainability of transitions and curtails the Fund's ability to provide differentiated services tailored to country circumstances.

B. Transparency

23. Of all the elements of a results culture, transparency is perhaps the most transformational. Transparency is a commanding incentive for better data quality, more efficient use of resources, more careful monitoring, better policy compliance and benchmarking.³ Transparent financing, in line with the International Aid Transparency Initiative (IATI) standards, requires development partners and borrowing members to use objective criteria for resource allocation and publish relevant information in an accessible and timely manner.
24. A document on increasing transparency for greater accountability will be presented to the Executive Board in December 2017. Beginning in the IFAD11 period, the Fund will disclose:
 - Transition policy and procedures;
 - Income and financing terms classifications by country ; and
 - Financing terms by country by year.

More communication and coordination with others

25. IFAD's communications to borrowers on the timeframe and impact of a transition will be formalized, and consultations with the borrower's ministry of finance will be required before implementation. This will enable the borrower's views to be taken into account in any decision to change financing terms and the related timing. Coordination will be stepped up with other IFIs and official bilateral creditors.

Clearer criteria for transition

26. Country classification will be based on the dual criteria of: (i) GNIpc; and (ii) creditworthiness. In the first case, it is proposed that the base criterion for determining IFAD's financing terms be aligned with that established by IDA and used by all other IFIs examined, as shown in annex I and described in more detail in annex III and appendix I. In the second case, IFAD will adopt the creditworthiness criterion developed by the International Monetary Fund (IMF) and

² See IDA16 Mid-Term Review – Review of IDA's Graduation Policy, para. 2.

³ Development Assistance Committee, *Aid Predictability – Synthesis of Findings and Good Practices* (October 2011).

World Bank to determine country debt sustainability, for application to borrowers on highly concessional terms.

27. Comparator IFIs, including IDA and the AfDF, use these criteria to classify countries in one of the following four categories as summarized in table 2 below:
- Countries that fall below the IDA cut-off point for highly concessional terms (“HC cut-off”) and are not creditworthy are called IDA-only countries;
 - Countries that are above the HC cut-off and are not creditworthy are also IDA-only countries, called gap countries;
 - Countries that fall below the cut-off point for blend terms (“blend cut-off”) and are creditworthy are called blend countries; and
 - Countries that are above the blend cut-off and are creditworthy are eligible for ordinary lending terms, unless they have just met the two criteria and remain on blend terms during a phasing out period, or are considered small states, including small islands and subject to IDA exception⁴.

Table 2
Country classification proposed

		<i>Creditworthiness to sustain IBRD[*] financing</i>	
		<i>No</i>	<i>Yes</i>
GNI per capita above IFAD-IDA operational cut-off for more than 2 consecutive years	No	Countries below HC cut-off and not creditworthy (IDA-only non-gap status): highly concessional lending terms and eligible for Debt Sustainability Framework financing based on level of debt distress	Countries below blend cut-off and creditworthy (blend status IDA/IBRD): blend lending terms and eligible for phasing in-phasing out instrument from blend to ordinary
	Yes	Countries above HC cut-off and not creditworthy (IDA-only gap status): blend lending terms and eligible for phasing in-phasing out instrument from HC to blend	Countries above blend cut-off and creditworthy (IBRD only): eligible for ordinary lending terms

* International Bank for Reconstruction and Development.

Note: The Policies and Criteria for IFAD Financing refer to IDA classifications in definitions of highly concessional and blend financing, hence the references to IBRD financing and the creditworthiness criterion.

Voluntary graduation

28. Given IFAD’s principle of universality, this approach paper does not propose a mandatory threshold for graduation but rather a voluntary one. Graduating from financial support from IFIs should be the ultimate goal of any country, in that it signals the lack of permanent development challenges and the move from the status of recipient to one of donor. It is proof that development efforts have been successful and, most of all, sustainable.
29. Graduation is a delicate matter and relies on a careful case-by-case analysis of relevant country-specific factors in addition to GNIpc and creditworthiness criteria. Graduation requires transparency and a coordinated approach with other multilateral donors. It must embed the necessary flexibility to determine whether or not a country is ready to graduate out of concessional resources, while at the same time being based on tangible income, vulnerability and performance measures.
- #### Fair and adequate pricing
30. As part of IFAD’s road map towards accessing market borrowing, it will be paramount to assure the adequacy of the IFAD’s loan pricing terms to the Fund’s own funding costs. Taking into account that IFAD is not a for-profit institution,

⁴ The World Bank Group defines small states economies as "countries that (a) have a population of 1.5 million or less; or (b) are members of the Small States Forum". See www.worldbank.org/en/country/smallstates/overview for more information.

Management will review loan pricing upon completion of the credit-rating process. This will require additional changes to the Policies and Criteria for IFAD Financing.

C. Sustainability

31. The third guiding principle of the transition framework is sustainability. Sustainability, in this context, means the condition whereby development progress reached with IFAD's support is long-lasting. Any improvement in social and economic conditions that is achieved through, inter alia, concessional financing and concerted donor efforts can only bear fruit if it leads to permanent changes embedded in a country's systems and policies. Any proposed strategy should therefore be developed under a long-term view. The transition framework must include forward-looking measures over and above purely financial support to reduce a country's risk of backsliding. Such measures should be differentiated by country circumstances to: (i) prevent or mitigate the adverse impact of crises for vulnerable countries; and (ii) leverage successful reform paths in countries showing positive development trends. IFAD's country strategies should become a living management tool to present the proposed package of support.
32. A sustainable transition calls for diversifying IFAD's lending instruments to better tailor support for Members on a differentiated basis, as recognized in the enhanced business model for IFAD11. IFAD has a single lending instrument that has not evolved since its founding. Appendix II reveals that other IFIs offer a much wider choice of products, providing more flexibility to borrowers including instruments that focus on longer-term investments or support for government reforms that can facilitate more sustainable development results.

