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IFAD Policy on Project Restructuring

Note to Executive Board representatives

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Abbreviations and acronyms

COSOP	country strategic opportunities programme
MDB	multilateral development bank
PBAS	performance-based allocation system
SECAP	Social, Environmental and Climate Assessment Procedures

Recommendation for approval

The Executive Board is invited to consider and approve the IFAD Policy on Project Restructuring, as presented in this document.

IFAD Policy on Project[1] Restructuring

I. Introduction

1. Improving project implementation performance is key for IFAD's contribution to reaching the global Sustainable Development Goals. To raise operational efficiency, including flexibility and adaptability to changing circumstances during project implementation, IFAD committed under the Eleventh Replenishment of IFAD's Resources (IFAD11) to prepare a policy on project restructuring.[2] The policy was to incorporate both existing instruments and new policy elements into a single policy framework with the objective of contributing tangibly to enhance project performance, efficiency in delivering value to IFAD's clients and development effectiveness, also thereby improving disbursement rates.

2. At its forty-fifth session, the Executive Board approved a report of the Audit Committee that contained, in paragraph 10, a proposed aspect of the loan cancellation policy (see annex I, paragraph 3). The Executive Board later approved a revision to the IFAD approach to use of cancellation of approved loans and/or grants at its 111th session (annex I, paragraph 3). This proposal supersedes the documents or sections referenced in annex I, paragraphs 3 and 4.

II. Policy rationale

A. IFAD's current restructuring approach and experience

3. Project implementation is the responsibility of borrowers/recipients. IFAD's 2007 supervision policy[3] is based on the notion of implementation support: that is, IFAD supports borrowers in reviewing implementation progress, identifying and resolving implementation problems and building capacity, while ensuring compliance with fiduciary requirements and loan covenants. During implementation, changing environments may call for adapting projects to improve project performance and increase development impact. Such adjustments may be remedial measures to fix issues affecting project performance or they may build on elements that are working well to enhance development objectives.

4. The degree of actual use of restructuring is hard to determine in the absence of a comprehensive system capturing restructuring actions. While there may be scope for more proactively tackling issues during project implementation through restructuring, there is a perception that being candid about potential or problem projects – which may lead to restructuring – is an indication of weak performance on the part of the project and/or IFAD staff. Borrowers may be reluctant to request restructuring if they think that restructuring may mean a cancellation of IFAD allocations.

5. IFAD does not currently have a consolidated restructuring policy in place. It does have the "Revision of IFAD approach to use of cancellation of approved loans

[1] "Project" in this policy refers to IFAD-financed projects or programmes.
[2] Commitment 3.2, Action 17: "Introduce a project restructuring policy and corresponding procedures, in line with the concept introduced in the Development Effectiveness Framework (DEF) and the business model paper." Report of the Consultation on the Eleventh Replenishment of IFAD's Resources, IFAD11/5/INF.2, and Enhancing IFAD11 Business Model to Deliver Impact at Scale, IFAD11/2/R.3.
[3] IFAD's Policy on Supervision and Implementation Support, EB 2006/89/R.4/Rev.1.

and/or grants"[4] approved by the Executive Board in 2014, in addition to various internal procedures that are often complex and require burdensome and duplicative documentation. Annex I presents a summary of IFAD's current approach and experience.

B. Benchmarking

6. IFAD's current approach to project restructuring was compared to that of three other multilateral development banks (MDBs) (see annex II). The key conclusions of the benchmarking exercise are as follows:

- Changes introduced during implementation do not present additional institutional or operational risks. Therefore, most project modifications can be delegated to Management.
- The types of changes during implementation that require approval by the Executive Board should be clearly defined.
- Internal processes should be streamlined to reduce duplication of documentation and accelerate the approval process.
- Capturing changes in project implementation support reporting systems is vital both for accountability and for eventual evaluation.

III. IFAD Policy on Project Restructuring

A. Definition

7. During implementation, a project may need to be adjusted in response to changes in country priorities or circumstances, either to meet the original project results or to address issues that place the project's capacity to deliver on its objectives and results at risk. A project may also require additional financing to scale up its development effectiveness or fill financing gaps. Broadly speaking, the definition of "project restructuring" is any measure adopted during the implementation stage which helps meet these needs.

8. Viewing successful restructuring as a measure of proactivity in portfolio management should provide an incentive for IFAD's country teams to carry out restructurings as needed. Borrowers will also be incentivized by the ability to recommit cancelled funds within their country programme as the more efficient use of resources has a positive effect on their performance-based allocation system (PBAS) allocations.

