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IFAD
Investing in rural people

# Framework for IFAD non-Sovereign Private Sector Operations and Establishment of a Private Sector Trust Fund

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# Contents

**Annexes:**

**I.** Proposed instrument for the establishment of a private sector trust fund for the implementation of IFAD's Private Sector Engagement Strategy (the ''Private Sector Trust Fund'')

**II.** Financial Instruments

**III.** List of private sector entities contacted during market scoping

**IV.** Examples of complementarity between PoLG and NSOs

**V.** The Enhanced Blended Concessional Finance Principles for DFI Private Sector Operations of the DFI Working Group on Blended Concessional Finance for Private Sector Projects

**VI.** Measuring impact of IFAD's NSOs

**VII.** Environmental and social frameworks for NSOs with private sector FIs

**VIII.** Assessing additionality and development results

**IX.** Comments received and Management responses

# Abbreviations and acronyms

| | |
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| ABC Fund | Agribusiness Capital Fund |
| CSNs | country strategic notes |
| DFIs | development finance institutions |
| ESG | environmental, social and governance |
| ESMS | environmental and social management system |
| ESRS | Environmental and Social Review Summary |
| ESS | environmental and social standards |
| FIs | financial intermediaries |
| FOs | farmers' organizations |
| GPR | Global Engagement, Partnerships and Resource Mobilization Division |
| IFRS | International Financial Reporting Standards |
| MSME | micro, small and medium-sized enterprise |
| NAV | net asset value |
| NPLs | non-performing loans |
| NSOs | non-Sovereign Private Sector Operations |
| PAI | Private Sector Advisory and Implementation Unit |
| PD | probability of default |
| PoLG | programme of loans and grants |
| PSS | Private Sector Engagement Strategy |
| SDGs | Sustainable Development Goals |
| SECAP | IFAD's Social, Environmental and Climate Assessment Procedures |
| TA | technical assistance |

# Executive summary

1. Increasing IFAD's impact on food insecurity and rural poverty requires moving beyond routine interventions and scaling up resources and actions. Sourcing funds from, and delivering funds to, non-state actors, particularly the private sector, is key in this respect, as recognized by the 2015 Addis Ababa Action Agenda.

2. IFAD has a long track record of working indirectly with the private sector through its programme of loans and grants (PoLG) – particularly through its value chain projects, which represent 70 per cent of its portfolio – but also with foundations and civil society, especially farmers' organizations, indigenous peoples' groups and non-governmental organizations. While significant, these efforts cannot entirely meet the financing needs of IFAD’s target groups. A direct and strengthened engagement with the private sector is needed.

3. This was the impetus for the Governing Council’s February 2019 decision to amend IFAD’s Basic Legal Texts to facilitate the Fund's direct engagement with the private sector. In September 2019, IFAD adopted a new Private Sector Engagement Strategy (PSS), which defined the strategic directions to be followed.

4. Building on the guidance provided in the PSS, this Framework presents the broad approach and modalities behind IFAD’s non-Sovereign Private Sector Operations (NSOs). Specifically, the Framework provides key information on: (i) the criteria for, and modalities of, IFAD’s funding of NSOs and the safeguards required; and (ii) the description of the instruments envisaged for such funding.

5. IFAD’s NSOs are intended to complement the solutions already available through IFAD’s PoLG. They will leverage the Fund’s value proposition, which is based on: (i) an exclusive focus on rural development and a deep understanding of the rural sector’s needs; (ii) a long-term vision and patient investment horizon; (iii) a portfolio approach creating opportunities for linkages with public sector projects; (iv) a reputation as a trusted partner with persuasive convening power underpinned by strong, long-term relationships with governments; (v) extensive field presence with privileged access to data on farmers and agriculture ecosystems; (vi) higher-risk appetite through focus on smaller tickets and crowding-in of investments for small-scale producers; (vii) expertise as a proven assembler of development financing; and (viii) strong targeting and impact measurement frameworks.

6. Unlike other global agriculture programmes with public and private sector windows, IFAD’s NSOs will be closely linked to its PoLG by design, and will therefore take advantage of synergies between country-endorsed public sector programmes and activities, and emerging private sector businesses. This close link will ensure the additionality of IFAD’s NSO activities as well as reinforce country strategies in agriculture. It will help to ensure that NSOs are part of a larger focus rather than opportunistic interventions in agriculture.

7. The Framework starts by defining the criteria and eligibility for financing private sector entities and listing general eligibility requirements. It then lists five principles of engagement, namely: country ownership; complementarity with the PoLG; compliance with IFAD’s Rural Finance Policy; avoidance of control; and promotion of transparency and accountability.

8. The Framework also describes the screening process for NSOs based on the criteria set in the PSS: strategic alignment; additionality; expected development results; environmental and social issues and risks.

9. The Framework then proposes three financial instruments to be deployed in IFAD-supported NSOs – debt, equity and risk mitigation products. Main features and examples of use are provided for each instrument. Additionally, the Framework

emphasizes that NSOs should benefit from, and be strengthened by, embedded technical assistance (TA) as a way of ensuring their overall success and strengthen their development impact.

10. The Framework also enumerates the risks and risk mitigation measures and procedures for NSOs. This includes a description of the risk assessment process and pricing guidelines, a description of portfolio management, risk management and control measures, along with provisioning and capital requirements. It also defines how NSO environmental and social (E&S) risks will be screened and assessed based on IFAD’s Social, Environmental and Climate Assessment Procedures (SECAP) requirements adapted for NSOs. The purpose of the E&S screening is to identify the potential social, environmental and climate impacts and risks associated with a given NSO and to define the measures needed to minimize them.

11. The Framework also clarifies that NSOs will be driven by investment opportunities, including those that may arise from IFAD country programmes, the PoLG, or other IFAD activities. IFAD’s operational staff – Country Directors, Country Programme Officers and technical specialists – as well as staff from IFAD-financed projects, will be key sources in identifying NSO opportunities.

12. While complementarity with the PoLG is important, NSOs will follow structuring, governing and implementing practices supporting individual private sector entities.

13. In order to deliver NSOs IFAD will adopt a review process based on the principles of rigour and flexibility. Indeed, almost every partner consulted by IFAD has highlighted the need to be quick and agile in dealing with the private sector. That said, IFAD will also ensure maximum rigour to protect its reputation and its privileges and immunities, to manage risks, including those arising from E&S aspects and litigation and to preserve its financial position. All proposed NSO projects will be submitted to the Executive Board for approval.

14. The Framework further includes a proposal to establish a Private Sector Trust Fund to help mobilize resources for the PSS, particularly from private sources. Although the trust fund will be able to receive resources from Member States, it will also be seeking to mobilize funding from private sector impact investors and foundations.

15. In conclusion, as part of the PSS implementation, the Framework for NSOs was developed to provide the broad approaches and modalities guiding IFAD’s operations with the private sector. The Framework is intended to set the broad rules governing IFAD’s interactions with private entities.

16. To implement NSOs, IFAD will take a gradual approach to engage more directly with the private sector, ensure country ownership and consultation with governments, avoid mission drift by building on IFAD's comparative advantage, and work, as far as possible, with other development partners and United Nations agencies.

## Recommendation for approval

The Executive Board is invited to approve:

- The Framework for IFAD's non-Sovereign Private Sector Operations (the Framework); and
- The proposed instrument establishing a Private Sector Trust Fund for the implementation of the Private Sector Engagement Strategy (PSS), for application to the receipt, administration and use of all resources to be committed to the trust fund as of the adoption of such instrument.

# Framework for IFAD's non-Sovereign Private Sector Operations and Establishment of a Private Sector Trust Fund

# I. Introduction

## A. Background and rationale

1. Increasing IFAD's impact requires scaling up resources and actions to accelerate delivery of the Sustainable Development Goals (SDGs) – particularly SDGs 1 and 2. Sourcing funds from, and delivering funds to, private sector actors is key in this respect, as recognized by the 2015 Addis Ababa Action Agenda.

2. IFAD has a history of working indirectly with the private sector through its programme of loans and grants (PoLG) – particularly with its value chain projects, which represent 70 per cent of its portfolio. It has also worked extensively with foundations and civil society, especially producers' organizations, indigenous peoples' groups and NGOs. Indeed, a specific focus of IFAD has been to strengthen small producers and their organizations through their integration into supply chains, while at the same time providing needed infrastructure and rural financial services, promoting good policies and building resilience to climate change. IFAD has been also an active promoter of innovation and agriculture research for development. But while significant, these efforts need to be built upon and better coordinated.

3. This was the impetus for the Proposed Amendments to the Basic Legal Texts of IFAD to Facilitate the Fund's Engagement with the Private Sector, which were adopted by the Governing Council in February 2019. Subsequently, in September 2019[1] IFAD adopted a new PSS for the period 2019-2024[2]. The PSS set two main objectives: (i) mobilizing private funding and investments for rural micro, small and medium-sized enterprises (MSMEs) and small-scale agriculture; and (ii) expanding markets and increasing income and job opportunities for IFAD's target groups. A mid-term review of the PSS is expected at the end of 2021.

4. As indicated in the action plan (action 2.1) of the PSS, IFAD committed to develop a Framework for its private sector operations which is necessary to start implementing the PSS. In addition, the action plan (action 2.2) mentions that IFAD would also develop basic financial instruments and related policies and guidelines, which would allow the Fund to engage directly with financial institutions and other private sector entities.

[1] Governing Council Resolutions 208/XLII and 209/XLII.
[2] IFAD, EB 2019/127/R.3.

5. This Framework responds to action 2.1 and 2.2 of the PSS action plan. It is meant to guide the delivery of IFAD's non-Sovereign private sector operations (NSOs). These are expected to strengthen the Fund's development impact while being commercially viable, adhering to sound environmental, social and governance (ESG) standards, and promoting the coordination of public and private sector efforts. The NSOs will aim to leverage IFAD's extensive knowledge and experience to attract and de-risk private funding of IFAD's main target groups, with a focus on job creation, women's empowerment and strengthened resilience to climate change.

6. The NSOs could be particularly useful in countries with high public debt and openings for private sector investment. Indeed, by channelling funding through like-minded private investors, NSOs would help create opportunities for small-scale producers and rural communities without placing an additional burden on government finances. Similarly, in fragile countries with weak implementation capacity, NSOs could make a significant difference.

7. IFAD will gradually engage directly with the private sector, ensuring country ownership and consulting with governments. It will avoid mission drift by building on IFAD's selectivity and comparative advantage, working as much as possible with other development partners and United Nations agencies.

### B. Scope and objectives of the Framework

8. Building on the guidance provided in the PSS, this Framework defines the broad approaches and modalities guiding IFAD's NSOs. It provides key information on: (i) the specific criteria, modalities and safeguards required in IFAD funding of such projects; and (ii) a description of the prospective instruments to be used.

9. This Framework will not apply to: (i) any financing which is extended to public entities or any other entity having a sovereign guarantee or a direct and irrevocable undertaking from a Member State; or (ii) any financing, which is classified by IFAD as a sovereign operation. It will recognize the dynamic nature of NSOs and will therefore not attempt to define every operational arrangement concerning NSOs at IFAD in detail; rather, it will serve as an overarching guide on how IFAD will operationalize its PSS.

## II. Strategic considerations

### A. Strategic positioning of IFAD's NSOs

10. IFAD's NSOs are intended to complement the solutions already available through other development partners and both commercial and non-commercial players in rural areas. Indeed, there are already a large number of entities delivering loans and technical assistance (TA) to small producers there. Notwithstanding the efforts of existing actors in the field, the gap between demand and supply for finance remains wide, mostly due to real and perceived risks and the usually high cost of delivering agriculture-oriented funding, particularly for small producers. Certain value chains such as coffee and nuts, where information is more easily available, are being partially served today by social investors and local commercial banks. However, higher-risk value chains such as food crops, which are characterized by volatile local markets, remain underserved. It is precisely in those higher-risk value chains that finance is most needed. And that is where IFAD can play a catalytic role, leveraging its deep knowledge and experience of sustainable and inclusive rural transformation.

11. At the same time, there are opportunities for IFAD to invest in tighter value chains, where additionality could be achieved with financing provided at, or around, market rates. Cooperatives and MSMEs involved in cocoa post-harvest processing in West Africa and Latin America are good examples. Many already have access to short-term financing for pre-harvest needs, but are unable to secure the long-term

financing needed to upgrade facilities and generate more value for their products. Some cooperatives also require working capital as well as injections of funds to better manage price risks and to expand their own farmer-based credit programmes. Other, smaller cooperatives with a limited number of buyers lack finance to expand their production and markets. But availability of this type of funding is currently insufficient due, among others, to tight prudential regulations.[3] Importantly, IFAD's NSOs will aim to deliver financing bundled with TA and other de-risking activities leveraging on the PoLG, which should provide a powerful tool to lift these entities to more financially sustainable levels.

12. IFAD will target sectors and entities that represent high priorities for the Fund, including: producers organizations, female and youth-owned and -operated SMEs; MSMEs committed to recovering and conserving ecosystem services[4] and building resilience through integrated and biodiverse farming systems; and entities that strongly support climate-smart approaches, among others. IFAD's financing will aim to help these actors grow and generate sufficient revenues, allowing them to access more commercial sources of funding later on.

13. Most international financial institutions (IFIs) and impact funds price their risks with the same methodologies used by capital markets. This produces financial conditions that are unacceptable to many of the participants in agricultural value chains, particularly the vulnerable groups targeted by IFAD.

14. IFAD will offer funding directly to agribusinesses or through financing arrangements with like-minded, responsible and accountable financial intermediaries (FIs) or other organizations such as leasing companies, impact investment funds and innovative alternative lenders such as those using technology-based solutions. This funding will try to offer terms and conditions adapted to the needs of those operating in the high-impact, high-risk sectors of IFAD's target market. IFAD funding will aim to offer particularly:

(i) **Patient capital**. IFAD's additionality lies in providing or crowding-in financing that markets are not able or willing to offer due to the perceived risks and high transaction costs involved. This entails the deployment of patient capital, with maturity commensurate with agricultural cycles and reflecting the higher-risk profiles and time frames involved in building sustainable value chains. Overall, it means offering more flexible and suitable terms and conditions.

