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## IFAD's Proposal for Piloting Results-based Lending

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## Abbreviations and acronyms

AsDB	Asian Development Bank
ARRI	Annual Report on Results and Impact of IFAD Operations
DLI	disbursement-linked indicator
FIPS	Faster Implementation of Project Start-up
FLM	flexible lending mechanism
IFI	international financial institution
M&E	monitoring and evaluation
PforR	Program-for-Results (World Bank)
RBF	results-based financing
RBL	results-based lending
SWAp	sector-wide approach

## Recommendation

As one of its commitments under the Eleventh Replenishment of IFAD's Resources, (IFAD11), IFAD will develop a proposal to pilot results-based lending (RBL) for consideration by the Executive Board. This proposal builds upon the Concept Note on Results-based Lending (TFWG 2018/3/W.P.2) presented to the Working Group on the Transition Framework and provides more streamlined information about the IFAD-specific proposal on how to pilot RBL.

The Working Group on the Transition Framework is invited to review and endorse the rationale for introducing RBL operations in IFAD and the proposal for a pilot phase as summarized below.

**Demand-driven voluntary pilots.** IFAD will undertake a demand-driven selection process, with regional divisions promoting the concept of RBL among borrowing countries. Piloting of the instrument in different countries to assess its suitability to a variety of development challenges will be encouraged. The decision to use the RBL instrument will be voluntary. No country will be obliged to adopt RBL instead of investment lending and no country will be excluded a priori from using RBL.

**Piloting a variety of RBL mechanisms:** IFAD will benefit from experimenting with different types of RBL to learn what best fits its capabilities and comparative advantages. This document outlines two main types of RBL undertaken by other international financial institutions (IFIs): project RBL and programmatic RBL. The proposal is for IFAD to introduce at least one of each type of RBL during the pilot phase.

**Piloting in specific areas.** Potential focus areas for IFAD's pilot of project RBL could include: (i) public services to farmers such as extension services (e.g. business planning assistance) and infrastructure services (e.g. irrigation); and (ii) incentive programmes for behavioural change of smallholder farmers (e.g. crop conversion linked to climate adaptation). IFAD will explore other areas for project RBL pilots. Potential focus areas for piloting IFAD's programmatic RBL could include support at the central, provincial and local levels of government as part of a broader government-owned programme.

**Partnering during the pilot phase.** The proposal suggests that IFAD's initial pilot of programmatic RBL be undertaken in partnership with an IFI that has experience with this type of RBL, drawing on technical assessments for the use of country systems undertaken as part of programmatic RBL. IFAD would participate as a cofinancier and would review these assessments. This approach will allow IFAD to gradually build the required competencies – both at headquarters and in the field – in all the aspects of RBL, including with government discussions, design, supervision and monitoring.

**Financing of pilots through PBAS allocations with additional administrative support.** Pilot RBL operations will be financed through part or all of the performance-based allocation system allocation for each participating country as per the terms established for each country category. Consistent with the voluntary spirit of the pilots, the decision as to the share of a country's PBAS allocation for IFAD11 to be devoted to RBL will remain with the country. There will be no additional "premium" allocation for RBL, nor will a portion of the PBAS allocation be set aside for it. Limited additional administrative resources will be dedicated to the design, implementation and assessment of the pilots.

## Recommendation (continued)

Duration of the pilot phase. The pilot phase will be time-bound and designed as a learning effort. Based on the experiences of other IFIs, it is proposed that the pilots be undertaken over a period of at least six years, in line with the typical duration of a programmatic RBL operation, to be able to evaluate its full cycle. It is proposed that IFAD undertake at least two or three pilots (representing a modest proportion of the projects approved annually). This will allow for an assessment of the RBL process at the end of the pilot period.

Self-assessment after three years to gather lessons learned. Three years after the approval of the first pilot, IFAD will undertake a self-assessment aimed at gathering the most wide-ranging lessons possible. The self-assessment will include: (i) the costs incurred for the design and supervision of the operation; (ii) the demand from borrowers; (iii) the role played by IFAD in designing the operation; (iv) the criteria used by IFAD to select the pilots; (v) the internal level of familiarity with the RBL instrument and the need for further learning/training; (vi) the disbursement trends of the ongoing operations; and (vii) the experience in data gathering by the independent assigned party as part of the verification protocol for disbursement-linked indicators

Realistic and shared choice of disbursement-linked indicators (DLIs). The selection of DLIs should take into consideration the practical aspects of measuring, monitoring and verifying achievement of the results, including the specific challenges of the agricultural sector. The DLIs should be clearly defined and measurable, with clear protocols for monitoring. The DLIs should be structured so as to take into account the country's context and the borrower's capacity, and should be realistic in considering whether it is feasible to achieve the results selected as DLIs during the implementation period.