Transition of structural vulnerabilities
33. Crises, including conflicts and natural disasters, are two of the main causes of vulnerability and can, if not tempered by swift intervention, quickly reverse years of development efforts. Over the past decade all IFIs have ramped up efforts to propose more flexible mechanisms for more effective engagement with countries during crises and their aftermath. IFAD has enhanced the poverty focus of its resource allocation by developing the IFAD Vulnerability Index (IVI) and including it in the PBAS formula. The IVI includes measures to capture the multidimensional nature of poverty. The transition framework will make use of the IVI to assess countries' vulnerabilities.
34. Proposals in this area are drawn from experiences of other IFIs and cover specific aspects of vulnerability. These could include:
 - (i) Updated policies and guidelines on crisis prevention and recovery
 - IFAD has a set of existing policies that establish the rules of engagement in crisis situations.⁵ In 2007, IFAD also adopted the IDA guidelines for post-conflict and crisis-affected countries (including natural disasters) to implement an allocation methodology that is in line with PBAS methodology.
 - As a first measure, IFAD would swiftly reassess existing policies and procedures drawing on continuous lessons learned in experiences in crisis areas and ensure that the principles of engagement are coherent with the enhanced IFAD11 business model.
 - (ii) Special support for small island developing states and small states
 - For small state economies, concessional terms are to be proposed irrespective of the base criteria; the addition of the IVI to the PBAS

⁵ These include the IFAD Framework for Bridging Post-Crisis Recovery and Long-Term development of 1998, the IFAD Policy on Crisis Prevention and Recovery adopted in 2006, and the IFAD Guidelines for Disaster Early Recovery adopted in 2011.

formula and increase in minimum allocations helps this group of countries address challenges more effectively.

(iii) Regional operations framework

- Vulnerabilities are cross-border in nature. Regional operations are in all IFIs a fundamental part of the broader strategy to promote regional integration, justified by their high potential for development impact. Specific strategic and operational frameworks have been established to recognize the specific features of regional operations, which offer the potential for higher economic returns compared to national operations but also involve significant additional challenges compared to standard country operations. Regional operations are also effective in providing regional public goods.
- Introducing a regional lending programme in addition to the existing grant programme would be an innovative tool for IFAD to step up its offer and enhance internal expertise by leveraging the extensive experience of larger IFIs.

Transition of performance status

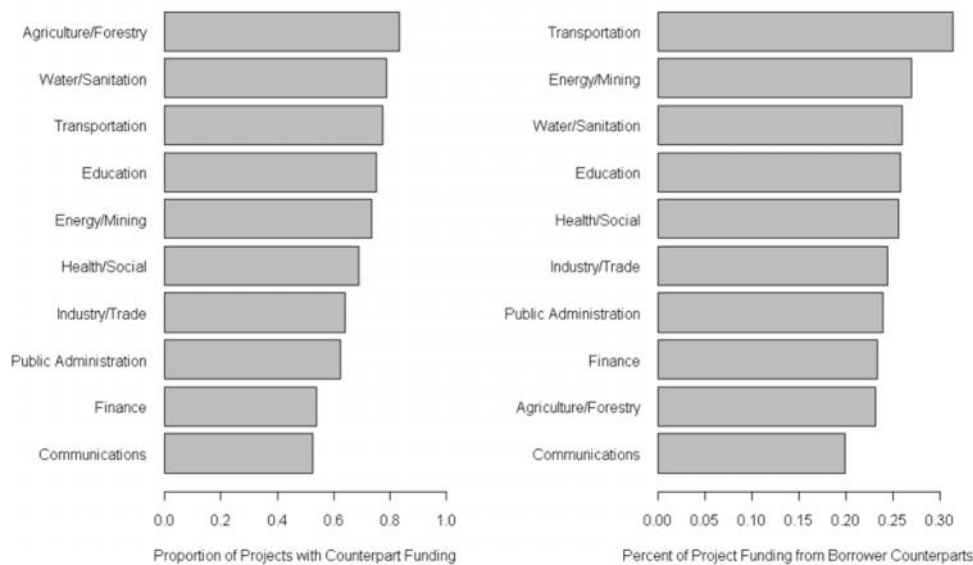
35. When countries are progressing in their development efforts and in the absence of crises, transitional support must be tailored by leveraging successful government policies and government-owned mechanisms.
36. In evaluating country performance, clear and transparent criteria should be applied. Through the participatory process of reviewing the PBAS formula, IFAD built a strong consensus around variables to measure country performance, both on a broader institutional level through the enhanced rural sector performance (RSP) assessment, and on an IFAD-specific level, through the portfolio performance and disbursement (PAD) variable. IFAD will make use of these variables to measure performance in the context of the transition framework, to ensure consistency and build on the existing consensus among Members.
37. Potential innovations in this area could include:
 - (i) Additional financing to leverage positive performance
 - Establishing a transitional support window for countries transitioning from blend to ordinary status could be an effective way of increasing IFAD's financing to eligible countries while at the same time allowing for less concessional terms, thereby increasing IFAD's resources.
 - Similarly, a scale up facility to provide additional financing outside the PBAS at less concessional lending terms would provide for a win-win situation where IFAD can place increased funds borrowed at market terms.
 - (ii) Guarantees to facilitate private sector engagement
 - Notwithstanding the proliferation of guarantees offered by multilaterals to attract private sector investments, there is still plenty of room for multilaterals to step in and de-risk private investments by leveraging their de-facto preferred creditor status. There is ample experience and choice of guarantee mechanisms with varied levels of sophistication offered by all MDBs.