(ii) **Blended finance**. Management is aware that the positioning of IFAD's NSOs will expose the Fund to riskier parts of the market and involve financing on more flexible and concessional terms, thus implying lower returns. Nonetheless, this is well aligned with IFAD's mandate. Therefore, in accordance with the Enhanced Blended Concessional Finance Principles for development finance institutions (DFI) Private Sector Operations, IFAD will first risk-price the proposed financial product and then evaluate the required level of minimum concessionality. This approach means that IFAD will not necessarily offer lower rates or pricing – it could offer for example longer maturities or lessened collateral requirements. The development impact of the blended funding provided to private sector entities and the potential for addressing market failures will, in all cases, be thoroughly assessed and disclosed. Besides, an appropriate portfolio management system allows for cross-subsidizing activities.

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[3] Prudential regulation refers to the rules that financial institutions must observe in order, inter alia, to control risks and hold adequate capital and liquidity reserves. They also include reporting and public disclosure requirements and supervisory controls and processes.

[4] Ecosystem services include: provisioning services such as the supply of food, fibre, biomass and freshwater; regulating services such as flood and erosion control, and water purification; and supporting services such as soil formation, photosynthesis, pollination, nutrient and water cycling (Millennium Ecosystem Assessment, 2005).

## B. IFAD's comparative advantage

15. IFAD is the second-largest multilateral development investor in food security and agriculture. As such, its comparative advantage with respect to other impact financing players and development partners lies in its unique knowledge and expertise of the context in which small producers operate. This will allow the Fund to venture into financing market segments that other actors consider as risky, leveraging on its information capital. Equally compelling will be IFAD's ability to take innovative models and bring them to scale globally, something that small impact investors and social entrepreneurs struggle to achieve.

16. Unlike other IFIs and global agriculture programmes, IFAD's NSOs will be closely linked to its PoLG by design and therefore will take advantage of synergies between country-endorsed public sector programmes and activities and emerging private sector businesses. This close link will ensure the additionality of IFAD's NSO activities and reinforce country strategies in agriculture. It will help make sure that NSOs are part of a larger strategy rather than opportunistic private sector investments in agriculture.

17. Furthermore, IFAD's NSOs will benefit from lessons learned from other development partners. From the outset, there will be agreement on the risk appetite of NSOs, which will allow IFAD to take the risks required to address the needs of its target beneficiaries. This will make IFAD's NSOs flexible and truly responsive to small-scale producers' needs, e.g. by investing in smaller projects currently not served by larger IFIs.

18. IFAD's value proposition to private sector partners will be based on: (i) an exclusive focus on rural development and a deep understanding of rural sector needs; (ii) a long-term vision and patient investment horizon; (iii) a portfolio approach creating opportunities for linkages with public sector projects; (iv) a reputation as trusted partner with persuasive convening powers underpinned by strong, long-term relationships with governments; (v) a wide field presence with privileged access to data on farmers and agricultural ecosystems; (vi) a higher-risk appetite with a focus on smaller tickets and a crowding-in of investments in small-scale producers; (vii) expertise as a proven assembler of innovative development financing, more recently through the establishment of the Agribusiness Capital (ABC) Fund; and (viii) strong targeting and impact measurement frameworks.

# III. Eligibility for financing and investment criteria

## A. Defining eligible private sector recipients

19. In the context of this Framework, it is important to distinguish between: (i) eligible private sector recipients, which are the entities that are eligible to directly receive funding from IFAD; and (ii) private beneficiaries, which are the expected end-beneficiaries of projects undertaken by private sector recipients. In line with IFAD's mandate, the end-beneficiaries are expected to be poor, small producers and rural households in developing Member States.

20. Private sector recipients include: for-profit private companies, private and institutional investors, commercial banks and investment funds (private equity funds, debt funds, blended finance funds and impact funds); other financial vehicles that are majority-owned and/or managed by private entities; and state-owned enterprises that have sound financial and governance structures and comply with private sector practices.[5]

21. Eligible private sector recipients include MSMEs, cooperatives, corporate farms and social businesses. Private sector recipients are those enterprises in which

[5] These typically include the following criteria: (i) adequate managerial autonomy; (ii) distinct legal personality; (iii) capacity to sue and to incur debts on their own account; (iv) financial and commercial viability; (v) adequate profitability and capital as confirmed by audited financial statements.

individuals or private sector entities hold either (i) more than 50 per cent of the voting stock or voting rights; or (ii) a percentage of the voting stock or voting rights enabling participants to direct the policies and management of the enterprise ("controlling interest"). When private sector recipients are partially owned by public entities, (holding less than 50 per cent of voting stock/voting rights) preservation of operational autonomy and managerial freedom will need to be ascertained and legal due diligence will further be required to understand clearly the regulatory regime applicable.

## B. General eligibility requirements

22. **Country Eligibility**. Any private sector recipient domiciled in an IFAD Member States is eligible for funding. While geographic balance will be sought in developing the NSO portfolio, special efforts will be deploying to originate and deliver NSOs in fragility-affected countries.

23. **Eligibility requirements relating to all recipients**. In line with its mandate, IFAD must ensure that projects undertaken by private sector recipients contribute to poverty reduction and rural development in its Member States. Therefore, private sector recipients must satisfy the following core requirements: (i) be incorporated in an IFAD Member State, with the IFAD-financed project located and/or implemented in one or more low or middle income countries; (ii) be a legal entity; and (iii) be the subject of a clean legal opinion. All private sector recipients are also required to adhere to all of IFAD applicable policies, where relevant, including those on anti-money laundering, countering the financing of terrorism and anti-corruption.[6]

## C. Principles of engagement

24. IFAD's NSOs will be implemented in accordance with the following principles:

- **Country ownership**. IFAD's partnerships with private sector entities at country level will recognize the primacy of country ownership and buy-in through consultations with the government.[7] Accordingly, IFAD will be seeking "no objection" from the government as part of any NSO approval process. This will not, however, apply to regional NSOs, where clear evidence concerning individual country investments and activities cannot be fully established at approval stage. For example, regional investment funds typically only have indicative country coverage in their investment strategies at the approval stage and can neither confirm nor quantify how much will be invested in several countries.

- **Complementarity**. NSOs are meant to strengthen IFAD's development impact. Complementarity with the PoLG and other IFAD investments and activities at country level will be key in this respect. At the minimum, NSOs should align with priorities outlined in country strategic opportunities programmes (COSOPs) or country strategic notes (CSNs). Such complementarity could, for example, be achieved by having the NSO targeting the same group of beneficiaries as a sovereign operation or by scaling up an initiative funded through an IFAD grant. More specifically, while an IFAD-financed public sector investment project could build the capacity of small-scale producers to supply the market, an NSO could finance the working capital of market intermediaries buying from producers (see annex IV for selected examples of complementarity between NSOs and the PoLG). This allows IFAD to de-risk the private investment. A close link between NSOs and IFAD's PoLG represents a unique approach to investing in agriculture. At the same time, IFAD will also consider complementary NSOs

[6] IFAD will commit its own resources to NSOs with due regard to assessment of the impact on IFAD's financial sustainability and funding needs for PoLG.
[7] In line with IFAD's Rural Finance Policy, the government is represented by the Ministry of Economy/Planning/Finance (but they delegate to the Ministry of Agriculture if necessary).

supporting innovative business models, services or technologies that have a positive effect on its target group but do not necessarily originate from IFAD's portfolio of design or ongoing operations.

- **Compliance with IFAD's Rural Finance Policy.** In line with IFAD's Rural Finance Policy, NSOs will be guided by the six principles governing IFAD's rural finance interventions: (i) support access to a variety of financial services; (ii) promote a wide range of financial institutions, models and delivery channels; (iii) support demand-driven and innovative approaches; (iv) encourage – in collaboration with private sector partners – market-based approaches that strengthen rural financial markets, avoid distortions in the financial sector and leverage IFAD's resources; (v) develop and support long-term strategies focusing on sustainability and poverty; and (vi) participate in policy dialogues that promote an enabling environment for rural finance.
- **Avoidance of Control**, IFAD shall not manage any private sector recipient to which it provides funding under non-sovereign terms and shall not exercise voting rights for such purposes or for any other purpose which, in its opinion, falls within the scope of managerial control.
- **Transparency and accountability**. IFAD will promote transparency and accountability by making non-sensitive information publicly available about its NSOs and regularly report on the performance of its NSO activities. But in order to protect private business information, IFAD will publicly disclose a Summary of Investment Information and, if appropriate, an Environmental and Social Review Summary, depending on the environmental and social (E&S) categorization.

## D. Investment screening criteria

25. To optimize the impact and minimize the risks connected with IFAD's NSOs, resources will be allocated to private sector recipients based on the five criteria set out in the PSS namely: relevance, additionality, impact, E&S standards and risks. NSOs will also be reviewed to identify and assess any financial, operational, fiduciary, integrity and reputational risks (see section IV).[8] The outcomes of this process will be documented in the NSO project documents to be internally reviewed by IFAD Management and summarized in the relative investment proposal submitted to the Executive Board for approval.

(i) **Relevance.** In order to assess relevance, IFAD will, during the review process, consider how the NSO objectives and design fit in with its mandate (poverty reduction and rural development), its country development priorities and its agriculture-rural sector strategy (when available). Compatibility with IFAD's priorities as set in the COSOPs/CSNs, and its four mainstreaming priorities (climate change, gender, youth and nutrition) will also be examined, as will complementarity with its ongoing and planned engagement in the country.

(ii) **Additionality.** The assessment of IFAD's additionality during the review process will entail studying the project's needs and characteristics, and how IFAD's support adds value or helps address a market failure. In line with the practices of other IFIs, the assessment will recognize that IFAD's additionality could be financial and/or non-financial. Financial additionality would entail the provision of funding that market sources are not willing to provide or the delivery of more adapted terms such as longer maturities, more flexible repayment terms, or lower interest rates. For example, IFAD could offer a long-term loan to help a local cooperative invest in a processing plant transforming produce supplied by women small producers. An initiative of this

[8]Note that the screening and management of IFAD's NSOs will reflect the Principles for Responsible Investment in Agriculture.

sort needs patient capital, which is not available from commercial banks. In such a case, IFAD would ask the recipient to document its failure to obtain a loan from a bank, while also assessing the project's commercial viability to the maturity of the loan. Similarly, IFAD's financial additionality could stem from its catalytic role in helping mobilize private sector funding and investment. For example, IFAD could provide a guarantee to a local commercial bank to mitigate part of the risk of its lending to small producers. In this case, IFAD's additionality would be assessed by comparing how much the bank would have invested in these smallholders with and without IFAD's intervention. IFAD will also assess, where applicable, the availability of such risk mitigation instruments from commercial sources.

IFAD's additionality could also be non-financial, stemming from improvements in the social and governance practices of the private sector recipient, or from the provision of advisory services to bring added benefits to youth, women and other disadvantaged groups. Again, IFAD could use its technical expertise and know-how of rural areas and fragility-affected countries to strengthen the design of an NSO. An example is IFAD's role in designing the ABC Fund and providing a grant to its TA facility. Furthermore, additionality could be demonstrated when IFAD is able to support private sector entities in adopting more rigorous E&S practices and greener technologies.

(iii) **Impact/development results.** In terms of development results, IFAD will seek to support projects that, in addition to being commercially viable, can clearly benefit IFAD's target groups, namely small-scale producers and their organizations, rural women and men and youth. The ex ante assessment of development outcomes will thus entail a review of the NSO's expected benefits in terms of job creation, female empowerment, reducing environmental footprint, agro-ecosystem services and advancing biodiverse farming systems to build resilience to climate change and availability of nutritious food, as well as the overall promotion of private sector development. IFAD will pay particular attention to any market implications and will aim to encourage greater competition and transparency through its NSOs.

In order to assess ex ante additionality and development results, IFAD will use a counterfactual of no-project scenario and only measure direct outcomes, unless indirect outcomes can be tracked and documented reliably. The assessment will also take into consideration the country and sector context. That means that NSOs delivered in fragility-affected countries are deemed to deliver higher development outcomes than comparable ones in stable countries and are therefore prioritized. The same goes for operations targeting nascent or underserved sectors. For more details on the abovementioned criteria, see annex VIII.

(iv) **Environmental and social standards and risks.** Details of how IFAD will assess risks and the ESG aspects of NSOs are included in sections V and VI, which respectively discuss risk management and safeguards.

# IV. Proposed financial instruments

26. IFAD's financial offering to private sector recipients involves three main instruments: (i) debt instruments, including working capital and long-term loans for capital expenditures (i.e. investment) to eligible agri-SMEs, cooperatives and selected agri-focused value chain actors; lines of credit and loans to FIs, rural and agricultural banks, microfinance institutions (MFIs), commercial banks, FIs, investment funds and other types of institutions targeting small producers and agri-SMEs; (ii) equity instruments; and (iii) risk mitigation. In the deployment of these instruments, IFAD will neither provide refinancing nor participate in financial operations that do not benefit its target population. To further strengthen the

development impact of these financial instruments, IFAD will also aim to provide targeted TA to private sector recipients (see annex II for a more detailed description and examples).

27. These financial instruments were informed by a scoping of market needs and gaps to adequately finance sustainable and inclusive rural transformation (see annex III for the list of private entities contacted).

28. In terms of strategic deployment of these instruments, Management's proposal is to start with simple instruments and prioritize indirect lending early on. The Fund would gradually expand the range and increase the sophistication of the tools employed, as its capacity, expertise and reputation with the private sector is established. Ultimately, IFAD aims to be able to aggregate other IFIs around its projects, scaling up impact and sharing risks.

## A. General characteristics of the debt instrument

29. **Size range.** Loan sizes will reflect the impact objectives established by IFAD as well as the risk and the economics of any given NSO. For instance, smaller loans would be more suitable for high-risk, high-impact agri-SMEs. Examples could include: primary production of food crops, food processing plants, female-owned and operated businesses, and investments seeking to promote climate resilience and reduced carbon footprint (see box 1). Larger loans would be more relevant for more established SMEs and FIs with a longer track record, with strong governance structures, robust financial performance and financial needs that require longer investment cycles such as equipment purchases.

Box 1
**Climate Loans**

Climate change is affecting small producers everywhere as highly adverse weather patterns and frequent disease outbreaks impact quality and productivity, and periodically increase the food insecurity of IFAD's target group.