Independent verification protocol for DLIs. A key feature of any RBL operation is the verification protocol of the DLIs agreed as part of the design between the lender and the borrowing government. An separate entity, independent from both the borrowing government and the lender, whose capacity and reliability are assessed as part of programme preparation, will be identified in the DLI matrix included in the project/programme document. The scope of the verification are the objective and quantitative measures related to numerical indicators agreed for each DLI with respect to agreed baselines. This process does not entail rating the project or assessing its performance. The Independent Office of Evaluation of IFAD (IOE) has no role in this process. IOE will assess the project/programme at completion in line with current rules for loan investment projects.

Executive Board approval of each pilot and, if needed, waivers. The proposal suggests that IFAD's RBL will not be guided by a new policy; instead, interim guidance will be provided by Management to design and implement the pilots. The proposal further suggests that the pilot launch be accompanied by an indication of any policy and/or procedural waivers that may need to be approved by the Executive Board. Each pilot project will also be presented to the Executive Board for discussion and approval.

## IFAD's Proposal for Piloting Results-based Lending

### I. Background and rationale for IFAD results-based lending

1. IFAD is currently constrained by its menu of lending products. In contrast to other international financial institutions (IFIs), which have a wider choice of options, IFAD currently has a single lending instrument. With IFAD's increased focus on policy dialogue and partnership-building, it has been raising its profile to engage at a higher level of policy and institutional reform. Developing a lending mechanism to target IFAD's financing at the delivery of concrete results and broadening the scope of IFAD's financing to include areas critical to the delivery of broader government agricultural programmes have the potential to bring IFAD to the next level.
2. IFAD has committed to piloting results-based lending (RBL) during the Eleventh Replenishment of IFAD's Resources (IFAD11). The IFAD11 commitment states that IFAD will pilot diversified products tailored to different country circumstances, noting that it will "develop a proposal to pilot results-based lending for consideration by the Executive Board".<sup>1</sup>
3. There is preliminary evidence from IFAD borrowers of a demand for RBL. In 2017, the Corporate-level Evaluation on IFAD's Financial Architecture was undertaken to assess IFAD's financial architecture, including inputs from governments and IFAD staff on expanding IFAD's product offering. Respondents suggested that more products would increase choice and flexibility, enabling borrowing countries to select the product that best meets their needs. There was strong agreement that IFAD should develop an RBL approach,<sup>2</sup> with financing that is disbursed according to the achievement of specific programme results and performance indicators. Some borrower countries signalled their interest in IFAD providing support through more results-based approaches to incentivize performance. They reported a preference for IFAD support that contributes strategically to government programmes and helps build government capacity for managing expenditures and investment programmes. While it is recognized that such surveys do not equal commitments, and that there might be different levels of understanding of the instrument, they provide an encouraging starting point for proposing the instrument.
4. IFAD's Transition Framework calls for better tailoring of IFAD products to its Members. IFAD has mapped out a path to transition borrower countries in a predictable and sustainable way. It also envisages an IFAD that can respond to borrowers' demand for more tools and provide more flexibility in its support. To this end, IFAD will need to tailor support for Members on a differentiated basis, as recognized in the enhanced business model for IFAD11.
5. IFAD aims to increase the effectiveness of its lending and non-lending activities. IFAD's overall project lending performance is good, with an aggregate rating of "moderately satisfactory", but there is an ambition to enhance this performance. The 2016 and 2017 Annual Reports on Results and Impact of IFAD Operations (ARRIs) suggest that adopting more strategic approaches, increasing coordination with other partners and focusing more on institutional development are key to increasing IFAD's effectiveness. IFAD now engages in activities beyond project lending including policy dialogue, knowledge management and partnership-building. These activities have also been rated in recent years as "moderately

<sup>1</sup> See GC 41/L.3/Rev.1, Report of the Consultation of the Eleventh Replenishment on IFAD's Resources, commitment 3.6, monitorable action 36.

<sup>2</sup> From the corporate-level evaluation on IFAD's Financial Architecture: Of non-IFAD respondents, 70 per cent assigned high or highest priority to developing an RBL product along with 59 per cent of IFAD respondents.

satisfactory” and there is a similar desire to enhance performance. An effort is under way to: build stronger linkages that enable the flow of knowledge from project management units to governments and other stakeholders; scale up successful experiences and results at the project level; support broader policy dialogue and partnership-building; and better link lending and non-lending activities. Enhanced non-lending activities would also be critical to any programmatic engagement in RBL.