- IFAD is introducing one product, loan guarantee funds,⁶ but can leverage best practices to facilitate investment from the private sector in the rural smallholders sector.
- (iii) Results-based products to finance wider agricultural reforms
- The strength of results-based lending lies in its inherent incentive mechanism as disbursements are linked to pre-agreed, measurable results. The World Bank introduced a programme-for-results instrument to fund specific government expenditure programmes in 2011, followed by other IFIs. Introducing such a programme for specific policy reforms in agriculture in line with the IFAD Strategic Framework 2016-2025 could be beneficial, enabling IFAD to promote its target groups' priorities, thereby strengthening its role in policy dialogue and leverage its own financing. Also, it could collaborate with other development partners by pooling resources.

Cofinancing as driver of sustainability

38. Domestic cofinancing has always been inherent in IFAD's way of operating. It is an essential indicator of the level of country ownership of development programmes and thus a sine qua non for sustainability of results. As evidenced in the business model for IFAD11, three quarters of IFAD's operations in LICs already receive a degree of domestic cofinancing; those in the most fragile situations receive almost twice as much as those in a non-fragile context. The level of domestic cofinancing varies widely. Evidence shows that domestic cofinancing increases in relative terms, inter alia, as a development agency's own financial contribution to a given country increases, and as a country's own performance with regard to poverty alleviation improves. Similarly, domestic cofinancing in UMICs has increased considerably in recent years.
39. Experience shows that introducing mandatory project cofinancing ratios increases programming risks when governments or counterparts are challenged to come up with the resources. Setting cofinancing floors also entails the risk of fueling a downward rather than an upward trend in performance.

Figure 1
World Bank historic cofinancing by sector



Source: Splitting the Check: Counterpart Commitments in World Bank Projects, 2011.

⁶ Loan guarantee funds, IFAD, October 2014.

40. As shown in figure 1, although more than 80 per cent of the World Bank's agriculture and forestry projects receive cofinancing, the amount of such cofinancing is low, not exceeding 25 per cent. One reason for this trend is the absolute size of projects in the agricultural sector, which at the World Bank are comparatively smaller than infrastructure projects.⁷ This correlation was also seen at IFAD, where efforts to increase project size are likely to positively impact the cofinancing amount.
41. IFAD will develop a strategy to identify the drivers of cofinancing in IFAD operations and identify ways of maximizing cofinancing from all sources: domestic (governments and beneficiaries), international and private sector. Separate corporate targets will be introduced for domestic and international cofinancing and included as IFAD11 commitments, in line with historic trends and the overall corporate target proposed for the IFAD11 period. These targets will be cascaded into regional and country-level targets to be agreed in the context of country strategies, based on national development strategies and priorities. The targets will be reassessed periodically as part of the regular country strategy review progress.
- Country strategies
42. This approach paper proposes to reinforce the nature of country strategic opportunities programmes (COSOPs) as medium-term programmatic strategies providing for tailored support as countries evolve in their development transition. Recent reforms in country strategy preparation have introduced more flexible, longer-term planning with mid-course corrections. The goal is to move away from short strategic cycles that allow insufficient time to achieve results, carry heavy reporting requirements and create uncertainty. Using the COSOP as a framework for a more holistic transition programme for the country will allow IFAD to structure both lending and non-lending interventions in a more predictable way with a longer term theory of change. Sustainability of benefits will then become a more central element of the country strategies. In the case of fragile situations and highly vulnerable countries, fragility assessments will be prepared as part of the COSOP process, to monitor conditions and evaluate the need to revise support mechanisms.

⁷ See Matthew S. Winters and Jaclyn D. Streiffeld, *Splitting the Check: Counterpart Commitments in World Bank Projects* (2011).

Draft Report of the Executive Board to the Governing Council: Amendments to the Policies and Criteria for IFAD Financing

I. Introduction

1. At its 122nd session in December 2017, the Executive Board approved a document entitled Approach to a Transition Framework, to provide further information on a proposed framework that will be a key complement to IFAD's evolving financial architecture and the enhanced IFAD11 business model. Drawing on research and the experiences and practices of other IFIs, IFAD has tailored this transition approach to its role as the international champion of smallholders – both women and men.
2. Transition refers to the process by which the per capita income level of a country eligible to borrow from IFAD on more concessional terms increases to a level equal to or above the specified threshold for such terms and/or the country's creditworthiness for such terms improves, meaning that less concessional terms are applicable. The purpose of the transition framework is to smoothen this process and avoid shocks and distortions both for borrowers and for IFAD. It will provide for a gradual phasing in of less concessional terms, on the basis of objective criteria, taking into account the borrower's demand for concessional funds and its development progress.
3. Reversal refers to the process by which the per capita income level of a country eligible to borrow from IFAD on less concessional terms drops to a level below the specified threshold for such terms and/or its creditworthiness for such terms deteriorates, thus making more concessional terms applicable. The transition framework will provide that such a borrower will promptly benefit from such "softened" terms.
4. The aim of the transition framework is to ensure a smooth, predictable and sustainable transition for borrowers, on an equitable basis, through lending and non-lending support. The default period for implementation of less concessional terms for countries in transition will be aligned with IFAD's replenishment period, but changes will still be made annually for countries in reversal and for exceptional cases.

II. Revision of the Policies and Criteria for IFAD Financing

5. The Approach to a Transition Framework describes the road map and essentials for the transition framework. It also proposes related clarification and upgrading of the Policies and Criteria for IFAD Financing (the Policies), which were adopted by the Governing Council in February 2013. The Policies define the broad eligibility criteria for IFAD financing to Member States and the financing terms associated with each financing product. The terms and conditions for financing currently take into consideration each borrower's national income (gross national product [GNP]) and an assessment of its creditworthiness. Financing products from replenishment resources have been defined with varying degrees of concessionality and include grants and loans; the latter may be on highly concessional, blend or ordinary terms. Financing is also provided under the Debt Sustainability Framework (DSF) to eligible countries in the form of a grant or a combination of a grant and a highly concessional loan.
6. At its 122nd session, the Executive Board approved transmittal of this report and a proposed resolution to the forty-first session of the Governing Council for adoption.