IFAD, as a funder of climate resilience and adaptive natural resources management and practices supporting resilient, biodiverse and carbon sink farming systems providing a diversity of food and income sources could offer a wide range of short- and long-term financing solutions through its NSOs including: (i) long-term loans for tree crop rehabilitation/renovation; (ii) long-term loans for reforestation, rangeland rehabilitation and shade-tree cover; (iii) long-term loans for systems designed to recover the physical quality (e.g. water storage capacity) and chemical characteristics (e.g. nutrient content) of soils – the aim here is to increase productivity, maximize water use efficiency and ecosystem functioning of watersheds, and transition to resilient, biodiverse farming systems with high integration of sectors (e.g. livestock, fish, crops and multiple-use trees) for resources recycling and use efficiency and carbon storage; (iv) short-term loans for pre-harvest financing to expand climate-resilient, organic farming, including waste management, rainwater harvesting water efficient irrigation equipment and digital solutions for water use efficiency and renewable energy equipment; (v) short-term loans to help young and female entrepreneurs develop their businesses in areas such as innovative, climate-smart food production and businesses for provision of inputs and technical and market services for resilient, biodiverse and carbon sink farming systems; and (vi) Trade Finance loans to smaller, higher-risk cooperatives that providing shade-trees for carbon storage.

30. **Maturity.** The market's needs span a wide spectrum of loan terms and maturities commensurate with agricultural development cycles, financing necessities, risk profiles, and coverage capacities. IFAD debt products[9] will have maturities that attempt to balance all of these characteristics. In general, shorter terms will be offered for pre-harvest needs, working capital, and/or lines of credit. Longer terms will be offered for productive investments requiring more time to generate business income and/or agricultural and agroforestry production with longer-term development cycles such as soil recovery and crop renovation projects.

31. **Reimbursement terms.** Reimbursement terms should be flexible and adapted to project needs, e.g. quarterly, annual, or end-of-period bullet payments.

[9] Debt products refer to various ways in which the debt instrument can be used and structured.

Reimbursement of short-term loans by non-financial intermediary, private sector recipients will be made over shorter periods and at higher frequency.

32. **Currencies.** IFAD will offer both hard and local currency loans depending on the specific needs of the borrower. Local currency will be considered mainly when there is a strong development and additionality element and when there is a cost-effective way for IFAD to manage the foreign exchange risk. IFAD's portfolio of local currency loans will be expanded when the Fund has built capacity to handle such risk and identified an efficient and cost-effective way to handle it.

33. **Collateral requirements.** Lenders typically look for guarantee/loan coverage ratios above 120 per cent at any given time. In this regard, although not a mandatory requirement for each transaction, as this may hamper impactful investments, consideration will be given to accepting collateral such as high-grade securities, buildings and equipment – particularly for capital expenditure and longer-term loans. For short-term loans such as for working capital, securities typically requested will include floating charges on inventories, and/or export contracts for tradeable commodities. All NSOs secured by inventory should also include collateral management structures. IFAD should deploy its in-house technical capacity to set up collateral, and work with existing, professionally-managed collateral schemes. Note that IFAD NSOs will aim to promote innovative approaches to collateral by supporting cash-flow-based lending and data-driven lending.

34. IFAD will pay special attention to the design of its debt instruments, notably lines of credit (LOCs), drawing on the lessons learned from other IFIs (see box 2). This means ensuring accurate targeting of LOC resources to recipients, providing incentives for FIs to achieve development results and close monitoring of development results in addition to commercial and financial performance.

Box 2
**Lessons learned from other IFIs over lines of credit**

**LOCs** are considered an appropriate instrument for IFIs to reach a large number of beneficiaries in underserved market segments, while also keeping project origination and supervision costs at acceptable levels. They are seen as financially profitable, contributing to financial sustainability while limiting risk exposure. As for partner financial institutions (PFIs), LOCs respond to their needs to secure long-term loans given that in most developing countries banks only provide short-term financing. But LOCs do have a long and contentious history including in sister IFIs such as the World Bank. A report prepared in 2006 by the World Bank's Independent Evaluation Group concluded that implementation of Bank guidelines for LOCs was poor and that LOC outcomes were not very good. These findings brought the instrument into general disrepute in the development community. Nonetheless, a thorough reading of the report provides a more nuanced picture, for it argues that the problem lies with the implementation modalities rather than the instrument itself. In fact, the report states that "LOCs can be a useful instrument when used well and should not be entirely discarded from the Bank's lending toolkit". It confirms that when they are carefully prepared, well designed, follow good practices and are disbursed in a timely manner, they tend to meet their objectives. In addition, they can be useful for meeting specific needs at important points in time. This qualified conclusion is also borne out by a 2018 Evaluation Synthesis published by the Independent Development Evaluation group of the African Development Bank.

The relevance of these lending instruments to end-beneficiaries will be informed by the following criteria, which IFAD aims to reflect in the design of its LOCs:

- Balance between achieving IFI's and PFI's risk/profitability and providing financial services to underserved but riskier market segments;
- Design of a consistent system for controlling and monitoring financial metrics as well as development results for both the PFIs and sub-borrowers. Reporting requirements on sub-loan and sub-borrower performance should be defined ex ante and followed closely during the disbursement of sub-loans; and
- Technical assistance to help FIs to enter new market segments such as green lending, and to fulfil their reporting obligations. LOCs alone may not be sufficient to create an effective financial intermediation system in support of private sector development.

## B. General characteristics of the equity instrument

35. IFAD's equity funding will be channelled through specialized investment funds targeting agri-SMEs providing financing and financial services to rural populations, thus ensuring alignment with IFAD's development impact goals. Direct investments in agri-focused and other businesses offering innovative and effective services and solutions could also be considered, subject to rigorous assessment, given the high

risks they entail. IFAD will give priority to NSOs targeting fragility-affected countries and those likely to strongly increase the incomes of small producers, while also enhancing job creation, women's empowerment, resilience, mitigation and adaptation to climate change and the restoration and conservation of ecosystem services.

36. **Size range.** The size of equity investments will be determined using the same criteria for all NSOs – namely additionality, risk, development impact and the economics of the particular NSO. Governance criteria and relations with other investors will also be taken into account while assessing the right level of investment. IFAD will also ensure that there is no crowding out of other potential investors. A minimum investment level will be established to ensure that, where feasible, returns are sufficient to cover IFAD's transaction costs.

37. **Duration.** IFAD's time horizon will be determined on a case-by-case basis. Equity investments are intended to provide capital over a relatively long period. Industry benchmarks range between 4-10 years for direct investments and 10-12 years for indirect investments. Longer-term direct equity investments will be prioritized for entities focusing on higher-impact value chains where IFAD's additionality is greater.

38. **Exit strategy.** Exit strategies are typically subject to the legal structure of an NSO as well as risk/return expectations. Closed-ended funds are self-liquidating. Open-ended funds offer opportunities to invest continually over a longer period and offer greater flexibility in negotiating exits. As for direct equity investments, exit strategies usually entail selling to existing stakeholders or to a third party, which could be a financial or an industrial entity interested in the project's next stage of growth. Regardless of the private sector recipient's legal structure, all IFAD exit strategies will aim to achieve sufficient returns and pre-established social and environmental metrics.

39. **Currencies**. Equity investments in investment funds are usually made in hard currencies, with the fund manager being responsible for providing adequate hedging strategies to manage the currency risk. IFAD will refrain from direct equity transactions in local currencies unless there is a strong additionality, development result and cost-effective approach to manage this risk.

40. **Representation.** Equity investments, whether in an investment fund, a financial or a private company, may translate into IFAD being represented in at least one of the private sector recipient's main governing bodies, possibly the Board or the advisory committee. But, IFAD will not be seeking to exercise an active role or achieve control over any private sector recipient of financing.

## C. Risk mitigation instrument

41. This instrument will be primarily used to cover and/or share risk with private sector recipients in order to encourage and stimulate greater investment and outreach to small producers and rural households. For example, IFAD could share risk with a bank to encourage it to introduce a new loan product exclusively targeting women with reduced or innovative collateral requirements.

42. There are various risk mitigation instruments on the market and Management's proposal is to start with two products:

43. **Risk-sharing facilities (RSFs)**. A RSF is a bilateral loss-sharing agreement through which IFAD can reimburse a private sector recipient (e.g. a bank or other business) a pre-determined fixed portion of the losses it incurs on an eligible asset or portfolio of assets that this private sector recipient is responsible to originate. The eligibility criteria of the assets to be covered by an RSF are usually pre-determined. An RSF is particularly suitable for private sector entities that do not require funding but rather a reduction in the risk of the assets they will be funding

or investing in. For example, a bank could seek an RSF from IFAD to extend a new loan product to climate-smart projects.

44. The share of losses covered by IFAD would aim to ensure the right balance between risk and development results. IFAD may accordingly consider a higher-risk coverage for NSOs in fragility-affected countries and for those benefiting underserved or nascent sectors such as technology-based solutions.

45. **Guarantees.** Guarantees enable private sector recipients to engage in greater business volumes in higher-risk sectors such as agri-SME finance. They are intended as a credit enhancement intervention that encourages lenders to extend financing in the form of debt to private sector entities. Guarantees could entail credit risk coverage on a single loan or bundle of loans. Guarantee amounts vary and depend on the level of risk presented by a particular transaction. Financial intermediaries normally seek higher guarantees for riskier loans and for operations where collateral is weak or non-existent. Guarantees play a vital role in catalysing finance in agri-SME value chains, and the expectation is that IFAD will support the expansion of these within its target group and geographies.

46. It is important to note that the three instruments proposed in this Framework could be used by IFAD on a standard basis or as first loss interventions (see box 3).

Box 3
**First loss**

First-loss refers to financial interventions aimed at de-risking an investment for some investor categories. It is typically made by investors who have a higher tolerance of risk with the aim of catalysing investors with higher risk appetites. For example, the European Commission/Group of African, the Caribbean, and the Pacific (ACP) countries, the Government of Luxembourg and AGRA provided funding to the first loss equity tranche of the ABC Fund to attract funding into more senior equity tranches.

First loss can take several forms, including:

- A risk-sharing facility with high rates of agreed losses to encourage a particular activity or cover a higher loss, e.g. from a project in a fragility affected country;
- A concessional loan subordinated to equity; and
- A special class equity share that would cover other equity classes with lower risk exposure.

First loss is most often needed by impact funds or innovative private sector business initiatives taking particularly high risks in serving a costly development mandate.

## D. Embedded technical assistance

47. Best practice shows that the provision of flexible and tailor-made TA to private sector recipients and end-beneficiaries of IFAD financing is a key tool when serving risky market segments. Such assistance de-risks an investment and blend its terms and conditions, thus increasing overall effectiveness and development impact. NSOs instruments will, where appropriate, include TA bundled with financial investment support. Note that the design of TA interventions will aim to maximize synergies with services already offered by IFAD’s PoLG. For example, if through the PoLG, IFAD is already offering extension services to targeted farmers, the TA will not do so but instead focus on improving the private sector recipient’s lending, e.g. by buying from farmers to improve services provided to them.

48. TA services will be directly managed – though not necessarily provided – by the private sector recipients, which will partly contribute to their costs under IFAD’s oversight. Such support will typically include:

- Technical knowledge related to the specific nature of the investment, including market studies, the design of appropriate financial products, technology transfer and technical processes, innovation, environmental and social sustainability, gender equality and climate resilience;

- Strengthening the governance structures and processes of private recipients to ensure their effective use of the resources, allowing them to better serve the intended end private beneficiaries;
- Financial management systems and capacities, such as accounting, budgeting, cost control, reporting, auditing and procurement, which are typically areas of weakness in SMEs and in some FIs operating in rural areas;
- Monitoring and evaluation systems and equipment to: (i) inform private sector recipients' action and improve their targeting capabilities and (ii) report on their development results; and
- Technical support, when needed, to end private beneficiaries on agricultural know-how, transition to climate-resilient and biodiverse farming systems, financial training, etc.

49. The duties of IFAD Management will include identifying and validating TA needs with private sector recipients as well as monitoring and evaluation.

# V. Risk management

50. IFAD's goal in engaging with the private sector is the delivery of impactful NSOs while helping to build the capacity of the private sector recipients to manage the financing effectively and efficiently. At the same time, IFAD's presence should help to mitigate real and perceived risks associated with financing private sector projects. While doing so, IFAD itself will be exposed to a greater variety of risks as detailed below.

## A. Key risks

51. In any NSO intervention, IFAD will mainly be exposed to the following:

- **Reputational risk.** This is the risk of associating with, or investing in, a private sector recipient that is not aligned with IFAD's mandate, or found to be less than reputable in its operations. Such a risk can also arise from poor environmental and social management or from violations of local laws and regulations, or again from infringement of IFAD policies. To minimize any likelihood of mission misalignment, IFAD will be screening all NSOs for relevance and expected development benefits, and will need to present a convincing case to the Executive Board when seeking project approval. NSOs will also be subject to IFAD's internal review process to assess the reputational risk of establishing financial partnerships with private recipients. This process involves, inter alia, assessing private sector recipients on ESG indicators based on internationally recognized guidelines. It also examines whether the recipient complies with UN-Business guidelines on cooperation with the business sector.[10] Agreement with private sector recipients will also include, where appropriate, representations and warranties addressing compliance with IFAD's mandate and other applicable policies, relevant United Nations guidelines or applicable law and which include appropriate early termination clauses applicable to IFAD in cases of material non-compliance. Furthermore, the due diligence process will help to verify that the partnership with a business sector recipient supports the interests and needs of IFAD target groups, and that any partner IFAD engages with will maintain IFAD's transparency, integrity, independence and neutrality. It will also assess any unfair competitive advantage enjoyed by partners or any conflict of interest that may be created as a result of collaboration. Moreover, the

[10] Guidelines on Cooperation Between the United Nations and the Business Sector state that: (i) the United Nations will not engage with business sector entities that are complicit in human rights abuses, tolerate forced or compulsory labour or the use of child labour, are involved in the sale or manufacture of anti-personnel landmines or cluster bombs; and (ii) the United Nations will not engage with business sector entities violating sanctions established by the United Nations Security Council.

IFAD Policy on Preventing and Responding to Sexual Harassment, Sexual Exploitation and Abuse will apply to private recipients.