6. RBL has the potential to scale up and increase IFAD’s impact. The introduction of an RBL approach has the potential to increase IFAD’s focus on results and higher-level impact. In both project and programmatic RBL, such a mechanism has the potential to draw on IFAD’s experience with smallholder farmers and indigenous peoples, and scale up development impact among these groups.

## II. IFAD’s proposal for piloting results-based lending

### A. Leveraging IFAD’s comparative advantage

7. IFAD’s focus on smallholder farmers can shift the paradigm of government service provision at the local level. Within the many areas of support to the agricultural sector, IFAD’s comparative advantage lies in its focus on smallholder farmers and rural communities, and its ability to connect them to broader markets through value chain support. IFAD is recognized, in particular, for targeting the poorest segments of the farming sector in geographically remote areas. It is also noted for spearheading innovation and testing solutions at the local level that can be replicated and scaled up. IFAD’s focus on smallholder farmers and its experience with innovation enable it to support government services in becoming more performance- or results-based, increasing the impact on its target group. There is significant potential to introduce more participatory approaches to promoting results attainment in RBL; IFAD could draw on its experience in this area – its hands-on approach and its relationships with rural communities and farmers’ organizations – to deliver meaningful project results.
8. IFAD can also bring the perspectives of smallholders to larger government programmes. The Fund can leverage its vast experience of supporting smallholders by bringing their perspectives to bear on policies and programmes at the provincial and national levels. IFAD can draw on experience in supporting institutional development at the local level to influence programme delivery, policies and institutional development at higher levels of government. This would provide a significant opportunity for IFAD to scale up its impact in line with its scaling-up agenda,<sup>3</sup> while maintaining its focus on smallholder farmers. Governments’ multi-year expenditure programmes for agriculture and rural development aim to improve agricultural productivity through a variety of means, such as linking rural production to markets and encouraging investments in needed rural infrastructure and climate-smart production. When IFIs and donors join governments to finance these programmes, they can jointly support a variety of reforms (e.g. shift subsidies) and improve the performance of government agencies. They can also introduce a results focus that increases the impact of both the development partners’ financing and the government programmes they are supporting. However this focus on central governments and national programmes can make it easy for development partners to lose sight of the smallholder perspective; IFAD could fill this crucial gap. A current example of IFAD putting this into practice is in Indonesia, where it is providing parallel financing to a large-scale irrigation development programme supported by the Asian Development Bank (AsDB). IFAD will integrate the perspectives of smallholder farmers to improve

<sup>3</sup> Brookings, *Scaling up Programs for the Rural Poor: IFAD’s experience, lessons and prospects (Phase 2)*, Brookings Global Economy and Development (January, 2013).

infrastructure planning, and will provide farmers with capacity-building support, value-chain financing and support for on-farm and off-farm institution-building.

## B. Learn from IFAD's own experience

9. IFAD has been endeavouring to expand its array of services to borrowers. Along with other IFIs, IFAD has experimented with flexible lending mechanisms (FLMs), sector-wide approaches (SWAp) and other forms of programmatic support. The uptake of FLM after its introduction in 1998 was vigorous: 20 FLM projects were approved between September 1998 and April 2002. However, a Board decision in 2002 limited FLM operations to those already approved or in the pipeline (until the mechanism had been thoroughly evaluated) and a Management self-assessment in 2007 concluded that FLM had had only limited success. It was then agreed that the positive features of FLM would be integrated into other IFAD project designs. A subsequent effort involved the SWAp mechanism. IFAD introduced a policy for SWAps in 2005.<sup>4</sup> The SWAp concept was intended to bring together external assistance and domestic funds within a single-sector strategy and expenditure framework, owned and led by governments with development partners progressively aligning and harmonizing their procedures with country systems. While SWAps were relatively prevalent in social sectors, there was less uptake in the agricultural sector<sup>5</sup> and IFAD did not engage in any new SWAps after the approval of the policy.
10. Lessons learned from these early initiatives can inform IFAD's development of RBL approaches going forward. While these two initiatives were not fully successful in achieving their goals, they introduced important elements that IFAD can build on in future RBL efforts. For instance, the triggers used for FLM tranches provided experiences that can be drawn on in the formulation and monitoring of DLIs. In addition, the programmatic nature of SWAps together with their focus on results built a foundation for programmatic results-based financing (RBF) in other organizations.<sup>6</sup> These initiatives also provided a number of lessons on the critical foundations needed for RBL, including strong government leadership and institutional capacity of both government and IFI staff in order to develop appropriate results chains and DLIs. They underscored the challenges of adapting new approaches to each organization's context and the effort needed to build ownership and institutional capacity within an organization.