III. Proposed amendments to the Policies and Criteria for IFAD Financing

7. Time frame for transition. Transition is a process that typically extends over several years. It is important that both the borrower and IFAD make this change in a methodical manner after carefully considering all factors. Annual changes, as provided for in the current Policies, cast doubt over the sustainability of such changes, and have yielded numerous reversals due to the instability of the underlying economic factors. A more gradual process of transition, involving the phasing in of less concessional terms and resources can help smooth the transition. It will also help ensure that the borrower has the appropriate capacity to absorb resources. This process will allow marginal changes in the base criteria (i.e. national income) to stabilize and endure before financing terms are revised. Only in exceptional circumstances such as natural disaster or a dramatic change in the economic circumstances of a borrower should an annual reclassification be made. However, in the case of a country undergoing a process of reversal, such reversal would continue to be addressed on an annual basis, unless it is expected to be temporary. Towards the end of a replenishment period, Management will pay close attention to countries that are on the margins of eligibility – and hence on the cusp of a transition – to ensure that discussions with borrowers and other stakeholders are completed in an effective and timely manner. It is proposed that a comprehensive implementation of changes in classification be undertaken only once before the start of each replenishment period, with the possibility of annual changes during the replenishment period, in case of reversal. This is reflected in subparagraphs 15(a)(ii) and 15(a)(ii)(1) of the Policies.
8. Gross national income (GNI) and reference to IDA/IBRD operational cut-off. In the current Policies, IFAD's method of determining country eligibility for highly concessional, blend or ordinary lending terms uses fixed thresholds based on GNP per capita in 1992 prices. Alternatively, IFAD may use IDA classifications. By contrast, the PBAS methodology used at IFAD considers GNI data as a key component. IDA and peer IFIs also rely on GNI per capita using the Atlas Methodology to determine the level of concessionality to be provided. The difference between the data used by IFAD and those used by peers has historically been marginal. However, with the lowering of the IDA GNI thresholds in recent years, this difference has increased because the GNI data used by IFAD is driven by a deflation factor (see table 3 below). This means in practice a change in lending terms for a very limited number of countries that have highly concessional terms for IFAD financing but would move to blend in line with IDA financing thresholds.

Table 3

GNI thresholds for highly concessional and blend terms for IFAD and IDA

	2014		2015		2016		2017		2018	
	IDA	IFAD	IDA	IFAD	IDA	IFAD	IDA	IFAD	IDA	IFAD
HHC	1 215	1 403	1 215	1 403	1 185	1 466	1 185	1 486	1 165	1 507
Blend	1 985	2 276	1 985	2 276	1 945	2 379	1 945	2 410	1 905	2 445

It is proposed that the Policies be amended to provide for the following:

- GNI is substituted for GNP as the initial base criterion for determination of lending terms;
- The top threshold for highly concessional lending terms is aligned with the income threshold in GNI per capita (or IDA operational cut-off) below which countries are IDA-only countries;

- (c) Countries with a GNI per capita lower than or equal to the IDA operational cut-off are eligible for highly concessional lending terms;
- (d) Countries classified as “small state economies” by IDA are eligible for IFAD’s highly concessional lending terms;
- (e) Countries with a GNI per capita higher than the IDA operational cut-off that are still eligible for IDA financing will be eligible for highly concessional lending terms unless they are classified as “gap countries” or “blend countries” by IDA;
- (f) Countries classified as gap countries or blend countries by IDA will be eligible for blend lending terms; and
- (g) All other developing Member States are eligible for ordinary lending terms.

These changes are reflected in subparagraph 15(a)(ii)(1) of the Policies and in the deletion of subparagraph 15(a)(ii)(2) which is no longer relevant.

9. Devaluation of the CFA franc. The reference to the “impact of the recent devaluation of the CFA franc”, which the Executive Board was mandated to take into account in determining applicable lending terms, is outdated. It is proposed that subparagraph 15(a)(ii)(3) of the Policies be deleted.
10. Fragile situations and small economies. The current Policies mandate the Executive Board, when allocating resources, to give priority to countries characterized by food insecurity and severe poverty in rural areas. Fragile situations and small economies should also be considered as additional criteria for such prioritization. It is proposed that these criteria be included in subparagraph 15(a)(ii)(4), now renumbered (2), of the Policies.
11. Debt sustainability/creditworthiness criteria. The Policies specify that the Executive Board shall take into account an assessment by the President of IFAD of the Member State’s debt sustainability and its debt-servicing capacity in order to determine the financing terms to be applied. Other IFIs have revised their policies in recent years to replace the term “debt-servicing capacity” with the term “creditworthiness”. This concept underpins the transition frameworks of the other IFIs, in particular when a borrower transits to non-concessional funding from the development banks rather than from their concessional arm funds. It is proposed that, in subparagraph 15(a)(ii)(5), now renumbered (3), of the Policies, the expressions “debt sustainability” and “debt-servicing capacity” be replaced by the term “creditworthiness” to highlight that the transition is based on the twin criteria of per capita income and creditworthiness.
12. Shorter maturity periods at borrower’s request. IFAD’s current product range is limited to three products with fixed parameters in terms of maturity period, grace period and pricing in special drawing rights (SDR). Based on borrowers’ requests and IFAD’s gradually maturing capacity to manage financial instruments, it will be eventually proposed that an upgrade to the Policies be made to offer limited flexibility in maturity and grace ranges. For example, ordinary terms are currently offered with a 3-year grace period and 15-18-year maturity period. Borrowers could be given the flexibility to choose a grace period up to a maximum of 10 years and a maturity period of 35 years, as in the World Bank Group. The limited ranges would mitigate IFAD’s risks in managing the increased product range. This will both respond to borrowers’ requests and bring IFAD a little nearer to the options offered by other IFIs, thereby permitting IFAD to build up capacity over time. A marked distance, however, would still remain between IFAD and other IFIs in terms of full flexibility and options. For the time being, it is only proposed that some flexibility be allowed to respond to requests for shorter maturities, as made by borrowers from time to time. It is proposed that the words “(unless a

shorter maturity is requested by the borrower)” be included where maturity periods are defined in subparagraph 15(a)(iii).