- **Fraud, corruption and financial crime risks.** IFAD's Policy on Preventing Fraud and Corruption[11] and its Anti-money Laundering and Anti-terrorism Financing Policy[12] reflect the Fund's commitment to preventing the use of IFAD funds for illegal purposes. These policies apply to private sector recipients or any financing managed by the Fund and any of their agents or personnel in connection with an NSO. Agreements with regulated business entities or agencies partnering with IFAD to unlock funding and services to support NSOs and/or IFAD12 will be reviewed and appropriate representations and covenants will be included to address prohibited practices and similar issues.
- **Legal risk.** By financing private sector recipients, IFAD's legal risks could increase and will require careful management and mitigation. Close analysis of every NSO will be conducted by IFAD's Office of the General Counsel with the assistance of external/local experts to examine the regulatory (including issues of enforceability of collateral and insolvency) regime[13] of the jurisdiction where the project is to be implemented and where the private sector recipient is incorporated, if different. Financing to the private sector can also give rise to increased litigation risks so that IFAD's Social, Environmental and Climate Assessment Procedures (SECAP) team will have to continually monitor the suitability and effectiveness of the project complaint mechanism to ensure it is fit for purpose for all IFAD's operations and activities.
- **Fiduciary risk.** Developing NSOs requires an appropriate risk management approach so that IFAD can properly assess how far the relevant internal controls, financing flows, financial reporting and procurement policies provide reasonable assurance of the appropriate use of funds and eliminate the risk of fraud and corruption. IFAD will be implementing rigorous risk assessment (see section V.B) and supervision processes (section VII) in this respect.
- **Financial risk.** Depending on the level of intervention as well as on the selection of private sector recipients and types of instruments, financial risks can be significant. These mainly stem from the risks embedded in the private sector of any given Member State, but is also due to the difficulty of accurately pricing financing in emerging or volatile markets. Financial risk could also result from adverse government action or political interference. To mitigate this risk, a thorough review and risk management process will be put in place (see section V.B).

## B. Risk assessment

52. NSOs will be subject to a risk assessment by IFAD's risk management team independent from the project origination team, to evaluate the potential risks (e.g. financial, fiduciary, legal, reputational) involved. Risk assessment for debt financing will include an evaluation of the borrower's ability to meet proposed contractual obligations, including their ability and willingness to repay loans. Although credit risk is the main type of financial risk when dealing with private sector recipients, other risks will be considered depending on the nature of the proposal, including operational and commercial risks, and the financing instrument being requested. It should be noted that equity investments can provide higher returns than debt but also entail higher variability and risks. Because both risks and returns can be considerably higher than in debt, equity investments require

[11] EB 2018/125/R.6: Revised IFAD Policy on Preventing Fraud and Corruption in its Activities and Operations (December 2018).
[12] EB 2019/128/R.41/Rev.1.
[13] Including issues regarding enforceability of collateral and insolvency.

extremely rigorous due diligence, careful structuring and close attention to shareholding rights. They also entail a sustained focus on long-term value creation, involving post-disbursement engagement.

53. The risk assessment process will also include an evaluation of the adequacy of credit enhancements provided to IFAD. Credit enhancements include collateral and guarantees, individually or combined. Collateral assessments will include an evaluation of collateral strength and enforceability, and of the implications in ratings and capital requirements prior to the approval of the NSO. For the assessment of guarantees or standby letters of credit, the creditworthiness of the guarantor shall be higher than that of the borrower.

54. An internal credit risk assessment will be produced for each NSO based on a risk measurement framework (see annex VII) that includes the internal score models combined with tools and governance structure to validate ratings. IFAD's country risk ratings will serve as critical inputs in the internal rating of NSOs. The country risk rating will serve as a ceiling, meaning that an NSO project rating shall not be better than the country rating unless supported by strong enforceable credit enhancements (typically financial guarantees). Internal scores are a key input required for the computation of capital charges and provisions since they are mapped to specific risk parameters.

## C. Pricing and conditions

55. IFAD's contribution and additionality can be enhanced by offering pricing based on both risk and development results. In order to deal with high-risk NSOs, (with high development impact and additionality) IFAD will adopt a portfolio approach to manage its private sector funding activities. This involves defining a portfolio growth strategy that permits flexibility and variety in the financing products offered, while at the same time achieving the desired impact and profitability in IFAD's private sector portfolio.

56. Critical to the success of this approach will be the sound and objective measurement of risk for each project. Pricing will, as noted, be based on the balance between risk and development results. For example, projects deemed high-risk but with strong development results may be offered development performance incentives to reinforce NSO programme priorities and to further promote pro-poor practices. On the other hand, less risky projects with lower development performance will be priced according to market rates.

57. A blended pricing approach – based on a combination of commercial and concessional financing – will allow sufficient cost coverage of IFAD services over time. IFAD aims to use blended finance to help bridge gaps and address market failures in areas with strong development outcomes. Other formats such as data-based analytical investment memorandums, standardized loan applications and interconnected digitalized monitoring tools will be vital to the success of this approach since all of these contribute to streamlining processes and cutting costs. In order to ensure that blended finance interventions do not translate into unnecessary subsidies for private sector recipients, IFAD will be adhering to and applying, as part of its screening process, the Enhanced Blended Concessional Finance Principles for DFI Private Sector Operations (annex V).

58. Generally, pricing of NSO loans will be risk-based by aligning conditions to the rating of the private sector borrower, the defaults probabilities and the prevailing market conditions (which might also impact on the additionality role of IFAD). Risk-based pricing results from a consideration of the following factors:

- Base rate, or the market reference rate at which funds can be sourced;
- Funding margin, or the cost of sourcing at the base rate;
- Average life of the financial product;

- Credit premium, to cover the losses associated with the probability of default; and
- Flexible margin, to align with market prices or other lenders' pricing. A negative adjustment may be applied to reflect IFAD's additionality, considering the expected development results.

59. IFAD will charge fees, including prepayment, guarantees and other relevant fees on private sector financing. Although the administrative costs are not directly computed for each transaction, IFAD will ensure that its NSO portfolio is financially sustainable enough to cover operating costs. To that end, Management will monitor the administrative costs associated with the deployment of NSOs at transaction and portfolio level.

## D. Portfolio monitoring, risk management and control

60. All credit exposures and investments will be monitored regularly to ensure compliance with exposure limits and make certain that the NSO portfolio complies with the terms and conditions outlined in each respective legal agreement, including financial covenants.

61. Performance and compliance metrics of the NSO portfolio will be reported on a regular basis through an NSO Portfolio Report, which will be discussed at the Financial Risk Management Committee. The report will include issues such as the evolution and composition of the NSO portfolio, ratings and capital consumption.

62. For investments accounted in IFAD's consolidated balance sheet, and in conformity with International Financial Reporting Standards (IFRS), financial instruments must be subject to forward-looking impairment allowances. Allowances must be recognized for either 12-month or lifetime expected credit losses (ECLs), depending on whether there has been a significant increase in credit risk since initial recognition.

63. The ECL comprises a three-stage model based on changes in credit quality since origination or initial recognition of the financial instrument – the date on which disbursement conditions have been met (for loans), or the date on which the instruments were purchased by the Fund. Impairment is reported based on either:

   (i) 12-month or lifetime ECLs, depending on the stage allocation of the financial instrument; or

   (ii) The ranking attributed in the portfolio, which is divided into performing loans (stage 1), underperforming loans, which are watch-listed (stage 2), and non-performing loans or NPLs, (stage 3).

64. Close monitoring and, if necessary, corrective measures will be taken in cases where there is an increased risk associated with any credit exposure or investment. The following is not an exhaustive list of circumstances that can increase the risk profile of private sector recipients:

- Negative economic conditions at country or sector level;
- Events at government level affecting the conduct of business;
- Non-repayment of principal and/or interest due (90 days);
- Decline in value compared to projections;
- Deterioration of creditworthiness not due to extraordinary circumstances;
- Breach of financial covenants;
- Threatened litigation; and
- Threat of bankruptcy proceedings by other creditors.

## E. Provisions and capital requirements

65. Provisioning criteria for investment disclosure in IFAD's consolidated balance sheet must be established in conformity with IFRS requirements. From a purely financial point of view, NSOs will be part of IFAD's consolidated balance sheet, and therefore subject to most of the accounting and financial requirements currently applied to the sovereign portfolio.

66. Losses in the NSO portfolio may fall into two broad categories: expected losses and unexpected losses. Expected losses are the statistically probable losses associated with a given risk class and are typically reflected in the price of the transaction. The ECL reflects a probability-weighted outcome, value of money over time and the best available forward-looking information through the inclusion of macroeconomic factors. Higher-risk transactions have a higher level of expected losses due to the combination of higher probability of default (PD) and/or a lower expected recovery of amounts in case of default.[14]

67. Expected losses will be covered in accordance with the impairment requirements specified by the IFRS.[15]

68. In order to monitor and report most accurately on potential losses in the NSO portfolio, IFAD will also account for unexpected losses. These are losses due to exogenous events and can be limited by adequate portfolio diversification.

69. For monitoring purposes, capital requirements for unexpected losses will be derived from specific principles established in the Capital Adequacy Policy.[16] NSOs in agriculture are inherently risky and do not benefit from preferred creditor treatment. That tends to make capital requirements greater than for public sector operations.

## F. Private sector product valuation

70. Private sector financial instruments must be accounted for at their fair value in line with IFRS requirements, as set out in the IFRS9 classification and measurement section. In assessing equity investments, the fair value is the price received when selling an asset or paying to transfer a liability in a transaction between market participants at the measurement date in a market condition. The valuation of direct investments of private equity funds primarily refers to the net asset value (NAV)[17] of the direct investments. The fund manager will be requested to provide this valuation in accordance with the valuation approach. Therefore, IFAD will assess the adequacy of the NAV and, if necessary, propose adjustments. The return on equity is usually calculated as the increase in the NAV, plus capital receipts, plus dividends, divided by disbursed capital. Equity investments may be consolidated, in line with IFRS requirements.[18]

# VI. Safeguards

71. The E&S screening and assessment will be based on IFAD's SECAP[19] requirements adapted for NSOs and will be proportionate to the nature of the NSOs while reflecting the business realities and the level of potential environmental and social risks and impacts associated with projected activities. The purpose of the screening

[14] Although historical defaults for NSOs are not existent for IFAD, PDs provided by the Global Emerging Markets Risk Data Consortium are expected to be applied in the computation of provisions and capital charges. The consortium database provides robust and reliable information related to historical PDs from sovereign and private sector operations funded by the main multilateral development banks and major DFIs worldwide.
[15] July 2014.
[16] EB 2019/128/R.43.
[17] The most common valuations techniques include cost price, discounted cash flows and earnings multiples.
[18] An equity investment is consolidated if there is "power over the investee; exposure or rights to variable returns from its involvement with the investee and ability to use the power over the investee to affect the amount of the investors' returns."
[19] IFAD is currently revising its environment, social and climate standards under SECAP as well as associated risk drivers under Enterprise Risk Management. This Framework refers to the SECAP to be adopted in 2020.

is to identify the main social, environmental and climate impacts and risks associated with a potential private sector recipient and project, and define the necessary steps for further analysis and risk mitigation.

72. Specifically, IFAD will conduct a gap analysis against SECAP to identify whether the private sector recipient, whether a business or financial intermediary, has the capacity and procedures to manage the environmental and social risks and impacts potentially generated by projected investments and on-lending operations. In order to partner with IFAD or receive support, the private sector recipient will be required to have in place: (i) an environmental and social management system (ESMS); and (ii) the organizational capacity and competency to assess, manage and monitor risks in direct investment projects and portfolio risks in financial intermediary projects. IFAD will make every effort to collaborate with the private sector recipient and agree on specific measures to ensure that IFAD's SECAP requirements are complied with. The measures, as defined in the SECAP, may include environmental and social impact assessments, environmental and social action plans, environmental and social management plans, and indigenous people's management and resettlement plans, depending on the project's environmental and social category and its risks and impact.

73. Where IFAD is jointly financing a project with other multilateral or bilateral funding agencies, the Fund will cooperate with them and the private sector recipient in order to agree on a common approach for the assessment and management of the project's environmental, climate and social risks and impacts. A common approach will be acceptable to IFAD, provided that such an approach enables the project to achieve objectives materially consistent with IFAD's social, environmental and climate standards.

74. IFAD support to private sector recipients is subject to portfolio and risk management provisions. In addition, IFAD reserves the right to examine any on-lending operations to ensure the NSO complies with IFAD's standards. Any additional costs resulting from working with the private sector would need to be made explicit from the start and reflected in the project/partnership business model. Environmental and social requirements will be clearly presented in the projects' legal agreements.

75. Private sector recipients are responsible for adhering to IFAD's environmental, social, and climate standards throughout the project life cycle, where applicable and as described in the legal agreement. IFAD will ensure that compliance is monitored and apply sanctions in the event of breaches. Furthermore, private sector recipients should establish an easily credible and independent local grievance mechanism to address concerns and resolve any complaints of persons affected by the NSO.

76. IFAD has developed E&S requirements and due diligence and monitoring procedures for financial intermediary projects in the SECAP. Guidance on international best practices in regard to managing E&S risks in FI operations, developing an environmental and social management system and monitoring and reporting facilities is given in annex VII. The suggested environmental and social framework for private sector investments and FI operations is intended to serve as guidance for IFAD when the SECAP is updated.

# VII. Project origination, supervision, monitoring and evaluation

## A. Origination

77. NSOs will be driven by investment opportunities including those that may arise from IFAD Country Offices, possibly during the design or implementation of investments financed through the PoLG or other IFAD activities. IFAD operational

staff – Country Directors, Country Programme Officers and technical specialists – as well as staff from IFAD-financed projects will be key sources for the identification of NSO opportunities. While complementarity with the PoLG is important, NSOs will follow different structuring, governing and implementing logics.

78. Within IFAD, the Private Sector, Advisory and Implementation Unit (PAI), will lead in the different steps in close coordination with Country Offices and regional divisions, while drawing on expertise from IFAD's technical divisions as needed. Country Directors with existing private sector expertise will be closely associated with the work of PAI. Internal capacity within PAI and IFAD as a whole will be enhanced as IFAD expands its NSOs portfolio through dedicated training and acquisition of additional expertise, as needed. Strong engagement with the Global Engagement, Partnerships and Resource Mobilization Division (GPR) is also envisaged. While NSOs may be determined by prospects arising at the country level, both GPR and PAI will be proactively seeking to work with public and private partners to identify innovative financial models that could apply to development needs, and actively supporting the design and early-stage implementation of those instruments.