<sup>4</sup> See EB 2005/84/R.5/Rev.1, IFAD Policy on Sector-Wide Approaches for Agriculture and Rural Development.

<sup>5</sup> The 2007 study of SWAps in agriculture noted only 15 operations worldwide (see *Formulating and Implementing SWAps in Agriculture and Rural Development*, Global Donor Platform for Rural Development).

<sup>6</sup> IFAD's experience with SWAps was limited to two or three projects, which were not considered fully successful. However, some valuable lessons were learned by IFAD and there were some positive results for its clients (e.g. more participatory and results-based delivery of services in the United Republic of Tanzania).



11. More recently, there have been promising initiatives to improve the results focus of IFAD's investment projects. Performance-based financing has been a growing element in microfinance and experiences from it have been shared with a variety of financial service providers and clients with the aim of improving access to financing. IFAD has introduced performance-based agreements<sup>7</sup> in a number of rural finance operations by employing outcome-based indicators that serve as triggers for fund disbursement and other project support.<sup>8</sup> An example is the Zambia Rural Finance Expansion Programme, which linked disbursements to quarterly baseline and impact survey reports. Performance-based agreements can take many forms to incentivize different actors. These kinds of incentive payments linked to IFAD's own disbursements represent important innovations, which embed the achievement of results into IFAD projects. Efforts will be made to identify further examples of innovation in past and ongoing projects, and build on this experience as IFAD pilots RBL approaches.
  12. IFAD has made a concerted effort to move more broadly towards a greater results focus. IFAD has established a structure for results measurement and management, and M&E at the project, country and corporate levels. This includes project results matrices, results-based country strategic opportunities programmes (RB-COSOPs), the annual Report on IFAD's Development Effectiveness (RIDE) built upon the Results and Impact Management System (RIMS), and the ARRI – IFAD's annual independent evaluation report. However, this structure has not been fully successful in shifting the Fund's focus towards results and outcomes. A 2013 study of IFAD found that "IFAD's results measurement and M&E are elaborate in design, but weak in implementation".<sup>9</sup> IFAD's internal annual reports have also noted that, while there has been progress on supervision and results management overall, M&E remains weak. This suggests that a more concerted effort to embed a results-based focus in projects and programmes (not only in results matrices attached to projects) could support an improved results orientation in IFAD. Close linkages and synergies with the results management framework in the COSOP and the results framework underpinning RBF instruments should be identified when selecting pilots.
- C. Demand-driven voluntary pilots
13. The pilot phase will be demand-driven and of a voluntary nature. It is proposed that a small number of pilots will be identified in the second half of 2018 and in the first quarter of 2019 by interacting with regional divisions. Management will request proposals from regional divisions to identify appropriate pilots based on input from government counterparts and on criteria that would indicate the suitability of the instrument to the development problem.
  14. The choice to use the RBL instrument is voluntary. No country will be obliged to use it and no country will be excluded upfront from using it. Capacity assessment will be undertaken and, if needed, appropriate measures for capacity-building and risk mitigation will be put in place for the pilots in interested countries. The amount

<sup>7</sup> The accepted definition of a performance-based agreement in the provision of financing is that, "the agreement: (i) is clear and specific about the expected results and how they will be measured; and (ii) strengthens incentives for good performance by defining benefits (or sanctions) that are tied to the achievement (or non-achievement) of the expected results" (Consultative Group to Assist the Poor, *Performance-Based Agreements: Incorporating Performance-Based Elements into Standard Loan and Grant Agreements* (Washington, D.C., 2010).

<sup>8</sup> See the IFAD "how to do" note, *Key performance indicators and performance-based agreements in rural finance*, (October 2014). This document notes that: (i) outcome-based indicators are mostly used for non-lending arrangements; (ii) subsidiary loan agreements are used between projects and financial service providers; (iii) grant agreements are used when support originates from an IFAD grant facility; (iv) management agreements are used when the financial service provider is mandated to execute a large part of the activities in an IFAD-supported project; and (v) other types of special agreements (e.g. letters of agreement) may also be used. A performance-based agreement may be used following structured dialogue involving IFAD and a financial service provider on the context, indicators, drivers of performance and sanctions.