13. Update to conditions of lending terms. As a result of the adoption of the Policies in 2013 and the updating of the General Conditions for Agricultural Development Financing the following year, specific conditions applicable to each of the lending terms should, for clarity and transparency, be established in the Policies, for example, the starting date of grace periods and for payment of the service charge and/or interest. It is proposed that subparagraph 15(a)(iii)(1), (2) and (3) of the Policies be updated to include such conditions.
14. Update to reflect single currency lending framework. In 2016, IFAD introduced the single currency lending facility, which allows ordinary, blend and highly concessional term borrowers to request financing denominated in euro or United States dollars as an alternative to SDR. In the light of the evident demand and to mainstream this facility, the Policies should also refer to relevant lending currencies. It is proposed that, in subparagraph 15(a)(iii)(6) of the Policies, the reference to “SDR” be supplemented by a reference to “the currency of the financing agreement”.
15. Update to reflect updated calculation of IFAD reference interest rate. In December 2009, it was decided that the IFAD reference interest rate would be calculated every six months. It is proposed to update subparagraph 15(a)(iv) in this respect.
16. Deletion of duplicative paragraph on resolution of arrears. As a result of previous revisions, the provision that authorizes the Executive Board, for the purposes of resolving arrears arising from time to time, to amend the terms upon which an approved loan is provided to a country has been duplicated in the Policies in slightly different wording in subparagraph 15(a)(iii)(7) and paragraph 16 of the Policies. It is proposed that paragraph 16 be deleted.
17. Power of the Executive Board to establish the transition framework. Paragraph 4 of the Policies provides that 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.” Paragraph 18 further provides that “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.” Based on these powers, and in view of the need to have a transition framework in place at the beginning of the IFAD11 period, the Executive Board should be tasked with adopting a transition framework before the end of 2018 upon a proposal to be submitted by the President. It is proposed that a specific reference to this process be added in a new paragraph 16 of the Policies.

IV. Resolution

In view of the foregoing, the Executive Board proposes the following resolution for adoption by the Governing Council at its forty-first session in February 2018:

Resolution .../XVI

Revision of the Policies and Criteria for IFAD Financing

The Governing Council of IFAD,

Recalling resolution 178/XXXVI, in which it decided upon the proposal of the the Executive Board to approve the Policies and Criteria for IFAD Financing;

Having reviewed the proposed revisions to the Policies and Criteria for IFAD Financing submitted by the Executive Board as contained in document GC 41/...;

Adopts the Policies and Criteria for IFAD Financing, as revised, which shall take effect on 1 January 2019; except for the revisions to paragraph 16, which shall apply from the adoption of this resolution; 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. A version of the Policies, showing additions (in underlined text) and deletions (in strikethrough text) is attached as annex Ia.

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 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.” As a result, the Policies and Criteria for IFAD Financing were adopted by the Governing Council in February 2013. In 2018, the Policies and Criteria for IFAD Financing were amended to reflect changes required to give effect to the transition framework.
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.”

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.
- (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~~ shall provide loans to developing Member States on highly concessional, blend and ordinary terms for approved projects and programmes. A review of the lending terms of each country shall take place prior to the start of every replenishment period. If such review concludes that a country has become, by a process of transition, eligible for less concessional terms, such terms shall be applied gradually to new loans extended throughout the replenishment period. However, a review of the lending terms of each country shall also take place prior to the start of every year in any replenishment period. If such review concludes that a country has become, by a process of reversal, eligible for more concessional terms, such terms may be applied immediately to new loans extended during that year. The criteria for determining the terms to apply to a specific country shall be as specified in this paragraph, in accordance with the following sequence:
- (1) Those developing Member States that, at the end of the year preceding the start of a replenishment period,
- (a) ~~having have~~ have a gross national ~~product (GNP)~~ income (GNI) per capita ~~of US\$805 or less in 1992 prices or classified as lower than, or equal to, the operational cut-off as determined annually by the 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 by IFAD [text moved to (4)];
- (b) are classified by IDA as a "small state economy" shall normally be eligible for highly concessional terms;
- (c) have a GNI per capita higher than the operational cut-off referred to in subparagraph (a) above and are still eligible for IDA financing shall normally be eligible for highly

concessional lending terms, unless they are classified as "gap countries" or "blend countries" by IDA;

- (d) ~~which are eligible for~~ are classified as "gap countries" or "blend countries" by IDA ~~blend terms will shall~~ be eligible for IFAD-blend lending terms, ~~provided that they are above IFAD threshold for eligibility for highly concessional terms;~~ and
- (e) ~~having a gross national product (GNP) per capita of US\$1,306 or above in 1992 prices are not eligible for highly concessional or blend lending terms in accordance with subparagraphs (a), (b), (c) or (d)~~ 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) (2) ~~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, and to fragile situations and "small state economies".~~
- (5) (3) ~~In determining the lending terms to apply to a country, the Executive Board shall also take into account an assessment by the President of IFAD of that country's debt sustainability and its debt servicing capacity creditworthiness.~~
- (4) The total amount of the loans provided each year on highly concessional terms shall amount to approximately two thirds of the total amount lent by IFAD.
- (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 on the principal amount outstanding of three fourths of one per cent (0.75 per cent) per annum, and have a maturity period of forty (40) years (unless a shorter maturity is requested by the borrower), including a grace period of ten (10) years, starting from the date of approval by the Executive Board;
- (2) Loans granted on blend terms shall be subject to a service charge on the principal amount outstanding of three fourths of one per cent (0.75 per cent) per annum, shall bear interest on the principal amount outstanding at a fixed rate of 1.25 per cent and shall have a maturity period of twenty-five (25) years (unless a shorter maturity is requested by the borrower), including a grace period of five (5) 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~~ bear interest on the principal amount outstanding at the IFAD reference interest rate per annum equivalent to one hundred per cent (100 per cent) of