## B. Supervision, monitoring and evaluation

79. Private sector recipients will be required to prepare logical frameworks with indicators to demonstrate the development results/outcomes and contribution to IFAD's strategic objectives of their projects. The logical framework will be included at the design stage and will be part of the appraisal/approval process.

80. IFAD's sovereign lending operations currently use core indicators as part of their logical frameworks. IFAD will rely on this method for NSOs as well by determining a core set of indicators, including job creation, increased income, improved access to finance, and uptake of technologies or practices for increased climate change resilience, and food security. Examples of indicators applicable to NSOs can be found in annex VIII. Wherever possible, indicators will be disaggregated by age and sex to ensure contribution to IFAD's corporate mainstreaming themes. NSOs will also use an adapted version of IFAD's programme delivery risk matrix in design and during implementation. This risk matrix may contain additional risks specific to NSOs.

81. Performance based on the indicators in the logical frameworks will be tracked during implementation and reported on through periodic progress reports from the private sector recipient. IFAD will be responsible for monitoring and supervising NSOs through supervision visits and reports.[20] Key dimensions to focus on during supervision will include progress towards achievement of development results utilizing indicators, efficiency, sustainability, financial performance, risk management and compliance with loan terms and conditions (including applicable E&S safeguards and management plans). IFAD will establish monitoring procedures to review the progress of E&S management plans and compliance of operations with contractual obligations and regulatory requirements.

82. IFAD will also conduct reviews of NSOs at completion to assess, inter alia, development results (including country-level results and contributions to IFAD's strategic objectives), IFAD's additionality and performance (including IFAD's screening at appraisal) and project monitoring and supervision.

83. Internal corporate IT systems for project design, supervision, monitoring and reporting (such as the Grants and Investment Project System [GRIPS] and the Operational Results Management System [ORMS]) will be used as far as possible and adapted as needed to accommodate NSOs. At the corporate level, IFAD will

[20] Supervision may also be conducted by external contracted third parties as needed.

report on the results of NSOs to the Executive Board based on appropriate indicators according to the sector, recipient and type of NSO.

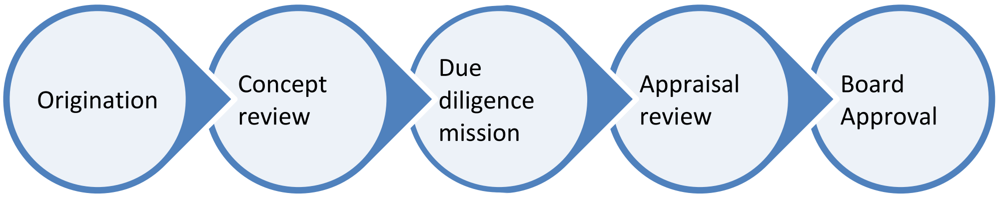
84. With regards to impact, an ad hoc programme of impact evaluation will be conceived in order to reflect the diversity of NSOs (annex VI).

# VIII. Governance and resource mobilization

## A. Review and approval process

85. In order to deliver NSOs, IFAD will adopt a rigorous and flexible review process. Indeed, virtually every single partner consulted by IFAD has highlighted the need for speed and agility in dealing with the private sector. Nevertheless, IFAD must also ensure rigour to protect its reputation and its privileges and immunities, to manage risks arising from E&S issues, litigation and to preserve its financial position (see figure 1). Note that all proposed NSO projects will be submitted to the Executive Board for approval.

Figure 1
**Review process of NSOs**




## B. Resource mobilization and trust fund

86. In order to support the delivery of NSOs, IFAD will seek to raise resources from traditional donors and global facilities such as the ones offering climate finance as well as from the private sector, including foundations and impact investors. There is in fact an opportunity to attract some private resources from investors who value development impact that can be achieved by IFAD.

87. To facilitate resource mobilization, a multi-donor trust fund for NSOs (the Private Sector Trust Fund) will be established to receive contributions for the implementation of the PSS, with IFAD acting as the trustee, following existing precedents. The proposal for the establishment of a multi-donor trust fund has been submitted to the Executive Board for approval and is included in annex I. The Executive Board has the authority to establish the proposed trust fund by virtue of Governing Council resolution 77/2, as amended by resolution 86/XVIII, which authorizes the Executive Board to exercise all most of the powers of the Governing Council, as determined by article 6, section 2(c) of the Agreement Establishing IFAD. Moreover, Governing Council resolution 134/XXVII delegates authority to the Board to decide on the establishment of such a trust fund.

88. The Private Sector Trust Fund will seek and accept contributions and funding from non-Member States and other non-state actors, including multilateral organizations, philanthropic individuals and foundations, and any other interested entities. In terms of type of resources, IFAD will seek to attract grants and low cost resources, while enhancing opportunities for co-financing with IFIs and private sector entities. Contributors will be given flexibility and the choice between allowing any earnings and fees to reflow to the trust fund, and so made available for additional NSO activities, and being paid out their pro-rata share of earnings from the portfolio of projects on a regular basis. Through the trust fund, IFAD will manage the contributions and reflows according to contributors' preferences. Given that NSOs will be ring-fenced in this dedicated trust fund, the capital of IFAD will not be impacted by the operations sourced from this trust fund and will continue to support only sovereign transactions. Any losses arising from investments made

using the resources of the trust fund would be borne by the contributors of such resources on a pro-rata basis to the limit of their initial contributions.

89. With regard to accepting supplementary funds to support NSOs, the PSS expanded the scope of the President's delegated authority in order to allow IFAD to accept supplementary funds from public organizations, the private sector and foundations to finance activities related to IFAD's mandate up to and including US$5 million. Any amount above US$5 million would require the Executive Board's approval. The acceptance of such funds would be subject to IFAD's internal due diligence process for private sector partners, as discussed earlier in this Framework.

# IX. Conclusion

90. This Framework for NSOs was developed to provide the broad approaches and modalities guiding IFAD's operations with private sector recipients. It is a necessary step towards the implementation of the PSS, for which a mid-term review is already planned for end 2021.

91. In conjunction with the Framework, a Private Sector Trust Fund is also being established to allow IFAD to mobilize resources from both Member States and non-state actors to implement its private sector strategy.

92. Management recommends that the Executive Board approves (i) this Framework and (ii) the Private Sector Trust Fund in accordance with the recommendation set out at the beginning of this document.

# Proposed instrument for the establishment of a private sector trust fund for the implementation of IFAD's Private Sector Engagement Strategy (the "Private Sector Trust Fund")

The Executive Board,

At its 129th session on ___ April 2020,

**Recalling** the relevant provisions of the Agreement Establishing IFAD, in particular Article 7 Section 1 (b), Section 2 (a) and (f);

**Recalling further** the relevant provisions of the Policies and Criteria for IFAD Financing, in particular paragraphs 11, 13 and 15;

**Having considered** the Private Sector Strategy approved by the IFAD Executive Board at its 127th session in September 2019;

**Having further considered** the Framework for IFAD's NSOs (the Framework) approved by the IFAD Executive Board at its 129th session in April 2020;

**Noting** Section VIII paragraph 30 of Governing Council resolution 203/XLI on the Eleventh Replenishment of IFAD's Resources which provides that "During the replenishment period, the Executive Board and the President are encouraged to take necessary measures to strengthen the Fund's catalytic role in raising the proportion of national and international funding directed at improving the well-being and self-reliance of rural poor people, and to supplement the resources of the Fund by using the Fund's power to perform financial and technical services, including the administration of resources and acting as trustee, that are consistent with the objective and functions of the Fund. Operations involved in the performance of such financial services shall not be funded by resources of the Fund."

**Decides that:**

1. A private sector trust fund (the "Private Sector Trust Fund") shall be established, constituted of the funds that shall from time to time be contributed in accordance with the provisions of this resolution, and any other assets and receipts of the Private Sector Trust Fund.

2. The Fund shall be the Administrator of the Private Sector Trust Fund and in this capacity shall hold and administer in trust such funds, assets and receipts. Decisions and other actions taken by the Fund as Administrator shall be identified as taken in that capacity.

3. Subject to the provisions of this resolution, in administering the Private Sector Trust Fund, the Fund shall apply the same rules applicable to the operation of the resources of the Fund, in accordance with the Agreement Establishing IFAD, the Policies and Criteria for IFAD Financing, the relevant rules, policies and procedures applicable to this Trust Fund and the Framework.

4. The resources of the Private Sector Trust Fund shall be held in a separate account.

5. The Private Sector Trust Fund's reporting currency shall be the United States dollar. Proceeds from or to the Private Sector Trust Fund should be denominated in a freely convertible currency in accordance with IFAD's policies and procedures.

6. The Private Sector Trust Fund shall be authorized to receive, upon the approval of the President in his/her capacity as President of the Administrator, the following resources for the general purposes of the Private Sector Trust Fund or for specific projects or programmes supported by the Private Sector Trust Fund:

(i) Funds transferred by IFAD from its resources pursuant to Governing Council resolutions;

(ii) Funds borrowed by IFAD and transferred to the Trust Fund;

(iii) Contributions made in a freely convertible currency directly by Member States;

(iv) Contributions made in a freely convertible currency directly by non-Member States and other non-state actors, including multilateral organizations, philanthropic individuals and foundations, and other entities;[21]

(v) Net earnings from investment of any resources held in the Private Sector Trust Fund pending the use of these resources for NSOs;

(vi) Payments of the principal and interests under NSOs;

(vii) Income from equity investments and guarantees or other instruments extended pursuant to the Framework; and

(viii) Other resources.

7. Except as otherwise decided in this resolution, all such resources shall be held in the Private Sector Trust Fund.

8. The resources of the Private Sector Trust Fund shall be used exclusively by the Administrator for NSOs to be implemented in any of IFAD's Member States eligible to be considered for investment under the Framework.

9. Any disbursement shall be subject to the availability of the resources of the Private Sector Trust Fund.

10. NSOs shall be approved by the Administrator in accordance with the provisions of the Agreement Establishing IFAD, the Policies and Criteria for IFAD Financing and with the modalities set forth in the Framework.

11. The Fund in its capacity as Administrator, acting through its President, is authorized:

(i) To make all arrangements, including establishment of accounts in the name of the Fund as Administrator, with such depositories of the Fund as the Administrator deems necessary; and

(ii) To take all other administrative measures that the Administrator deems necessary to implement the provisions of this resolution.

12. The privileges and immunities accorded to the Fund shall apply to the property, assets, archives, income, operations and transactions of the Private Sector Trust Fund. In this context, the Fund, through the President, may enter into such agreements and arrangements as may be required to ensure the said privileges and immunities and achievement of the purposes of the Private Sector Trust Fund.

13. The Fund shall maintain separate records and accounts to identify the resources and operations of the Private Sector Trust Fund. The Private Sector Trust Fund accounts will be maintained in accordance to IFRS and audited by IFAD's external auditors.

14. The President shall, as soon as practicable after the end of each financial year of the Fund, furnish to the Executive Board: (i) a report on projects and programmes financed from the Private Sector Trust Fund; and (ii) as part of its annual audited financial statement, an audited financial statement for the Private Sector Trust Fund.

[21] This would exclude contributors imposing policies and procedures different from the one adopted by the Fund.

15. The incremental administrative expenditures directly incurred by the Fund in administering the Private Sector Trust Fund and the expenditures directly incurred by the Fund in preparing and appraising projects and programmes for presentation to the Executive Board and, subsequently, in administering them shall be paid to the Fund from the resources of the Private Sector Trust Fund. Resources for this purpose shall be held in the administration the Private Sector Trust Fund.

16. Upon liquidation of the Trust Fund, all amounts remaining shall be transferred to the Fund.

17. The Fund shall not be liable for acts or obligations of the Private Sector Trust Fund, solely by reason of its capacity as Administrator.

# Financial instruments

This annex provides examples of financial products using the three instruments discussed in the Framework that IFAD can offer either directly or indirectly under its NSOs. This is not a comprehensive list and is mainly provided for illustrative purposes. During the initial implementation phase of the PSS, IFAD will focus its efforts on those products where the greatest additionality and development results can be achieved. Note that all proposed NSO projects will be submitted to the Executive Board for approval.

# Debt instruments

## Lines of Credit (LOCs)

**Object.** LOCs are usually a pre-set amount of money that a financial institution has agreed to on-lend to projects run by beneficiaries, which are typically SMEs or farmers organizations. LOCs are offered on a regular basis to support smallholder agriculture and have proved successful in improving cash flow management by agricultural small and medium-sized enterprises (agri-SMEs).

**Recipients.** Financial intermediaries usually need LOCs to reach riskier segments of the market and to offer access to finance to the rural population.

**Functioning.** LOCs can be drawn on as needed up to a maximum amount agreed upon with the borrowing financial intermediary. There is a pre-established loan period and repayment schedule.

**Amounts.** Typical amounts in the sector range from US$500,000 to US$4 million.

**Maturity.** The usual maturity period of a LOC is between one and five years; however, maturity can be longer depending on the needs of the underlying projects being funded.

**Currency.** Local currency lending leverages the most impact for this instrument but foreign currency LOCs are also commonly used.

**Rate and return.** Market rate returns can be achieved on LOCs depending on country, sector, targeted population, quality control and monitoring. Lower interest rates can be offered for high-impact interventions.

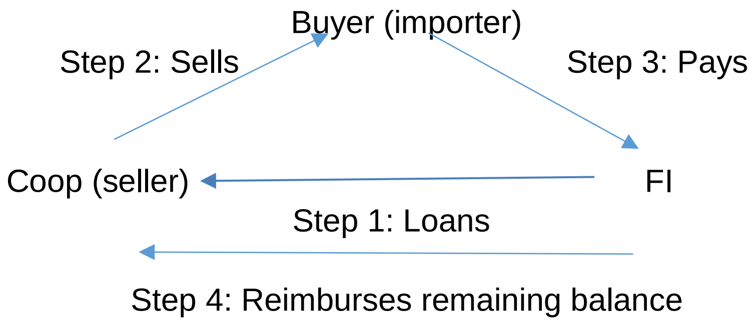
**Collateral.** LOCs can be unsecured – which normally implies higher interest rates – or secured depending on the risk profile of the recipient (FIs).