<sup>9</sup> See footnote 2.

of funds dedicated to RBL under each country's PBAS allocation remains voluntary, to be decided between IFAD and the country, according to the scope of the RBL type and operation. Each country will be free to decide whether to dedicate the entire PBAS allocation or a portion of it to the RBL operation.

#### D. Pilot a variety of RBL mechanisms in specific areas

15. IFAD should strive to pilot different types of RBL to learn what best fits its capabilities and comparative advantage, by experimenting with both project RBL and programmatic RBL.
16. IFAD's project lending can support governments and incentivize other actors to be more results-focused and emphasize the smallholder perspective. There is considerable potential for shifting IFAD's project lending towards a stronger and disbursement-linked results model, and making results a more integral part of IFAD's investment portfolio. This mechanism could be applied to a number of areas that IFAD currently supports, building on the limited performance-based financing currently offered. Given its focus on individual farmer families, IFAD's RBL would be particularly relevant to the provision of public services such as extension services, rural infrastructure and crop-conversion support linked to climate adaptation. Project RBL could also be applied to small-scale infrastructure given IFAD's role in enhancing smallholder returns and increasing income levels.
17. The area of climate-smart techniques and investments also has significant potential for using financial incentives to change farmers' behaviour. IFAD will be encouraged to explore other areas for RBL pilots and will review ongoing projects and the pipeline of additional financing to explore components or projects in which a results-based focus could be introduced. Performance metrics linked to the delivery and results of these services would benefit from the inputs of smallholder farmers, facilitated by IFAD. These projects could feature results-linked payments from central governments to lower-level intermediaries or service providers, providing a clear incentive for intermediaries to deliver services that achieve targeted results. It would draw on IFAD's ongoing experience with performance-based agreements in rural finance and other IFIs' experiences with investment lending using disbursement-based indicators.
18. In programmatic results-based lending, IFAD could play a useful role by bringing the smallholder perspective to large government-owned programmes. Over time, there may be scope for IFAD to assume a leading role in programmatic RBF, especially in small economies where IFAD may be providing a significant portion of development financing for agriculture. There may also be opportunities for IFAD to support government programmes at the provincial level, especially in countries where central governments have encouraged provincial reform and expenditure programmes are dedicated to supporting remote areas and rural poor people.

#### E. Partnering during the pilot phase

19. The complexity of the instrument, which is partially related to its novelty, is well acknowledged. IFAD will therefore partner with other IFIs especially for programmatic RBL. During the initial stages of the pilot, Management proposes that IFAD engage with another IFI that has experience with programmatic RBLs, enabling IFAD to gain experience during its initial foray into the area. Taking on the role of cofinancier, IFAD would work together with the lead IFI in designing and implementing programmatic RBF, bringing the smallholder perspective into the design and potentially supervising a specific portion of the project and related DLIs. A robust system would be needed to assess IFAD's contribution and indicate future roles for IFAD in supporting programmatic RBL. To date, these programmes have required considerable capacity to convene and carry out discussions with governments on key policy and institutional development issues; it would be difficult for IFAD to undertake such activities alone. RBF also requires the capacity

to assess the government systems to be used when financing is provided directly for a government expenditure programme. IFAD would initially need to rely on the lead IFI to carry out these technical assessments.

20. IFAD will draw on external expertise to support its efforts in RBL. Once candidates for pilots are identified, the design process will likely require additional support. Key design features include payment metrics, identifying the portion of funding attached to results, the pricing structure and the approach to verification. IFAD may need to engage consultants specialized in RBF to assist with this design. There are also considerable resources in the development community to support RBL design through donor-funded programmes and IFIs. Notably, the World Bank has developed training courses at different levels to build staff capacity on key aspects of programmatic RBL. The courses build staff capacity to make informed judgements about instrument design choices, including results frameworks and DLIs. The courses also assess areas of specific competence in broad fiduciary, environmental and social assessments for programmatic RBL. Other institutions offer training that is more focused on project RBL. Once pilots are identified, IFAD will leverage these training courses for the necessary parties. The Capacity-Scan programme (which supports governments in improving results and M&E capacity) is being piloted in the rural sector through the Advancing Knowledge for Agricultural Impact initiative to assess in-country results-based management systems and capacities, and identify shortfalls. These could potentially be deployed for IFAD's RBL pilots. As IFAD moves into more programmatic RBL, it may draw on country assessments (for example of public financial management) undertaken by IFIs and other donor-funded groups. It may also outsource these assessments with financing from the proposed Technical Cooperation Facility of the Faster Implementation of Project Start-up (FIPS) mechanism, for environmental and climate assessment. IFAD is a member of the Multilateral Development Bank (MDB) Working Group on financial management where the issues related to fiduciary aspects of programmatic RBL are often discussed. IFAD will be able to draw on vast experience in this field and apply it to its pilot proposals.