~~the variable reference interest rate, as determined annually by the Executive Board in accordance with subparagraph (iv), and have a maturity period of fifteen (15) to eighteen (18) years, including a grace period of three (3) years (unless a shorter maturity is requested by the borrower), starting from the date as of which the Fund has determined that all general conditions precedent to withdrawal have been fulfilled.~~

- (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 creditworthiness~~. 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; (ii) the net present value in SDR or the denomination currency of the financing agreement (as applicable) of the blend terms and ordinary terms specified in (2) and (3) above is maintained.
 - (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 method of calculation of the reference rate of interest (the IFAD reference interest rate) ~~for application in IFAD, which shall provide the basis for the review and revision prescribed in subparagraph (2) below;~~ and
 - (2) every six months, review and revise the IFAD reference interest rate for the following period on the basis of market rates. ~~decide, annually the rates of interest to be applied to loans on ordinary terms. For that purpose, it shall review 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 subparagraph (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~~

16. Transition Framework. In accordance with the delegation of authority established in paragraph 15(iv) above and paragraph 18 below, the Executive Board shall adopt prior to the end of 2018, and review prior to the end of 2019, a transition framework that shall establish the principles and procedures for the processes of transition and reversal referred to in paragraph 15(a)(ii) and their implementation in any replenishment period. In establishing the transition framework, the Executive Board shall be guided by the objectives of avoiding shocks and distortions for borrowers and for the Fund, and providing transparency through the furnishing to the Executive Board, on an annual basis, of information on developing Member States in relation to their income categories, relevant lending terms, and transition or reversal status under the transition framework.

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.

Background and current practices

I. Overview

- IFAD's commitments for new financing over the last three replenishment cycles have been predominantly at the most concessional end of the spectrum. As indicated in table 4 below, new financing approved as DSF grants and highly concessional terms have been sustained at a robust level, at 68 per cent of financed amounts over a 10 year period, fulfilling the mandate assigned in IFAD's Financing Terms and Policies of two thirds of commitments. Lending on blend (and intermediate) terms has remained very modest, at 13 per cent, less than the 19 per cent at ordinary terms. The proportion of financing on intermediate/blend terms has remained low, although this lending group was intended to be a transition stage for countries as they progress beyond the highly concessional stage towards ordinary terms.

Table 4

Amounts committed for each financing product group IFAD7 to IFAD10 (until August 2017⁸)
(Millions of United States dollars)

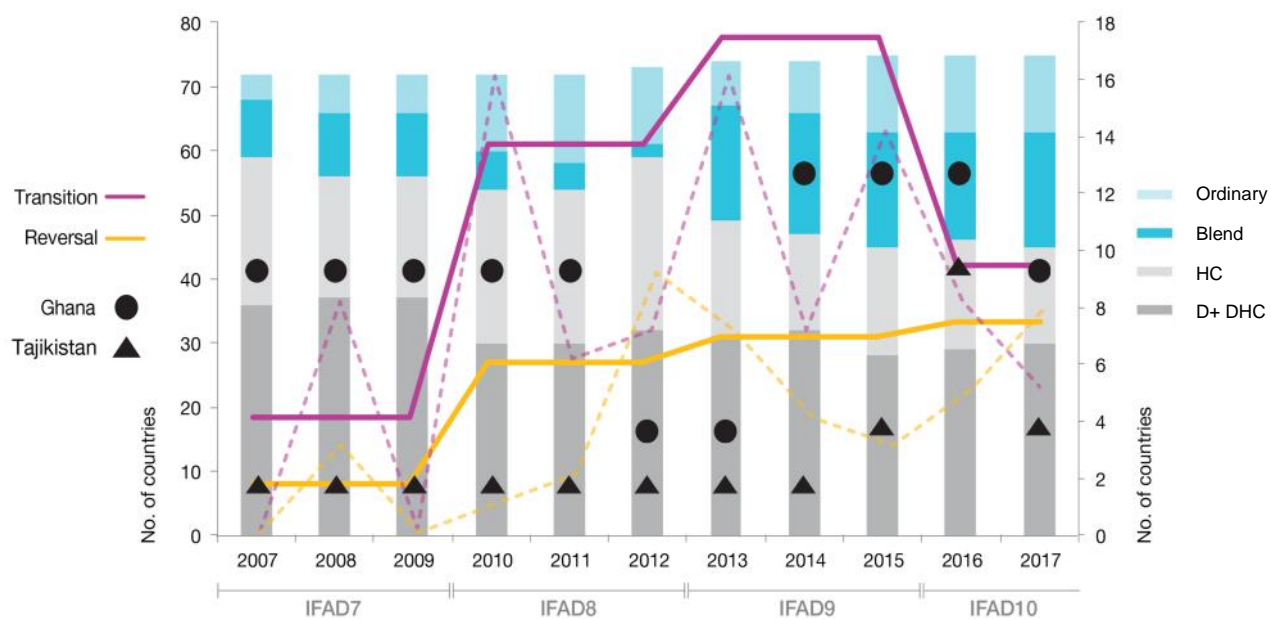
<i>Amounts committed/Financing terms</i>	<i>IFAD7</i>	<i>IFAD8</i>	<i>IFAD9</i>	<i>IFAD10</i>		<i>%</i>
DSF grants	300	469	242	132	1 143	13%
DHC (50%DSF/50%HC)	234	401	507	165	1 307	15%
HC	914	1 134	1 052	423	3 523	40%
Intermediate/blend	199	244	242	423	1 108	13%
Ordinary	185	437	623	421	1 666	19%
Total	1 832	2 685	2 666	1 564	8 747	100%