**Example of use.** An international chocolate manufacturer that sources from millions of small-scale cocoa farmers worldwide launches a programme in the West Africa region, to increase opportunities for farmers to convert cocoa farming into a sustainable venture. The chocolate company supports programmes that offer TA in good agricultural practices to improve productivity and livelihoods. As a part of its core objectives, the programme must foster the conservation and restoration of lands and forests where cocoa grows. Integral to the success of this programme is a financing facility to support farmers in meeting pre-harvest needs such as inputs, tools, fertilizers and hired labour. A LOC to a local FI financed by IFAD could be used to on-lend to the company's network of aggregators and SMEs, which in turn would manage their own credit schemes to on-lend directly to small producers. These repay their loans once they receive revenue from the sale of cocoa beans to the aggregator. The LOC is provided on an as-needed basis and credit risk is mitigated through the TA offered to the farmers and continual monitoring in the field based on individual farmer's development plans.

## Trade finance loans

**Object.** A trade finance loan is one of the most common instruments used by impact investors in the field of SME lending. This debt product facilitates the business relationship between importers (buyers) and sellers (exporters). Figure 1 below offers a schematic presentation of how the trade finance process works.

Figure 1
**Trade finance process**




**Recipients.** Agri-SMEs and cooperatives that are supplied by small-scale producers and structure the value chains. IFAD can offer this product directly to an SME, or indirectly through a local bank offering commodity and trade finance.

**Functioning.** A tripartite agreement is negotiated between the key actors. This agreement defines specific roles and responsibilities for each party as per the summary below:

- The cooperative negotiates an export contract with a buyer.
- The cooperative applies and is approved for a loan.
- The FI disburses the loan based on the percentage value of the contract.
- The cooperative purchases the product from small-scale producers to fulfil contractual requirements.
- The cooperative exports and the buyer receives the product.
- The buyer disburses full payment to the lender.
- Loan amounts typically range between 60 and 80 per cent of the contract amount.
- The lender subtracts principal and interest owed and disburses any overage funds back to the cooperative.

**Amounts.** Loan amounts range from US$200,000 to US$4 million for agri-SMEs and cooperatives. Larger amounts are appropriate for FIs offering trade finance in commodities markets.

**Maturity.** Up to one year and renewable subject to good performance.

**Currency.** Loans are mostly provided in hard currency since they are used for export crops bought and sold in United States dollars and/or euros.

**Rate and return.** This instrument can easily offer market rate returns while still making a significant impact on the livelihoods of the target group.

**Collateral.** Export contracts and/or inventories.

**Example of use.** A coffee cooperative in Uganda with 2,000 members has secured a buyer to purchase a container of green coffee but urgently needs resources to buy the cherry beans to process and fulfil the commercial commitments of the buyer. The cooperative approaches a local bank that offers the required cash thanks to an IFAD trade finance loan which has been secured by a signed export contract and a payment order defining the bank’s conditions for loan repayment. The cooperative uses the money to buy cherry coffee beans of the required standard from small-scale producers to complete the export contract.

## Working capital loans

**Object.** Working capital is the financing that allows agri-SMEs and cooperatives to operate daily and over a cyclical period, usually a campaign in the agricultural sector.

**Recipients.** Agri-SMEs and cooperatives often face cash constraints since most of their current assets (those convertible within a year) are in the form of stocks and inventories. Net income does not normally generate sufficient cash to cover the operating needs of the entity.

**Functioning.** Working capital loans are usually fixed-rate loan contracts with agreed-upon repayment periods, which are usually quarterly, semi-annual or annual.

**Amounts.** Typically, loan amounts range from US$500,000 to US$5 million.

**Maturity.** Working capital loans are amortized over a fixed period of one to three years.

**Currency.** Local currency lending is likely to achieve higher impact, but hard currency loans also could achieve good additionality and development results.

**Rate and return.** These range from concessional rates to market rates depending on sector, competition and development impact goals.

**Collateral.** Fixed assets, inventories, or company shares.

**Example of use.** A processor in Benin with an excellent credit record with impact investors sources raw cashew nuts (RCNs) from 5,000 small producers in the region, of which 80 per cent are young and women farmers. The company has insufficient cash to purchase RCNs since it is using its limited cash to upgrade a processing machine to run solely on renewable energy sources. It approaches impact investors requesting a loan to be repaid over a two-year period, but these lenders are not willing or able to offer further unsecured financing. IFAD could extend, through a funding facility, a working capital loan providing the processor with the cash needed to buy RCNs and fulfil the buyer’s contract. The processor, as a result, could generate increased sales and net income to cover debt repayment.

## Capital expenditures loans

**Object.** Capital expenditure (capex) loans are used to purchase, upgrade and maintain assets such as land, buildings, machinery and equipment.

**Recipients.** Agri-SMEs and cooperatives typically reach a stage where this kind of lending is required to add value to their current production – turning raw products into semi-processed or processed goods – and to integrate additional production stages.

**Functioning.** Capex loans are standard loan contracts that are extended over a longer period, with a predefined interest rate and repayment schedule. Best practice is to offer a grace period in order to enable the entity to earn sufficient revenue from the newly financed assets.

**Amounts.** From US$500,000 to US$20 million, depending on overall portfolio balance.

**Maturity.** From three to 12 years.

**Currency.** Local and hard currency.

**Rate and return.** These range from concessional to market rates depending on sector, competition and development impact goals.

**Collateral.** Fixed Assets, land mortgage or company shares.

**Example of use.** An agro-industrial company based in Bamako was created by an already successful young Malian entrepreneur. The company is seeking to diversify its activities to include shea butter processing and exportation. Once the plan is operational, the company expects to buy up to 30 per cent of the total shea production in the country. The company requires a capex loan of US$5 million to buy and install a new processing facility, which will be financed by IFAD through a direct or indirect loan.

In general, there is a huge gap in financing for equipment in the agri-SME/cooperative market due to the perceived risk and the long-term nature of activities. Impact investors offer some lending for this purpose in the tighter value chains like coffee and cocoa. IFAD could achieve significant additionality by expanding the scope of current capex lending in cash crops and/or to kick-start capex lending in higher risk, higher-impact value chains such as staple crops, fruits and vegetables. Food processing is a particular niche where demand is growing and significant investment is needed.

# Equity instruments

## Direct equity

**Object.** Direct equity investments provide long-term growth capital to private enterprises involved in structuring agricultural value chains. Equity is needed to add to the capital base of these agri-SMEs, so that they can access more debt funding and increase investment in their operations and fixed assets.

**Recipients.** Agri-SMEs dealing with small producers and cooperatives.

**Functioning.** Equity investments, unlike loans, do not give any right to fixed repayment or require any collateral. They, therefore, entail higher risks than lending. Equity investment gives rights to the shares of a company, as well as control and dividend rights in proportion to the equity stake acquired. Other fundamental negotiation points during an equity transaction are: governance, control and representation, sale and issuance of shares, and an exit strategy for the investor.

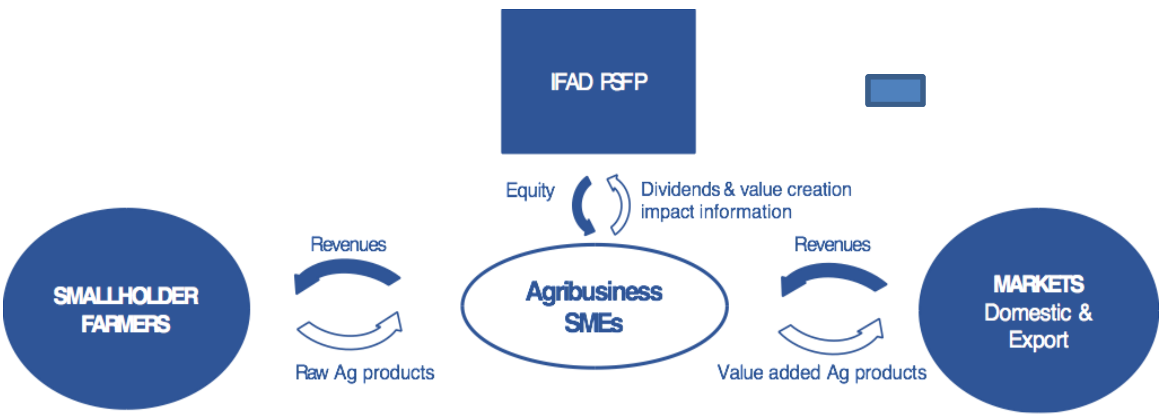
**Amounts.** Equity investments in agriculture and agrifood businesses in developing economies range from US$500,000 to US$15 million, depending on the country, sector and expected development results.

**Maturity.** Direct equity investments are usually exited after a period of four to eight years. Investment entailing strong additionality could require longer investment periods.

**Currency.** Direct equity investments are usually made in the currency in which the investee's capital is labelled.

**Rate and return.** Equity transactions in agriculture and agribusiness in developing economies deliver highly volatile net returns.

Figure 2
**Direct equity investment process**



**Example of use.** A rice-processing agri-SME has strong environmental credentials and produces, processes and sells rice and pacu (a fresh water fish) in Paraguay. Rice has a semi-aquatic ancestry and grows best in water-saturated soils. The agri-SME has also implemented an innovative crop rotation process that combines pacu production with rice production. The approach allows for significant cost savings in the production process since the pacu consumes weeds, insects and other pests detrimental to rice production. The principal environmental impacts of rice production and processing are pollution and biodiversity loss from agrochemical use, intensive water use and the emission of methane, which contributes to global warming. The agri-SME’s vision and operations are focused on, and structured around sustainable rice production, with 100 per cent of its production being organic. IFAD could make an equity investment to help double production over a four-year period, and could either directly buy shares in the agri-SME or indirectly invest through equity participation in a climate-oriented fund (see indirect equity).

### Indirect equity

**Object.** Indirect equity investments provide long-term capital to equity or debt investment funds. These in turn deliver long-term capital and other financial solutions to SMEs, start-ups, microfinance institutions and FIs involved with small producers and rural groups. Indirect equity investments allow those funds to grow their portfolio of investments and therefore scale up their investment and impact.

**Recipients.** Investment funds providing debt, equity or other financial solutions to agri-SMEs, start-ups, MFIs or FIs delivering the development impact sought by IFAD.

**Functioning.** Indirect equity investments would allow IFAD to scale up its impact while sharing the risk with other institutional and private investors. Key elements to consider when making an indirect equity investment include: (i) the strategic goals and investment strategy of the investment fund; (ii) target markets, end-beneficiaries and potential impact; (iii) ESG safeguards and governing structures; (iv) financial and operational processes to originate, structure, manage and exit transactions and the capacity of the fund management team.

**Amounts.** Indirect equity investments range from US$1.5 million to US$15 million, depending on fund sourcing and portfolio strategy.

**Maturity.** Closed-end funds self-liquidate after 10-12 years of operation. Open-ended funds do not liquidate and the exit route is usually a private sale of the shares within seven to 10 years.

**Currency.** Mostly hard currency.

**Rate and return.** In this area of investment, returns highly depend on the regional scope and investment strategy of the investment fund.

**Example of use.** The ABC Fund aims to catalyse impact capital for agri-SMEs and small-scale producers. The ABC Fund invests in small-scale companies and in SMEs, young entrepreneurs, women entrepreneurs and FIs. IFAD could make an indirect equity investment in the ABC Fund which would allow it to scale up its portfolio of investments and outreach.

## Risk mitigation instruments

### Risk-sharing facilities (RSFs)

**Object.** A RSF is an agreement into which IFAD would enter – typically with a financial intermediary – in order to encourage them to lend to small-scale producers and agri-SMEs. IFAD shares the risk by covering a portion of the losses incurred on an asset or portfolio of eligible assets.

**Recipients.** Banks, MFIs, and other FIs. The FI needs an RSF when extending its offer and targeting riskier segments of the population, typically the "unbanked" rural poor.

**Functioning.** The RSF reimburses the FI for a fixed percentage of incurred losses. A triggering threshold is usually set. The FI and IFAD must agree on eligibility criteria specifying the assets to be covered. A RSF can be organized directly between IFAD and the FI, or through a third-party specialized unit for investment fund management. Governance, administration, financial management and impact monitoring systems need to be defined in the RSF agreement. Servicing procedures for performing, delinquent and defaulted assets are also agreed upon upfront.

**Amounts.** US$500,000 to US$10 million.

**Maturity.** All underlying loans must be added to the facility portfolio during a ramp-up period of three to five years, or until the portfolio reaches a predefined maximum volume. After the ramp-up period, no new loans could be added but IFAD will continue to share losses in the amortizing portfolio until the last loan has been refunded or the RSF termination date has been reached.

**Currency.** Local or hard currency.

**Rate and return.** The RSF is potentially a low-cost financial instrument. However, allocating budget for TA for RSF set-up and for the beneficiary FIs is a critical success factor for these facilities.

**Example of use.** IFAD has experience with the RSF tool in its programmes. For example, the Programme for Rural Outreach of Financial Innovations and Technologies (PROFIT) in Kenya, which closed in 2019, implemented an RSF component. This was undertaken directly by the programme coordination unit in the Kenya National Treasury. PROFIT directly deposited RSF funds with the partner financial institutions (PFIs) as a cash guarantee in a designated bank account: US$3.7 million to the Agriculture Finance Corporation (AFC) and US$3.2 million to Barclays Bank Kenya (BBK). The deposits generated interest revenue. By programme completion, with the provided guarantees, the PFIs in Kenya had invested US$32.2 million in the agriculture sector with a leverage ratio of 4:7 against the RSF budget. The Kenya experience shows that RSF is an instrument with the potential to leverage private capital beyond IFAD resources into investments in line with IFAD development objectives. The AFC lent a total US$23.7 million to 1,029 clients, and BBK, US$9.16 million to 19 clients. The clients of the two PFIs were either smaller rural FIs or agribusinesses, which generated indirect benefits for some 153,194 rural beneficiaries.

## Guarantees

**Object.** A guarantee is a promise by one party to assume the financial debt of a borrower if that borrower defaults. A guarantee can be limited or unlimited, making the guarantor responsible for either partial or total debt of the borrower.

**Recipients.** Banks, FIs and MFIs.

**Functioning.** A guarantee agreement is made with a high-risk borrower or with an FI that intends to lend in a high-risk sector. The guarantor commits to covering a certain portion of the loan in the case of default or delay in repayment. Guarantees are normally activated as a last resort once the recovery process of a bad loan has been exhausted or when recovery of other securities and assets has been fully realized.