#### F. Financing of pilots through PBAS allocation

21. RBL pilots will need to be tailored to IFAD's scale and financed from a country's PBAS allocation. For the pilot phase, borrowers will draw on their existing IFAD11 performance-based allocation to finance RBL operations. There will not be any bonus or set-aside in the PBAS for countries willing to pilot RBL. Neither will there be a prescribed share of usage of a country allocation. Each country will be free to decide which portion, if any, to be dedicated to RBL. Additional financing for well-performing projects/programmes will be allowed in line with current procedures for investment projects.<sup>10</sup>

#### G. Dedicated resources to support design of pilots

22. The design and implementation of the pilots will be undertaken by existing staff. However, given the learning that will be required to carry out these new operations, Management suggests that limited additional resources be dedicated to the design and implementation during IFAD11.
23. Recognizing the contributions it could make in the policy arena, IFAD has expanded its knowledge services and is engaging more extensively in policy dialogue. While resources for expanding its non-lending services have been constrained, IFAD is now proposing FIPS instruments as a new source of funding to provide analytic and advisory services in support of policy engagement for the rural sector. This proposed funding would support policy-related analysis and engagement in policy processes relevant to rural sectors, including national- and local-level assessments

<sup>10</sup> In line with other IFIs' procedures, additional financing for RBL follows the same procedures as investment projects.

of the sectoral policy context, policy gaps and capability assessments for developing and implementing policies. FIPS funding is also envisaged to support partnerships, including consultations with key stakeholders. This funding will enable IFAD to prepare projects with a results-based focus (e.g. with better performance metrics for agricultural service delivery), and develop programmes that support broader government policy and institutional reform.

#### H. Duration of pilot phase

24. The pilot phase will last six years and the number of operations will be tailored to capacity assessments. It is proposed that IFAD undertake at least two or three pilots (representing a modest portion of annual project approval) over a six-year period. This will allow for an assessment of processes and impact at the end of the pilot period. Both AsDB and the Inter-American Development Bank (IDB) have introduced six-year pilot programmes to allow ample time for review and evaluation.<sup>11</sup> Depending on the outcome of these pilots, Management will propose a modality for mainstreaming a more permanent form of RBL at IFAD.

#### I. Self-assessment after three years

25. A self-assessment will be undertaken three years after the approval of the first pilot. Management believes that the first three years of pilot will yield a number of lessons, including (i) the costs of design and supervision; (ii) demand from borrowers; (iii) the role played by IFAD in designing the operation; (iv) an assessment of the criteria used by IFAD to select the pilots; (v) staff familiarity with the RBL instrument and the need for further learning/training; (vi) the disbursement trends of the ongoing operation; and (vii) the experience with the independent assigned party in data gathering as part of the DLI verification protocol.

#### J. Criteria for selecting potentially successful pilots

26. Criteria for selecting pilots will be based on lessons learned and will include government willingness and commitment. The uptake of the instrument will be of a voluntary nature: no country will be obliged to use RBL and neither will any country be excluded ex ante from using it. The decision about the use of the instrument will be the result of a joint analysis of the development problem by IFAD and the borrower and the conclusion that RBL might be a more effective solution than a traditional investment project. Government commitment to developing RBL approaches in the agriculture sector will be critical, and IFAD's ability to conduct frequent discussions with its counterparts on project results and DLIs (for example through field offices) will be an important selection criterion. In the case of programmatic RBL, IFAD will also consult with IFIs on potential Program-for-Results (PforR), results-based lending, results-based financing and loan-based-on-results instruments in the pipeline to seek opportunities for cofinancing programmes that are aligned with IFAD's mandate. Criteria for pilot selection will be also derived from the lessons learned at other IFIs. One key criterion for successful programmatic pilots will be for countries to have a well-defined agriculture programme as part of national expenditure and for there to be a clear understanding between the government and IFAD of the types of results to be achieved, the results chain to get there, the actors to be incentivized and the type of data available for monitoring results.

