Concessional Partner Loan Agreement with the Ministry of Foreign Affairs of Finland to Support the IFAD11 Programme of Loans and Grants

Note to Executive Board representatives

Focal points:

Technical questions: Charlotte Salford
Associate Vice-President
External Relations and Governance Department
Tel.: +39 06 5459 2142
e-mail: c.salford@ifad.org

Alvaro Lario
Associate Vice-President
Chief Financial Officer and Chief Controller
Financial Operations Department
Tel.: +39 06 5459 2403
e-mail: a.lario@ifad.org

Luis Jiménez-McInnis
Director
Partnership and Resource Mobilization Office
Tel.: +39 06 5459 2705
e-mail: l.jimenez-mcinnis@ifad.org

Katherine Meighan
General Counsel
Tel.: +39 06 5459 2496
e-mail: k.meighan@ifad.org

Domenico Nardelli
Director and Treasurer
Treasury Services Division
Tel.: +39 06 5459 2251
e-mail: d.nardelli@ifad.org

Advit Nath
Director and Controller
Accounting and Controller’s Division
Tel.: +39 06 5459 2829
e-mail: a.nath@ifad.org

Dispatch of documentation: Deirdre McGrenra
Chief
Governing Bodies
Tel.: +39 06 5459 2374
e-mail: gb@ifad.org

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For: Approval
Recommendation for approval

The Executive Board is invited to approve the detailed proposal, contained in part III of this document, related to the concessional partner loan (CPL) to be provided by the Republic of Finland through its Ministry of Foreign Affairs.

The CPL agreement was signed by the Ministry of Foreign Affairs of Finland and IFAD on 14 March 2019 and is fully compliant with the provisions of the CPL Framework approved by the Executive Board. The CPL agreement shall become effective upon approval by the Executive Board, following review by the Audit Committee.

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I. Executive summary

1. The Concessional Partner Loan (CPL) Framework, approved by the Executive Board at its special session held on 30 October 2017, sets out the parameters and criteria within which IFAD may borrow through the CPL modality from sovereign states and state-supported institutions. It was established in response to the need for IFAD to mobilize additional resources during the period of the Eleventh Replenishment of IFAD’s Resources (IFAD11) and possibly beyond, and as a key instrument in the financial framework of international financial institutions to expand the funding base beyond the standard core contribution.

2. A CPL is a loan provided by a Member State or a state-supported institution, under terms and conditions that include an interest rate significantly lower than market rates, long maturities and long grace periods. Members providing CPLs receive voting rights on the basis of the “grant element” embedded in such loans due to their concessional terms.

II. IFAD11 update

3. The most recent financial model update points to a financing gap for IFAD11 on the order of US$430 million. This is the amount of financial resources that IFAD needs to access through borrowing if it is to deliver a US$3.5 billion programme of loans and grants (PoLG), assuming that a level of core replenishment contributions in the amount of US$1.2 billion will be reached in IFAD11.

4. The above gap could be closed by further Member State contributions, for example through unrestricted complementary contributions. Alternatively, IFAD could activate the borrowing window, firstly through CPLs and subsequently through the Sovereign Borrowing Framework (SBF).

5. Over the past months, Management held conversations with several sovereign states and agencies that would be eligible to lend to IFAD under the CPL Framework. Discussions with Finland advanced rapidly. During IFAD’s Executive Board session in December 2018, Finland informed of its intention to provide a CPL to IFAD11. Along these lines, and to satisfy the 80 per cent CPL eligibility criteria, on 4 February 2019 Finland deposited an instrument of contribution (IOC) in the amount of EUR 4.62 million, additional to its original IOC of EUR 6 million, inclusive of regular resources and Debt Sustainability Framework. During IFAD’s Governing Council on 14 February 2019, Finland announced its decision to provide a CPL to IFAD11 in the amount of EUR 50 million. On 14 March 2019, the Minister
for Foreign Trade and Development of Finland, Anne-Mari Virolainen, and the President of IFAD, Gilbert F. Houngbo, signed the EUR 50 million CPL agreement, which is to become effective upon approval by the Executive Board of IFAD, following review by the Audit Committee.

III. Proposal to borrow from the Ministry of Foreign Affairs of Finland and adherence to CPL governance in regard to borrowing

6. Management is seeking Executive Board approval to borrow EUR 50 million from the Ministry of Foreign Affairs of Finland to finance part of the IFAD11 PoLG.

7. In line with CPL requirements, Finland is eligible to lend to IFAD because its core contribution to IFAD11 is 80 per cent of the average core contribution in local currency of the preceding two replenishment periods (IFAD9 and IFAD10).

A. Analysis of the proposal

8. In its main features the loan structure will be as follows:
   - Currency of denomination: euro;
   - Maturity: 40 years;
   - Grace period: 10 years;
   - Interest rate: 0.10 per cent per annum on the outstanding loan balance;
   - Commitment fee: zero; and
   - Drawdown: single-tranche drawdown.

9. Based on the terms above, and in line with the calculation criteria set forth in sections VI.B and VII of the CPL Framework, Finland’s CPL to IFAD11 includes a grant component of EUR 18.94 million, which makes Finland’s overall contribution to IFAD11 127 per cent above its contribution to IFAD10.

B. Use of borrowed funds

10. In line with the provisions of the CPL Framework, resources will be allocated through the performance-based allocation system to Member States borrowing on terms comparable to or higher than those applicable to the CPL, as appropriate, covering the whole set of lending products offered by IFAD. Priority will be given to loans provided on highly concessional and blend terms.

C. Financial ratios under the CPL Framework

11. The paper “Financial strategy for IFAD11 and beyond” provides that IFAD may borrow up to 50 per cent of the amount of the replenishment core contributions (i.e. up to US$600 million). CPLs would be the lowest-cost option for obtaining these borrowed funds.

D. Evaluation of risks

12. The risk management section of the CPL Framework (section VI.A) foresees that “in terms of risk management, CPLs provided to IFAD will be subject to similar risks and mitigation measures to those identified in the SBF” approved in April 2015. To this effect, the approach outlined in section VIII of the SBF on risk management will be followed where applicable for CPLs.

13. Currency risk is the main risk that IFAD might be exposed to if the funds were onlent in a currency different than the euro. As per section VIII, paragraph 30 of the SBF, IFAD will eliminate this risk by ensuring that the funds are onlent in the same currency as the loan, i.e. euro. If possible, after appropriate currency hedging, loans denominated in United States dollars may also be considered.
E. **Management of borrowed funds**
14. The proceeds from the CPL will be pooled with IFAD’s core resources and will be managed according to the Fund’s policies and procedures.

F. **Reporting**
15. IFAD will report on the resources mobilized under the CPL agreement and on use of the funds, in the IFAD Annual Report. The loan is an integral part of IFAD’s financial statements. Therefore, in line with auditing and reporting procedures, IFAD will provide the lender with yearly audited consolidated financial statements prepared in accordance with the International Financial Reporting Standards, and the related auditor’s report.