**Maturity.** Typically long term: more than seven years.

**Currency.** Hard currency.

**Rate and return.** Fee structures are often put in place for entities interested in receiving guarantees. These normally include a fixed origination fee of the total guarantee requested, plus an annual usage fee of the portfolio that has been leveraged.

**Example of use.** A rural financial entity has identified an opportunity to expand its loan offering to 3,000 small-scale producers engaged in the maize value chain in Burkina Faso. The producers – who are aggregated into a local cooperative – have just secured a new sales contract with the public sector that potentially could further diversify income sources and supplement household food consumption. Technical services will also be offered by a third party to help ensure that both volume requirements and quality standards are met. A critical missing link is finance. Small-scale producers require pre-harvest financing to purchase fertilizers and other inputs, and local banks are not willing to offer financing due to the high risk. IFAD could extend a guarantee to local FIs willing to take on the risk if offered the appropriate incentives. The guarantee is a promise made to the FI that a certain percentage of the loan amount will be covered in the event of default. Assuming a 50 per cent coverage ratio, IFAD's guarantee could double the size and scale of its investment.

# List of private sector entities contacted during market scoping

**Name (organization)**

1. **Temasek** (fund manager)
2. **ABN AMRO** (bank)
3. **Aceli Africa** (fund manager)
4. **AgDevCo** (fund manager)

5 **Alphamundi** (asset owner)
6 **Alterfin** (fund manager)
7 **ARAF, Capria funds** (asset owner)
8 **Blue Orchard** (fund manager)
9 **BNP Paribas** (bank)
10 **Ceniarth** (asset owner)
11 **ClimateWorks** (collaborative platform)
12 **DWS (Deutsche Bank)** (bank)
13 **Ecobank (WAICSA)** (bank/fund manager)
14 **FINCA Ventures** (fund manager)
15 **FMO** (asset owner)
16 **GAIN** (asset owner)
17 **Global Partnerships** (fund manager)
18 **Goodwell Investments** (fund manager)
19 **Grameen Credit Agricole Foundation** (fund manager)
20 **IDH, The Sustainable Trade Initiative**
21 **IFC Development Partners** 2
22 **Incofin** (fund manager)
23 **KfW** (development partner IFAD)
24 **Skoll Foundation** (asset owner)
25 **Livelihood Ventures** (fund manager)
26 **Mercy Corps Social Ventures** (asset owner)
27 **Moore Foundation** (asset owner)
28 **Mulago Foundation** (asset owner)
29 **Norrsken Foundation** (asset owner)
30 **Oiko** (fund manager)
31 **Rabobank** (bank)
32 **ResponsAbility** (fund manager)
33 **Mulago Foundation** (asset owner)
34 **Root Capital** (fund manager)
35 **Symbiotics** (fund manager)
36 **MCE Social Capital** (fund manager)
37 **Terra Silver (New Island Capital)** (fund manager)
38 **Triodos** (bank)
39 **Triple Jump** (fund manager)

# Examples of complementarity between PoLG and NSOs

1. The main source of additionality for IFAD's NSOs is the potential capitalization and synergies with its PoLG. Some examples of complementary interventions are provided below.

**Nigeria – Financing the rice value chain**

2. In Nigeria, IFAD is partnering with Olam International under the Value Chain Development Programme to strengthen the rice value chain. Small-scale producers are provided with funding, productive capacity and infrastructure investment and are integrated into the value chain through Olam. The programme started in 2015, initially working with 30 farmers, and has expanded to 4,976 farmers cultivating 6,609 hectares and producing over 25,200 metric tons of rice valued at US$9.8 million. This rice is purchased by Olam, creating 3,795 new jobs and increasing agricultural income, on average, by 25 per cent.

3. Bankable demand for financial services to acquire agricultural equipment has been generated as a result of the programme's investment in the rice value chain.

**Potential NSO intervention**:

- Funding for targeted farmers to acquire equipment through a partnership between Olam and a local financial intermediary. This could take the form of a risk participation agreement or a line of credit, which would allow farmers to make additional investments in production capacity in order to increase their incomes, reduce dependence on government support and create more jobs.
- Blending of funding from the Green Climate Fund's Private Sector Facility with commercial resources to offer an affordable line of credit through a local financial intermediary. This support would provide farmers with affordable loans to acquire, for example, solar-energy-based irrigation equipment.

**Paraguay – Guarantee mechanism for saving deposit certificates**

4. As part of the Family Farming and Sustainable Finance Project in Paraguay, savings deposit certificates (SDCs) served as collateral for operating capital credit given by banks or other financial institutions. The SDCs are used by the farmers' organizations as collateral to access wholesale credit at attractive interest rates, which is then passed on to their members as individual loans. The SDC mechanism has helped reduce the cost of smallholder borrowing to 50 per cent below the standard interest rates on the financial market. This mechanism is being replicated in two new projects in Paraguay; in one of them, a centralized trust fund will work as the guarantee.

5. Despite the positive results, banks are only willing to provide 1:1 funding (fully covered by the SDC). A first- or second-loss guarantee could increase banks' willingness to increase their funding leverage.

**Potential NSO intervention**:

- Funded or unfunded guarantees to FIs in Paraguay to increase the willingness of banks to finance farmers' organizations.
- Replication of the combined SDC and guarantee model in other countries in the region, where there is significant market liquidity but high resistance to invest in small-scale farmers due to the sector's inherent risk.
- Bundled TA would help FIs to develop adequate financial products that respond to financing requirements for climate-smart agriculture technologies requested by farmers' organizations as part of the PoLG.

**Philippines – Financing the cacao value chain**

6. In the Philippines, IFAD is financing the Rural Agroenterprise Partnerships for Inclusive Development and Growth Project (RAPID) to improve the competitiveness

of selected agricultural commodity chains, including cacao. The project works with identified anchor firms as drivers of value chain investments, for example, the national company Kennemer Foods International, which supplies fermented cacao beans to Mars Incorporated.

7. Existing financial institutions are reluctant to provide the required financing due to the perceived riskiness (and their limited knowledge) of the sector and the terms and conditions required (maturity, collateral, etc.). Agronomika is a financial company established with the support of Kennemer to provide innovative financial products and services to farmers and rural entrepreneurs in selected agri-value chains. It has intimate knowledge and understanding of the cacao value chain, but it is constrained by insufficient capital.

**Potential NSO intervention**:

8. Bundled TA and debt financing would increase Agronomika's capacity to provide adapted financial services to the RAPID target clients (including Kennemer's smallholder suppliers), both in cacao and in other value chains (which would require TA). There is strong potential for private financing to be leveraged from anchor firms through Agronomika. Bankable demand exists for:

- Equipment for fermentation of cocoa beans at the primary aggregation level (cooperatives and farmers' organizations);
- Improvement of smallholder' plantations, including replanting, investment in yield-enhancing measures and diversification through intercropping with suitable tree crops.

# The Enhanced Blended Concessional Finance Principles for DFI Private Sector Operations of the DFI Working Group on Blended Concessional Finance for Private Sector Projects

## Blended concessional finance definition

1. The DFI Working Group[22] defines blended finance as "combining concessional finance from donors or third parties alongside DFIs' normal own account finance and/or commercial finance from other investors, to develop private sector markets, address the SDGs, and mobilize private resources".[23] (DFI Working Group 2018, p. 7). The group is concerned with the operational level of institutions that are implementing private sector projects, and it focuses exclusively on issues surrounding the use of concessional finance.[24]

## Principles[25]

2. **Rationale for using blended concessional finance.** DFI support for the private sector should make a contribution that is beyond what is available, or is otherwise absent from the market. It should not crowd out the private sector. Blended concessional finance should address market failures.

3. **Crowding-in and minimum concessionality.** To the extent possible, DFI support for the private sector should contribute to catalysing market development, mobilize private sector resources and minimize the use of concessional resources.

4. **Commercial sustainability.** DFI support for the private sector and the impact achieved by each operation should aim to be sustainable. It must contribute to the commercial viability of clients. The level of concessionality in a sector should be revisited over time.

5. **Reinforcing markets.** DFI support for the private sector should be structured to effectively and efficiently address market failures, and minimize the risk of disrupting or unduly distorting markets or crowding out private finance, including new entrants.

6. **Promoting high standards.** DFI private sector operations should seek to promote adherence to high standards of conduct by their clients, including in the areas of corporate governance, environmental impact, social inclusion, transparency, integrity and disclosure.

[22] The DFI Working Group consists of representatives from the International Finance Corporation (IFC), African Development Bank, Asian Development Bank, Asian Infrastructure Investment Bank, European Bank for Reconstruction and Development, European Development Finance Institutions, European Investment Bank, Inter-American Development Bank Group and Islamic Corporation for the Development of the Private Sector.
[23] DFI Working Group on Blended Concessional Finance for Private Sector Projects Joint Report, October 2018 Update (https://www.adb.org/sites/default/files/institutional-document/457741/dfi-blended-concessional-fiance-report.pdf), p. 7.
[24] Ibid, p. 20.
[25] Ibid, p. 8.

# Measuring impact of IFAD’s NSOs

1. In order to ensure the development effectiveness of NSOs, an ad hoc programme of impact evaluations will be created to address the diversity of these operations. This will entail designing more evaluations in the domain of microfinance, SMEs, producers’ organizations and cooperatives, and insurance and impact funds.

2. So far at SME level, IFAD’s Research and Impact Assessment (RIA) Division has assessed impact at the level of producers’ organizations (POs) and cooperatives as part of the IFAD10, ex post impact assessment agenda. As an example, PO-level impact was measured explicitly in the assessment of the Agricultural Value Chain Support Project (PAFA) in Senegal. Impact was estimated through a set of indicators to measure access to market, the extent of commercialization, diversification of the PO’s sources of income, crop diversification, assets and access to information. PAFA supported the establishment of contractual agreements with market operators for the sale of PO members’ produce. The results show that on average, the POs targeted by PAFA experienced a gain of 158 per cent in the quantity of crop sold commercially, and earned 218 per cent more on the crops sold. In terms of income diversification, the POs were nearly 13 per cent more likely to engage in income-generating activities other than agriculture compared to their non-PAFA counterparts. Results on access to information are mixed and not significant, probably due to the fact that the POs were encouraged to share information outside their organization.

3. Impacts at the PO-level were also measured as part of a joint impact assessment of two projects in Sao Tome and Principe: the Participatory Smallholder Agriculture and Artisanal Fisheries Development Programme (PAPAFPA) and the Smallholder Commercial Agriculture Project (PAPAC). These projects demonstrate the efforts made to reduce rural poverty and increase economic mobility among small-scale farmers by strengthening community infrastructure, POs and their representatives within national Government and to support farmers’ professionalization and agricultural production. The impact assessment focused on three value chains: cacao, coffee and pepper.

4. The findings were generally positive. Project beneficiaries achieved, as expected, significantly higher rates of organic certification than non-beneficiaries. Critically, they also appear to enjoy higher levels of crop productivity, revenue on crop sales and market participation, income and asset ownership (particularly durable goods, productive assets and livestock), as well as greater dietary diversity and food security.

5. Similarly, in the impact assessment of the Project for Rural Income through Exports (PRICE) in Rwanda, remarkably strong impact was demonstrated at the cooperative level in terms of volume of coffee cherries processed, coffee washing station utilization rates, and the coffee prices received by farmers belonging to coffee cooperatives supported by the project. In the PRICE component for financing horticulture, it was found that farmers owning horticultural businesses exhibited very large increases in income (gains of more than 500 per cent were recorded). The results showcase the strong potential for high-value horticulture crops, which can be harvested at least twice within a year. This was especially the case among large-scale farmers with more than 5 hectares of land, who managed to capitalize on economies of scale as well as the short production cycles of the seasonal horticulture crops they grew. Moreover, most horticulture farmers paid off their loans within a year, suggesting the high profitability of horticulture businesses. Qualitative interviews conducted during the assessment show that some of these farmers borrowed additional capital for further investment in their businesses after receiving PRICE funds.

6. In the domain of private development funds, RIA is conducting the impact assessment of the Small and Medium Agribusiness Development Fund (SMADF)

project in Uganda. The SMADF is an innovative "impact investing" initiative that brings together public and private investors and service providers with the objective of stimulating the growth of small and medium-sized agribusinesses (SMAs) by providing them with long-term financing products.

7. The impact assessment is one of the most robust ever conducted on this type of initiative and aims to measure the impact on smallholder farmers connected to investee SMAs in terms of key socio-economic indicators linked to IFAD's strategic objectives.

8. Investees are selected based on their potential for both financial and social returns, such as their positive impact on the livelihoods of smallholder farmers. The SMADF has therefore a double obligation to secure financial gains for its investors while also ensuring that investments achieve social returns for the most in need. To determine the credibility of the SMADF, it is imperative to rigorously assess to what extent these obligations are fulfilled. To do that, an integrated set of tools has been developed, including the Global Impact Investing Ratings System, the monitoring and evaluation systems of IFAD and the SMADF Manager, and the impact assessment conducted by RIA.

9. Around half of the SMADF's investees will be included in the assessment. For each, data from beneficiary (treatment) and non-beneficiary (control) households will be collected at the baseline and five years after the investment. The methodology developed for the impact assessment will allow estimation of the impacts at the investee level and, through aggregation, at the level of the whole SMADF. The results of the assessment will provide robust evidence of the SMADF’s social returns, and combined with the its monitoring tools, will help increase transparency and generate important lessons to drive the improvement of a promising development approach that is still in its infancy.

# Environmental and Social Framework for Private Sector Operations

## Financial intermediary operations

The following components of an environmental and social (E&S) framework for private sector financial intermediary operations are derived from international best practices, following mostly the International Finance Corporation's Performance Standards (2012), Environmental and Social Review Procedures (2016) and Interpretation Note on Financial Intermediaries (2018). The framework has been adapted for IFAD's purposes and will serve as guidance for IFAD when the SECAP are updated in 2020.