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<sup>11</sup> For example, the AsDB policy paper *Piloting a Results-Based Financing for Programs Modality* (August 2012) stressed that "to enable learning-by-doing, it is proposed that AsDB pilot the RBF for programs modality for six years. This is the minimum time frame required to yield sufficient information for a subsequent review of RBF for programs operations, including both their design and implementation aspects. During the pilot, AsDB will put in place measures for training, dissemination, consultation and learning. AsDB will also learn from and exchange experiences with other development agencies. The experience derived from the pilot will inform the future policy direction of the RBF for programs modality." IDB's loan based on results pilot also has a six-year time frame.

## K. Realistic and shared choice of DLIs<sup>12</sup>

27. The choice of the right DLI is key: It should be jointly made and realistic. In RLB, disbursements are made based on the achievement of certain targets, as agreed in the definition of DLIs. During the programme preparation, IFAD will work with the borrowers to identify a set of indicators selected from the programme's results framework to be included in the DLI matrix. Capacity will be built to design DLIs, and to guarantee a common understanding of the targets to be reached as well as the payment modalities. During implementation, monitoring the achievement of DLIs allows the IFI and the borrowers to assess progress towards a programme's development objectives and to redirect it as needed. While DLIs vary in nature, they should be driven by desired outcomes or outputs; these can also be intermediate outcomes or outputs. The selection of DLIs should also take into consideration the practical aspects of measuring, monitoring and verifying achievement of the results. The DLIs should be clearly defined and measurable, with clear protocols for their monitoring. They should be structured so as to take account of the country's context and borrower capacity, and they should be realistic when considering whether it is feasible to achieve the DLI results selected during the implementation period. In this regard, it is important that governments are clearly in the driver's seat with respect to the design of RBL approaches and programmes and that both the overall results to be achieved and the specific DLIs to be used are developed in a participatory manner with active engagement by all stakeholders.

## L. Independent verification of DLIs

28. The DLI verification protocol must be solid and agreed upon. During the preparation of the RBL operation, IFAD will work with partners and the borrower to develop and agree upon the DLI verification protocol that substantiates the achievement of the DLIs. The verification protocol should include, as a minimum, the following:
- Clear definition of the DLI and how it will be measured.
  - Objective, detailed definition of what is required in order to consider the DLI as achieved.
  - Indication of whether disbursements associated with the DLI will be scalable.
  - Definition of the data sources that will be used to measure the DLI's achievement, including reporting frequency.
  - Baseline data and expected timing of DLI achievement clearly established based on comparable data sources.
  - Name of the government agency or third-party entity that will be responsible for providing relevant data and for verifying achievement of the DLI.
29. The DLI verification protocol should be an integral part of the monitoring and reporting arrangements for the RBL operation, and teams should agree upon the process through which the achievement of each of the DLIs will be verified. The DLI verification protocol and related verification arrangements are to be attached as an annex to the design document.
30. Verification of DLIs must be credible and independent. IFAD will work with the borrower to agree upon appropriate arrangements that will ensure credible verification of the achievement of DLIs. These arrangements could include the programme's established monitoring systems if they are assessed as having the

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<sup>12</sup> This section and the next one are largely sourced from the World Bank Programme for Results Guidance note (2012) which is a benchmark for the DLI choice and verification protocol, followed by all other IFIs who have introduced programmatic RBL.

capacity to produce objective, good quality and reliable data that will allow the timely verification of DLI achievement. In addition, external verification mechanisms, including the use of an independent agency in the country (e.g. the government statistics agency) or third parties (e.g. NGOs, private sector verification agencies, academic institutions) may be used. Any external institution providing verification must also be assessed to ensure that it has the experience and capacity to undertake credible verification. The primary objective is to ensure that a credible mechanism is in place for monitoring, measuring, and verifying the achievement of the DLIs. In some cases the World Bank has used external firms or consultants (both local and international). Firms can offer capacity and credibility when the independence of government agencies is questionable. The verification costs are normally part of the programme costs.

31. Verification is focused on the quantitative measures of outputs, intermediate outcomes or outcomes as described in the project document. It is not a subjective assessment of project performance and it is not performed in consultation with the Independent office of Evaluation of IFAD (IOE). IOE has no role in assessing nor verifying the measures attached to DLIs. IOE will evaluate the project/programme at completion, as is the current practice for investment projects.