- Phasing in-phasing out approach. The change in borrower classification over a 10 year period (from IFAD7 to IFAD10 [partial period]) indicates transition at a very modest level, as indicated below:
 - Overall, the number of borrowers that have transitioned from the most concessional terms (i.e. 100 per cent DSF grants) to less concessional terms is relatively low (18 of 28).
 - Only nine borrowers have transitioned from more concessional financing to least concessional (i.e. ordinary) terms, as follows:
 - Angola – HC in 2009, ordinary from 2015 onwards.
 - Armenia – Blend terms in 2009, ordinary from 2010 and 2015 (after reversing to blend in 2013).
 - China – Blend in 2009, ordinary from 2010 onwards.
 - Egypt – Blend in 2009, ordinary from 2012 and again from 2015 onwards (after reversing to blend in 2013).
 - Gaza and the West Bank – Blend in 2009, ordinary in 2016, with several reversals to blend in-between.
 - Georgia – Blend in 2009, ordinary from 2010 onwards.
 - Indonesia – Blend in 2009, ordinary from 2011 onwards.
 - Paraguay – Blend in 2009, ordinary from 2010 onwards.

⁸ To note that in IFAD10, the figures represent only part of the commitments forecast for the period and it is expected that the final percentages will remain within the assigned mandate.

(ix) Philippines – Blend in 2009, ordinary from 2014 onwards.

3. A number of borrowers have seen frequent changes in lending terms within a single replenishment cycle. Changes in borrower classification have been made annually on a case-by-case basis, resulting in an abrupt change of eligibility of a specific financing term for a borrower. For instance, financing terms for 75 borrowers were amended during the last three replenishment periods; of these, 12 borrowers saw amended terms in two consecutive years; 25 borrowers had a transition to less concessional terms and a reversal thereto, including eight borrowers which experienced this within the same PBAS cycle. This is shown in figure 2 below.