B. Guiding principles

9. To support the IFAD11 commitment to increase focus and agility in the use of resources, the proposed IFAD restructuring policy is based on the following principles:

- *Flexibility.* Maintaining flexibility in a dynamic and changing country environment is critical for ensuring project development impact.
- *Alignment to country strategies.* Each country strategic opportunities programme (COSOP) or country strategy note (CSN) represents the foundation for ensuring delivery of the country's poverty and targeting priorities. This policy will support restructuring to achieve country programme results.
- *Timely proactive management.* Early identification of projects at risk and actual problem projects, and the timely establishment of measures to

[4] Revision of IFAD approach to use of cancellation of approved loans and/or grants (EB 2014/111/R.12/Rev.1).

improve their performance, are crucial for greater development effectiveness and the efficient use of IFAD's resources.

C. Policy elements

10. Recognizing the importance of restructuring as a tool for project adaptability to changing circumstances,[5] the proposed policy presents the two restructuring modalities and other policy elements described below.

(i) Level 1 restructuring

11. Level 1 restructuring is a project restructuring involving: (a) a significant and substantial change in the scope or characteristics of the project from those originally approved by the Executive Board; or (b) a change in the Social, Environmental and Climate Assessment Procedures (SECAP) classification to category A. Level 1 restructurings are submitted for review to the Evaluation Committee and for approval to the Executive Board.

(ii) Level 2 restructuring

12. Level 2 restructuring involves any other modification of the project – for example reallocation of loan proceeds, extension of completion dates or changes in the project description that do not significantly alter the scope or characteristics from those originally approved by the Executive Board. The Associate Vice-President, Programme Management Department, approves level 2 restructuring.

(iii) Cancellations of financing and reuse of cancelled funds

13. Resources may be cancelled and recommitted to well-performing projects[6] or new projects in the same country within 12 months after the date of the cancellation. Since PBAS allocations are not altered by this process, recommitted funds may be carried forward to a subsequent PBAS cycle, subject to the overall time limit. Cancelled funds are available for recommitment on the financing terms for which the borrower is eligible in the year during which the funds are recommitted, subject to an assessment that the financial sustainability of the Fund is not accordingly impaired. To encourage proactivity in portfolio management, amounts cancelled from projects that have less than one year left before completion are not eligible for recommitment. Funds cancelled after the closing date are not eligible for recommitment and are returned to IFAD's resources.

14. In order to further incentivize proactivity, and based on the underlying principle of ensuring speedier implementation and a more efficient use of IFAD's resources, this restructuring policy includes a mandatory cancellation of the allocation to a project if:

    (a) The financing agreement has not entered into force 18 months after Executive Board approval; or
    (b) The financing has not started disbursing 18 months from entry into force of the financing agreement.

15. Pursuant to paragraph 13 above, the amount allocated to a project will automatically be cancelled unless, before the expiration date of the 18-month period, the Executive Board approves a further extension beyond that date of up to one year, as otherwise the allocation will automatically revert to IFAD's resources. This may be done through the lapse-of-time (LOT) procedure to expedite the process.

16. A cancellation following suspension as regulated under the General Conditions for Agricultural Development Financing (article XII, section 12.01) is not treated as a restructuring, and this policy does not apply to such cases.

[5] In line with IFAD's policy on crisis prevention and recovery (2006) and IFAD Guidelines for Disaster Early Recovery (2011).
[6] All funds recommitted to performing projects will be used in line with IFAD's procedures for additional financing.

(iv) Additional financing

17. Additional financing is an instrument that provides additional resources to an existing well-performing project and may be proposed in conjunction with project restructuring.[7] Additional financing can be used to scale up successful projects and/or to fill a financing gap quickly and flexibly. Procedures will be established to guide additional financing, but the following high level criteria should be established as a minimum:

(i) Consistency with the development objectives of the original project design. If the project is to be scaled up, modifications to the original design should be in line with the implementation recommendations provided during supervision.

(ii) The project should be performing well in terms of implementation progress as well as financial management and audit.

(iii) Additional financing will not extend the original project financing by more than three years.

(iv) Financing gaps should not cover more than 20 per cent of cost overruns.

(v) The activities to be financed must comply with all relevant IFAD policies at the time of the additional financing request, including SECAP, targeting policies and performance indicators.[8]

(v) Reporting and monitoring

18. Management will inform the Executive Board annually of project restructurings in the aggregate, by restructuring modality. An analysis of the impact of the restructuring policy will be provided after three years of implementation.

19. A comprehensive system is planned to track all restructuring and will facilitate the assessment of the relevance and effectiveness of project modification during project implementation.