#### M. Risk mitigation measures

32. The inherent risks of developing the new approach will be recognized and mitigated. One of the major risks related to RBL is the possibility that a project will not disburse funds. This can be mitigated in a number of ways. For instance, with programmatic RBL, careful attention should be paid to the respective weight of each DLI. The agreement between the IFI and the government should be explicit about what portion of the loan can be disbursed if there is only partial achievement of DLIs. Expectations may need to be adjusted since the timing of disbursements may be less predictable than for investment lending. For programmatic RBL, the use of country systems requires extensive ex ante assessment and agreement between the government and the IFI on programme action plans. IFAD will mitigate the lack of capacity for undertaking these assessments by relying on technical assessments undertaken by the lead IFI (to be reviewed and approved by IFAD). The risk of the government not fulfilling its obligations relative to the programme action plans can be mitigated by financing capacity-building efforts as part of the operation. In line with the practices of other IFIs for programmatic RBL, advanced disbursements in the range of 15 per cent to 25 per cent at signing could be proposed for the borrower to begin the necessary enhancements of country systems, if required as a project objective.<sup>13</sup> The specific risks related to the agricultural sector, as detailed in the Concept note on Results-based Lending, will be further mitigated by selecting primarily DLIs linked to outputs and intermediate outcomes, which are less challenging to measure.

#### N. Executive Board approval

33. The pilot phase will be time bound and designed as a learning effort, with the full engagement of the Executive Board. The proposal suggests that IFAD's RBL will not be guided by a new policy; instead, interim guidance will be provided by Management to design and implement the pilots supported. The pilot phase will be time bound and designed as a learning effort. The proposal further suggests that the pilot launch be accompanied by an indication of any specific policy/procedure waivers that may need to be approved by the Executive Board.

<sup>13</sup> The World Bank directive for PforR states that, "To provide a Borrower with resources to allow the Program to start or to facilitate the achievement of DLIs, the Bank may agree to make an advance payment (following the effectiveness of the legal agreement for the Financing) of up to 25 per cent of the Financing (unless a higher percentage is approved by Management) for one or more DLIs that have not yet been met ('advance'). When the DLI(s) for which an advance has been disbursed are achieved, the amount of the advance is deducted (recovered) from the amount due to be disbursed under such DLI(s)."

Each pilot project will be brought for discussion and approval by the Executive Board. At that time, Management, in consultation with the Executive Board, will review the need for any legal or policy changes to mainstream this effort. Maximum attention will be given to legal and fiduciary requirements, by building on lessons already learned through the MDB forum.

## The Disbursement-linked Indicator matrix<sup>14</sup>

1. The payment mechanism under each disbursement-linked indicator (DLI) should be clear and reflected in the DLI matrix. The financing amount allocated per DLI is determined by the IFI, in discussions with borrowers, based on the relative importance of the indicator to provide the incentive needed for achieving overall Program goals and outcomes. The more significant the DLI is for the achievement of the expected Program results, the more consideration should be given to assigning a higher portion of the financing amount to it.
2. Payment against one DLI can be proportionate. In discussions with the borrower, the Fund may agree to make disbursements against a DLI scalable—with the disbursement of financing proceeds proportional to the progress towards achieving the DLI. The decision to define scalable disbursements for a DLI should take into careful consideration the effect of a partial achievement of the indicator on the continued progress in the Program's results framework and on the eventual achievement of the entire development objective. In other words, scalability of disbursements may not apply to all DLIs. For instance, if a DLI refers to an action (e.g. modernization of procurement system in place), then it is either done or not. For each DLI with scalable disbursement, teams agree with the borrower on the formula to determine the amount of financing proceeds to be disbursed relative to the level of achievement of the DLI.
3. The DLI matrix will ensure clear overview of milestones and expected disbursements. The DLIs and the financing amounts allocated to the achievement of each DLI are recorded in the DLI Matrix. Taking into account the number of DLIs, the expected timing of DLI achievement, and the client's expected financing needs, the task team proposes an indicative time table for DLIs achievement and disbursement (e.g., on an annual, semi-annual, or quarterly basis). This time table is part of the DLI Matrix. A DLI can be specific to one period or defined to have stepwise targets over a series of periods. If DLIs are not achieved in the period initially planned, and are not time bound, they need not expire; the financing amount allocated to those DLIs may be made available for disbursement if the DLI is realized in later periods prior to the closing date. Similarly, if DLIs are achieved ahead of the expected period, disbursements can be claimed ahead of schedule. Lastly, if a DLI is not achieved by Program completion, the financing amount allocated to this DLI is not disbursed.

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<sup>14</sup> This section is largely sourced from the World Bank Programme for Results Guidance note (2012) which is a benchmark for the DLI choice and verification protocol, followed by all other IFIs who have introduced programmatic Results Based Lending.