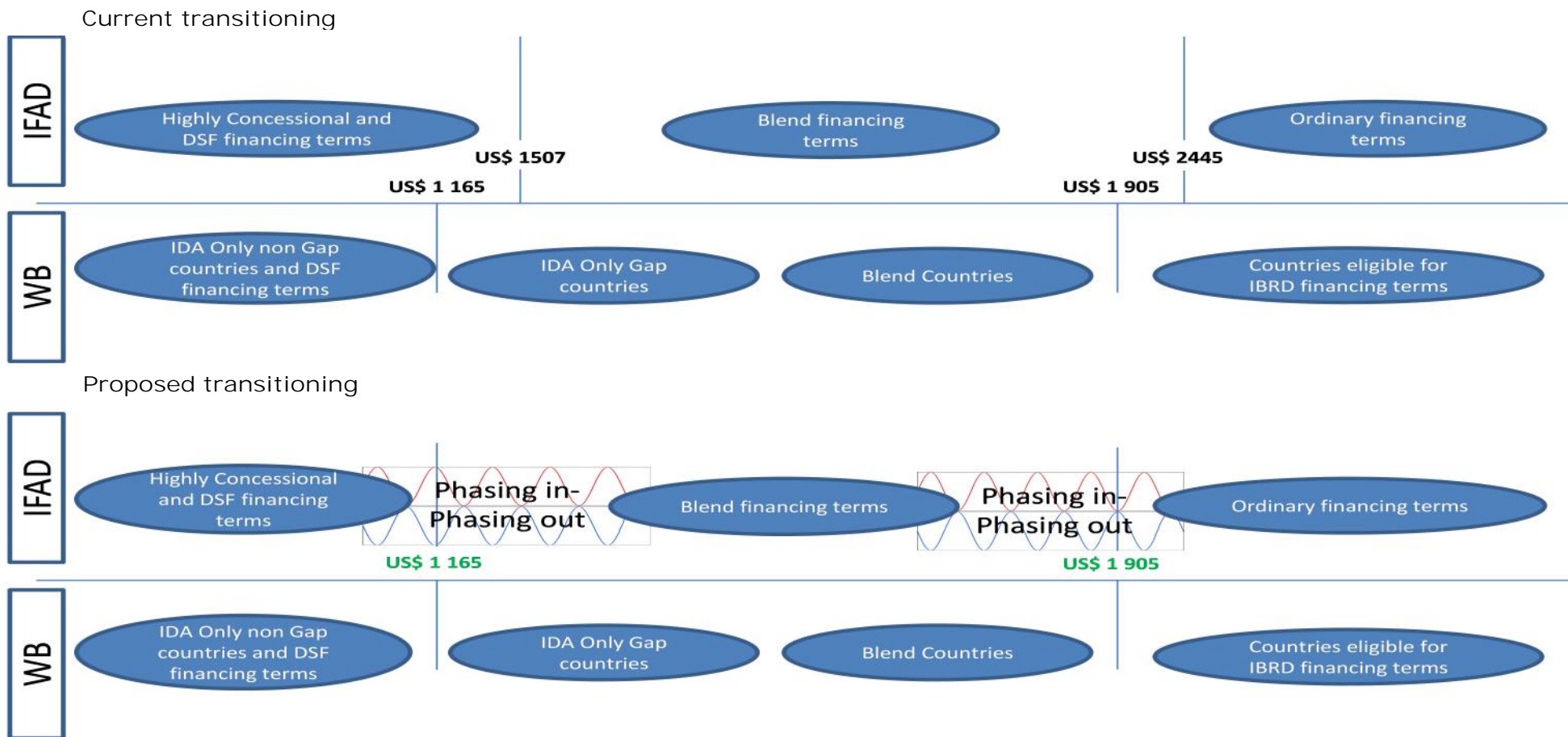
Practices of other IFIs

	<i>IDA/IBRD</i>	<i>IFAD</i>	<i>AsDB</i>	<i>AfDF/AfDB</i>	<i>IDB</i>
Resources Utilization - Structure	2 windows	1 window	1 window	2 windows	1 window
GNI criteria	GNI operational cut-off	GNI US\$805 in 1992 prices for non-IDA countries or IDA-only countries assigned highly concessional terms. Blend terms as per IDA.	Same GNI operational cut-off as determined by IDA.	Same GNI operational cut-off as determined by IDA; exceeds operational cut-off for more than two consecutive years.	Same GNI operational cut-off as determined by IDA; exceeds operational cut-off for more than two consecutive years
Creditworthiness criteria	Determined in consultation with IMF. Debt distress “traffic light” mechanism to classify countries eligible for grants.	Same debt distress traffic light as determined by IDA.	Creditworthiness adequate for ordinary capital resources (OCR)* or market-based resources.	Creditworthiness to sustain IBRD financing	Determined on consultation with IMF. Debt distress traffic light mechanism to classify countries eligible for grants
Other criteria	No	No	AsDB conducts its own debt sustainability analysis when needed.	AfDB conducts its own debt sustainability analysis when needed.	Uses a synthetic creditworthiness indicator, which is a mix of the risk of debt distress as assessed by IMF/World Bank DSF for LICs and the market perspective of the main credit-rating agencies.
Methodology of determination	GNI determined using Atlas Methodology. Debt distress analysis by IMF and World Bank	Same as IDA/IBRD.	Same as IDA/IBRD. Takes into consideration adjustments based on discussions with countries.	Same as IDA/IBRD Takes into consideration adjustments based on discussions with countries.	GNI determined using Atlas Methodology. Debt distress analysis by IMF and World Bank

	<i>IDA/IBRD</i>	<i>IFAD</i>	<i>AsDB</i>	<i>AfDF/AfDB</i>	<i>IDB</i>
Public disclosure	Disclosure of country classification by eligibility for source of financing (IDA or/and IBRD), by income/revenue category and by lending terms. Creditworthiness is disclosed via link to IMF website.	No	Country performance rating is disclosed. - Yes Country creditworthiness and credit ratings are not publicly available.	Country performance rating is disclosed. - Yes Country creditworthiness and credit ratings are disclosed.	No
Frequency and timing of transition	Countries remain on blend terms for two replenishment cycles on average. Graduation process is triggered when GNI threshold is exceeded for at least two of three consecutive years	Financing terms applied each year, six months after changes are made by World Bank on 1 July.	Reviewed during AsDF replenishment. Before replenishment period begins, AsDB consults with donors on volume of resources. Debt distress classification is reviewed annually. Transition from AsDF to AsDB-normal process four years. Full graduation beyond AsDB-normal process five years after crossing GNI thresholds.	Gradual phasing between AfDF and AfDB resources. For each country changing credit status, a transition programme is drawn up, defining modalities of support and AfDB role, length of transition and financing mix during that period. Normally 2-5 years after country has met both GNI and creditworthiness criteria.	No specific period. Transition supported by a lending blending mechanism to ensure smooth reduction in concessionality rather than an abrupt change.
Frequency and timing of reversal	Yes-Annually	Yes – Annually	Yes – Annually	Yes – Annually plus consideration to access to specific financing related to fragility.	Yes – to date no countries have “reverse-graduated”
Governing bodies	IDA Deputies (members) Vice-President approves operational implementation guidelines	Governing Council	Board of Directors President approves operational implementation guidelines.	Board of Directors Internal Committee approves operational implementation guidelines	Board approval
Acceleration of graduation	Yes, based on discussion at country level.	No	Yes, based on discussion at country level.	Yes, incentives for voluntary acceleration of graduation are offered.	N/A

* OCR, which consider AsDB concessional core resources.

Country Transitioning - WBG and IFAD compared



*Figures mentioned above correspond to operational cut-off/ thresholds for FY18.

Main Lending Instruments by IFI

	<i>Caribbean Development Bank</i>	<i>Inter-American Development Bank</i>	<i>World Bank Group</i>	<i>European Investment Bank</i>	<i>Asian Development Bank</i>	<i>African Development Bank</i>	<i>IFAD</i>
Investment lending							
Specific projects	yes	yes	yes	yes	yes	yes	yes
Financial intermediary	yes	yes	yes	yes	yes	yes	no
Technical assistance	yes	yes	no	yes	yes	yes	no
Global multiple works	no	yes	yes	no	yes	yes	no
Conditional credit lines	no	yes	no	no	no	no	no
Policy based							
Economy wide	yes	yes	yes	no	yes	yes	no
Sector/ subsector	yes	yes	yes	no	yes	yes	no
Debt and debt service reduction	no	yes	yes	no	yes	yes	no
Adaptable programme loans	no	yes	yes	no	yes	no	no
Emergency							
Natural disaster	yes	yes	yes	no	yes	yes	no
Financial crisis	no	yes	yes	no	yes	yes	no
Results							
Results-based lending	no	yes	yes	no	yes	no	no
Private sector							
Loans	yes	yes	yes	yes	yes	yes	no
Cofinancing loans of private investors	no	yes	yes	no	yes	yes	no
Guarantees	yes	yes	yes	yes	yes	yes	no