IV. Financial impact and risk management

20. The financial impact of introducing this restructuring policy has been analysed, and includes a small reduction in cancellation balances available for IFAD's resources and slightly reduced liquidity due to faster disbursements. The overall impact is not significant either in itself or in proportion to IFAD's resources.[9]

V. Next steps

21. This Project Restructuring Policy will be effective from 1 January 2019. Financing approved before this date will not be subject to the provisions set out in paragraphs 14 and 15 above. Management will develop associated procedures and guidance for staff and will roll them out together from 2019, along with any required changes to IFAD's operational tools for portfolio monitoring, including automated workflows for quicker response times and for tracking and reporting on restructuring. The content of the new policy and how it fits into the supervision and implementation support process will be covered in the Operations Academy and other materials as required.

[7] An existing project is defined as a project approved but not yet completed.
[8] In cases where new policy requirements are effective at the time of the additional financing, these apply to the project as a whole and not just to the additional financing part.
[9] A financial sustainability scenario has been modelled based on assumptions over a 50-year time frame. The impact is sustainable for IFAD's financial model and in compliance with IFAD's Financial Framework and Scenarios for IFAD11.

VI. Recommendation

22. It is recommended that the Executive Board approves the IFAD Policy on Project Restructuring as outlined above. In particular, the Board is requested to note that the policy:

(i) Provides for Executive Board approval for project restructuring entailing a significant change to the scope or characteristics of a project or a change in the SECAP classification to category A;

(ii) Provides for reallocation of cancellations within a 12-month rolling basis from the date of the cancellation rather than on a calendar year basis;

(iii) Provides for reallocation of cancellations across IFAD replenishment periods subject to the overall time limit;

(iv) Provides that the current two-year time limit from Executive Board approval and signature of the financing agreement be shortened to 18 months from Board approval and entry into force;

(v) Provides that in the event that disbursements have not begun 18 months from entry into force of the financing agreement, the allocation to the project be cancelled.

(vi) The recommitment of cancelled funds to well-performing or new projects should be consistent with the current country strategy (COSOP or CSN) or IFAD’s policy on crisis prevention and recovery (2006).

IFAD's Current Restructuring Approach and Experience

1. Current IFAD policy and procedures. These establish different levels of approval processes for each type of restructuring for additional financing, changes in scope as follows:

   - Restructuring through changes and amendments are approved by Management (Associate Vice-President, Programme Management Department or President), except those that are combined with additional financing, which are approved by the Executive Board together with the proposal for additional financing.
   - Restructuring through changes and amendments that significantly change the scope or characteristics of a project is approved by the Executive Board.
   - Restructuring through full or partial cancellation is approved by the President.
   - Restructuring through full or partial cancellation and recommitment is approved by the President, and submitted to the Board for approval.

2. Supervision and Implementation Support (SIS) Policy empowers country teams to make proactive and regular modifications to active projects to promote development effectiveness. The SIS policy provides an overall framework and is updated from time to time to ensure that it promotes agility.[10]

3. Cancellations of financing. The revision of IFAD approach to use of cancellation of approved loans and/or grants[11] allows for resources to be cancelled and recommitted to well-performing projects or new projects in the same country within the calendar year in which the cancellation occurs, provided that it does not extend beyond the current replenishment period. This means that cancellations in one replenishment cycle cannot be carried forward to a subsequent replenishment cycle. PBAS allocations are not altered by this process. Cancelled funds are available for recommitment on the financing terms (grants or loans) for which the borrower is eligible in the year during which the funds are recommitted. A minimum cancellation of US$1 million is needed to recommit funds to another project in the country. The policy also provides that amounts cancelled from projects that have less than one year left before completion are not eligible for recommitment. Cancellations after a closing date are also not eligible for recommitment and are returned to IFAD accounts.

4. Signing of the financing agreement. In 1992[12] the Audit Committee recommended that the Executive Board adopt a policy providing for automatic cancellation of any loan that had been approved but not signed after a period of two years. This policy highlights IFAD resources assigned to countries which are not being actively used and acts as a driver to ensure buy-in from borrowers.

5. General Conditions for Agricultural Development Financing give IFAD the authority to make unilateral changes for: (i) reallocation of proceeds among categories and reduction of percentages of categories; and (ii) postponement of project completion and financing closing dates.

6. Financial Management and Administration Manual.[13] This manual provides for changes during implementation in certain circumstances.

7. IFAD experience. Since the adoption of direct supervision in 2007, IFAD has increased its development effectiveness. About 77 per cent of projects achieved their development objectives in 2017[14] compared to 66 per cent in 2007,[15] as rated

[10] IFAD Policy on Supervision and Implementation Support, EB 2006/89/R.4/Rev.1.
[11] Revision of IFAD approach to use of cancellation of approved loans and/or grants, EB 2014/111/R.12/Rev.1.
[12] EB 92/45/R.8, para. 10.
[13] Financial Management and Administration Manual (FAM) www.ifad.org/web/guest/document-detail/asset/39637251.
[14] IFAD Portfolio stocktaking exercise 2018.

in project completion reports. As of June 2018, 74 per cent of the portfolio was considered not at risk and 26 per cent was classified as at risk (potential and actual problem projects), of which around 61 per cent chronically at risk. The share of projects at risk is similar across regions. The corporate proactivity index is about 37 per cent. An analysis[16] shows that IFAD's overall disbursement rate was about 85 per cent, indicating that about 15 per cent of approved financing was cancelled. Of this, the majority of cancellations (62 per cent) took place at completion, about 31 per cent before the first disbursement and only 7 per cent during implementation. While these indicators may indicate additional scope for more proactively tackling issues during project implementation, without a systematic tracking system it is difficult to determine to what extent restructuring has taken place.

8. Reallocations: About 25 per cent to 30 per cent of projects undergo changes that require a reallocation of loan funds among categories of above 30 per cent of the original allocation, thus requiring an amendment to the financing agreement to adjust schedule 2. These amendments are handled internally.

9. Additional financing: Over the past few years, Management adopted the practice of designing operations with financing gaps, with full project costs to be covered over two PBAS cycles. This practice has strong positive effects on efficiency because it reduces design costs and elapsed time to deliver and is in line with the IFAD11 business model of fewer and larger operations to achieve greater efficiency and development effectiveness. About 21 per cent of projects receive additional IFAD financing and this share is expected to increase to about 30 per cent of the total portfolio during IFAD11. In the move to financing bigger projects, the number of financing instruments per project has increased substantially, from 1.4 in 2013 to 2.2 in 2018. Although supervision is more efficient as a result because the project is the single interface with the Government during supervision, the administrative load for the IFAD financing provided has increased.

10. Problem projects. About 15 per cent to 17 per cent of the portfolio is classified as actual problem projects. About half of problem projects are restructured (equivalent to about 6 per cent to 8 per cent of the total portfolio), and this takes five years. Only 38 per cent of problem projects move to being classified not at risk, with improvements mainly as a result of changes to project management. About 30 per cent of actual problem projects are in countries with fragile situations, and about 25 per cent are in countries with weak agricultural institutions.[17] A problem project is not eligible for additional financing.

11. Better early warning. The corporate approach and systems for identifying projects at risk should be sharpened to trigger early warning when projects start to encounter problems, so that proactive measures can be put in place sooner in the project cycle.

12. Financing not disbursing following Executive Board approval. A recent analysis in connection with a corporate working group on suspensions showed that there were 14 non-disbursing loans and grants approved nearly three years previously, totalling some US$180 million (including two loans in a country under suspension at the time), and four non-disbursing loans and grants totalling US$20 million approved between four and eight years previously (including two loans in countries under suspension).

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[15] Supervision implementation and support policy, page 22.
[16] IFAD Disbursement performance, no. 14 Research Series, 2016.
[17] FAO Investment Centre, May 2015, analysis of the project completion reports for 32 closed persistent problem projects.

Benchmarking of Multilateral Development Banks' Approach to Restructuring and Modifications

World Bank	Asian Development Bank	African Development Bank
Supervision since 1945	Supervision since 1966	Supervision since 1966
Restructuring policy 2017	Restructuring parameters in operations manual	Policy on portfolio review and restructuring 1995
Level 1 – Change to safeguard category to A, alternative procurement arrangements, require Board approval[18]	Major - changes affecting the scope and outcome must be approved by Board	Changes approved by Board: • Lending instrument; • Application of loan balances to new projects or supplementary loans; • Project scope; • Use of loan balances which are beyond the present scope of project or sector
Level 2 – all other modifications requiring amendment to original legal agreements and signed before the closing date of original investment project are approved internally by Management	Minor - changes in costs, financing plan, outputs and performance targets, implementation arrangements, disbursement, reporting arrangements approved by Director General or delegate	Changes not approved by Board (information note to Board): No actions that require Board approval

[18] Before the approval of its new restructuring policy, changes to project development objectives were submitted to the Board, and now approval of these changes has been delegated to Management to reduce the time required for approval. This is expected to speed up addressing poorly performing projects so that corrections are adopted earlier in the project cycle. Streamlining restructuring policies and procedures, World Bank, July 18, 2017, para. 20.