**Suggested E&S framework for financial intermediaries**

| **DEFINITIONS AND GENERAL REQUIREMENTS FOR MANAGING E&S RISKS IN FI OPERATIONS** | |
|---|---|
| **Definition of the financial intermediary (FI) and coverage of E&S risk management** | The FI function is one of intermediation. It has delegated decision-making power to select subprojects. If IFAD funds are used to finance only a specific asset class (e.g. credit line to a specific sector), the requirements cover only that specific class, but if funds are used for general purposes, IFAD requirements will apply to the entire portfolio. |
| **Investment restrictions for existing clients** | IFAD will not engage in new investments with existing clients (FIs) whose E&S performance has been less than satisfactory in previous financial operations. |
| **E&S risk assessment principle** | Risk assessment incorporates country, region, sector, track record, capacity, commitment, type of financing, etc. |
| **Categorization of the FI** | FI-1: high (highest risk), FI-2: substantial, FI-3: moderate, FI-4: low. Categories are based on relative magnitude of E&S risks and impacts, in accordance with the SECAP. |
| **E&S covenants in legal agreements** | Covenants should be clearly defined in loan/subscription agreements. Required components are as follows: environmental and social management system, exclusion list, host country laws, E&S standards, E&S action plan, clearance of high risk subprojects by IFAD, annual reporting. |
| **Environmental and social management system (ESMS)** | |
| **ESMS components** | (i) an E&S policy; (ii) internal organizational capacity; (iii) E&S due diligence (ESDD) processes/procedures to identify risks and impacts of borrowers/investees; (iv) monitoring and review of portfolio; (v) external communications mechanism; and (vi) workplace safety at FI, emergency preparedness and response |
| • **E&S policy** | In its E&S policy, the FI should state the E&S requirements and standards that apply to the FI's lending/investment activities and that will be used to manage the E&S risk associated with the FI's portfolio. |
| • **Internal organizational capacity and competency** | FI establishes and maintains an organizational structure that defines roles, responsibilities and authority to implement the ESMS. Request organization, roles and responsibilities, staff experience, training, education and ensure adequate technical expertise, either in-house or external expert support to carry out due diligence and manage the environmental and social risks of the given FI subprojects. |
| • **E&S due diligence processes** | FI establishes and maintains a process to identify the E&S risks and impacts of operations, develops an environmental and social action plan (ESAP) and reviews proposed transactions against the exclusion list and national E&S laws and regulations. For higher-risk transactions, the FI will engage external qualified experts and develop the necessary supporting guidance documents and checklists. Reference to ESAP in the legal agreement between the FI and its sub-client should be added, if needed. |

| | |
|---|---|
| • **Categorization of subprojects** | Definition for higher-risk transactions: long-term corporate finance affecting indigenous peoples, potential involuntary resettlement or significant risks or impacts on the environment or health and safety, using IFAD categorization (high, substantial, moderate, low) or categories A, B and C:<br><br> Category A: Business activities with potential significant adverse environmental or social risks and/or impacts that are diverse, irreversible or unprecedented.<br><br> Category B: Business activities with potential limited adverse environmental or social risks and/or impacts of a limited number, generally site-specific, largely reversible, and readily addressed through mitigation measures.<br><br> Category C: Business activities with minimal or no adverse environmental or social risks and/or impacts. |
| • **Application of ES Standards 1-9** | ES standards applied for long term (>3 years) finance to higher-risk activities as applicable, depending on the risk profile.<br><br>FIs with portfolio and/or prospective business activities that present moderate to high environmental or social risks (i.e. Category FI-1 and FI-2) will require the higher risk business activities that they support to apply relevant requirements of the ES standards. |
| • **Compliance with the host country ESHS laws and regulations** | All FIs (FI-1 – FI-4)<br><br>FI requests compliance statement in its investment agreements with sub-clients and reports to IFAD through the annual environmental performance report (AEPR). |
| • **Compliance with the exclusion list** | All FIs (FI-1 – FI-4)<br><br>FI reports on the portfolio to IFAD through the AEPR, project brief, E&S category. |
| • **Clearance of high risk projects** | FI will send E&S documentation on high-risk subprojects for IFAD's review and clearance. For compliance verification, IFAD (i) reviews the environmental and social information collected by the FI; (ii) determines any additional information needed; (iii) assists with determining appropriate mitigation measures; and (iv) specifies conditions under which the subprojects may proceed. |
| • **Procedures for monitoring and review of portfolio** | FI establishes monitoring procedures to review progress with ESAPs and compliance of operations with any legal and/or contractual obligations and regulatory requirements. The FI reports on the portfolio to IFAD through the AEPR. |
| • **Disclosure** | Good practice: The policy is made available externally through public disclosure: it is included in corporate statements and reports, and published on the FI's website. |
| • **Review of FI's ESDD process** | At least annually |
| **MONITORING AND REPORTING** | |
| **Requirements for visiting the FI** | Visit the FI if serious deficiencies in reporting or performance are found. The frequency and focus of supervision visits are commensurate with the identified risks and the E&S performance of the FI. FI-1 projects are visited annually. |
| **Requirements for visiting the subprojects** | Visit at least one high-risk subproject when visiting the FI to ascertain the correctness of the E&S category; compliance with ESMS and IFAD's requirements at the subproject level; and skills and competence of the FI's environmental and social specialist staff. |
| **Reporting frequency** | AEPRs annually for FI-1 – FI-3 projects |
| **Reporting content** | FI-1 – FI-3 submit regular E&S performance reports describing progress made with respect to the ESAP and effectiveness of ESMS implementation at least annually, including:<br>▪ Portfolio breakdown by industry sector and product line; E&S category and sample ESDD reports; |

| | |
|---|---|
| | ▪ Cases of non-compliance and significant E&S accidents (lost time accident rate, fatality rate) or incidents related to a transaction; and<br>▪ Information on the implementation of any changes to the FI's ESMS;<br>▪ Where relevant, the FI clients' exposure to high-risk activities (e.g. coal-related activities or activities involving, palm oil, etc.) |
| **Reporting templates** | Tailored by sector and E&S category and FI type, leasing, stressed assets, funds, etc. |
| **Review of AEPRs** | E&S specialists complete a formalized AEPR review report with the environmental and social risk assessment and submit the report to the FI through the portfolio officers. |
| **Record keeping** | File Manager is used for all E&S documents and communication. |
| **External communications mechanism** | Those FIs required to apply IFAD's E&S standards to their financing and investment activities will establish and maintain an external communications mechanism. |
| **Emergency preparedness and response system** | Where an IFAD client's operations involve activities and facilities that are likely to generate impacts, FI establishes and maintain an emergency preparedness and response system to respond to accidental and emergency situations. |
| **FI clients must manage working conditions** | The E&S risks associated with the FI's internal operations are typically limited to managing labour and working conditions of employees (according to environmental and social standards 5 in regard to terms and conditions of employment and non-discrimination and equal opportunity), and ensuring that the necessary emergency preparedness and response plans are in place within the FI's premises to protect the health and safety of its employees and visitors. |

# Assessing additionality and development results

1. This annex outlines the general approach that IFAD will take in conducting ex ante assessments of additionality under its Framework for IFAD's NSOs. The first section defines the concept of financial and non-financial additionality and discusses how they will be assessed. The second section details the indicative development results framework for IFAD's NSOs.

## A. Additionality defined

2. IFAD will operationalize the concept of additionality in line with the definition set in the Multilateral Development Banks' Harmonized Framework for Additionality in Private Sector Operations.[26] The concept of additionality is expected to guide IFAD in structuring its NSOs so as to add value, make a contribution that cannot be achieved otherwise by commercial investors and, where applicable, avoid crowding out the private sector. Two dimensions of additionality are critical to IFAD in developing NSOs: non-financial additionality and financial additionality.

## B. Guiding principles for assessing additionality

3. In aiming to achieve value added and assessing the additionality of its NSOs, IFAD will be guided by the following general principles:

   (i) **Demonstrated additionality.** IFAD will assess additionality ex ante for each NSO at the time its intervention is being developed and screened for approval.This is because IFAD may be additional at the time it decides to intervene but this level of additionality could decrease over time because of changes in market conditions.

   (ii) **Additionality assessments should be evidence-based**, i.e. additionality is assessed at the project level and needs to be backed by data and knowledge of the project context.

   (iii) **Additionality assessments should be contextualized.** This means that the assessment of the same NSO may differ by country, sector, market, and/or client type. Equally, within the same country, levels of risk may vary across sector, market and/or client type**.**

   (iv) **Transparent attribution.** IFAD aims to ensure that the individual components of additionality are transparently attributed to each subcategory (non-financial or financial additionality) and not double-counted.

## C. Non-financial additionality

4. According to best practice, non-financial additionality is ascertained by asking the following questions:

   - Did IFAD's participation in the project (by virtue of its IFI status) provide implicit comfort to private investors (i.e. improve the investors' perception of the risks involved) and thus encourage them to proceed?
   - Did IFAD's participation help bring about a fair and efficient allocation of risks and responsibilities, e.g. between the public and the private investors?
   - Did IFAD's participation help improve the project design (by contributing knowledge or innovations), the functioning of the private sector recipient's business (e.g. through the adoption of new or better standards), or otherwise contribute to the client's capacity-building objectives?

[26] Multilateral Development Banks Harmonized Framework for Additionality in Private Sector Operations: https://www.adb.org/sites/default/files/institutional-document/456886/mdb-additionality-private-sector.pdf.

5. Two key aspects of non-financial additionality need to be considered when assessing IFAD's NSOs:

- **Political risk mitigation and enabling environment.** Unlike commercial lenders, IFAD's funding and support of projects can provide implicit comfort and risk mitigation because of its status as both a United Nations specialized agency and an IFI, and its well-established partnerships with Member State governments. Similarly, IFAD's presence in an NSO may provide comfort to private investors through its reputation, rich experience and in-depth knowledge of the policy environment in the agricultural sector and its understanding of the political, social and economic situation in its Member States. IFAD can thus identify both investment opportunities and investment challenges, and help to mitigate investment risks. It is in a unique position to facilitate linkages between its project beneficiaries and the private sector, helping to match demand for investment with supply and reducing market failures.

- **Standard-setting, knowledge, innovation and capacity-building.** IFAD can help induce change by supporting private sector recipients in raising their standards, improving their corporate governance, gender or environment and social governance strategies, and fostering their positive impact on rural women and/or youth or fragility affected countries. IFAD could also provide recipients with capacity-building and TA to better enable them to incorporate these changes. IFAD could leverage its own expertise and know-how in the wider context of the project area and the agricultural sector of the specific country and make use of its partnerships and networks in order to disseminate information and promote best practices and lessons learned. This could lead to the replication of successful projects and to positive sector-wide or regional spillovers.

## D. Financial additionality

6. Financial additionality relates to IFAD's overall ability to reduce private investors' exposure to credit, liquidity and market risk in ways that cannot be achieved using private sources and commercial financiers. Financial additionality therefore depends on the overall reduction in commercial risk relative to the counterfactual scenario of the NSO without IFAD's participation.[27] In particular, the assessment considers aspects such as:

- Would the private sector recipient have been able to obtain sufficient financing/financial support at the same level from private sources on appropriate terms? Judgments on this issue will consider pricing, tenor, grace period and currency.

- Did IFAD play a catalytic role in mobilizing funds from other investors and lenders, or was its involvement essential to complete the financing package?

7. Based on these considerations, IFAD's financial additionality will be assessed in five key categories:

- **Long-term financing.** In many instances, long-tenor financing is critical for NSOs, as it leads to improved commercial viability or maturity lengthening in the case of NSOs involving FIs. In particular, the assessment depends on the availability of long-term financing at commercially sustainable rates from market sources. Additionality is strongest when the project is not

[27] In terms of concessionality, IFAD will first price the financial product according to market conditions (as outlined in the framework) and then evaluate the needed level of concessionality based on different factors (such as development impact of blended funding provided to private sector entities, etc.). This is in line with the enhanced blended concessional finance principles for DFI private sector operations.

commercially viable without long-tenor financing and where there is evidence that commercial sources have no appetite or ability to offer such funding.

- **Improved currency matching**. Local currency funding can reduce an NSO's exposure to foreign exchange risks (due to floating exchange rates) by matching the currency of debt repayment with project revenue. The magnitude of additionality is affected by the feasibility of arranging local currency financing as well as country-specific factors (hedging options/costs, macroeconomic situation/exchange rate risks, etc.).
- **Capital mobilization/catalytic role.** IFAD's capacity as assembler of finance, convening power and expertise in mobilizing resources enable it to play a verifiable role in the fundraising process or provide a positive signal to crowd-in additional financing on commercial terms from an institutional or private financier.
- **Capital relief and enhancement.** The provision of risk participation agreements/guarantees could provide beneficiary institutions with capital relief to help scale up their operations. This is particularly relevant for FIs, which need to comply with capital adequacy ratios. IFAD's participation in the equity tranche of private companies may also prove beneficial by catalysing additional private capital.
- **Innovative financing structures and/or instruments**. IFAD may provide clients and partners with innovative financing structures that (i) add value by lowering the cost of capital or by better addressing risks and (ii) are not available in the market at a reasonable cost. It is understood that innovation is market-specific; a structure is therefore considered to be innovative if it is new to the specific market targeted by the project.

## E. Self-evaluation for IFAD's additionality

8. IFAD will screen and assess its additionality – financial and non-financial – in each NSO based on a six-point scale composed of the following ratings: 1 – highly unsatisfactory, 2 – unsatisfactory, 3 – moderately unsatisfactory, 4 – moderately satisfactory, 5 – satisfactory and 6 – highly satisfactory. The overall additionality will be based on the highest score, recognizing that additionality could be financial or non-financial.

Table 1
**Descriptor of self-evaluation criteria**

| Dimension | Subcategory | Description | Rating Scale |
|---|---|---|---|
| **Non-financial additionality** | Political risk mitigation and enabling environment | · IFAD is able to provide implicit risk mitigation and comfort to private investors and/or is able to provide support with respect to regulatory matters and help induce institutional change. | (1) Highly unsatisfactory<br>(2) Unsatisfactory<br>(3) Moderately unsatisfactory<br>(4) Moderately satisfactory<br>(5) Satisfactory<br>(6) Highly satisfactory |
| | Standard-setting and knowledge, innovation and capacity-building | · IFAD is able to support private sector recipients in improving their standards (in terms of corporate governance, ESG and/or gender and youth policies) and/or make a significant impact in terms of knowledge dissemination, innovation and capacity-building. | |
| **Financial additionality** | Long-term financing | · IFAD provides long-term financing that is not available in the market from commercial sources on reasonable terms and conditions. | (1) Highly unsatisfactory<br>(2) Unsatisfactory<br>(3) Moderately unsatisfactory<br>(4) Moderately satisfactory<br>(5) Satisfactory<br>(6) Highly satisfactory |
| | Improved currency matching | · IFAD provides local currency financing (or hedging) that is not available in the market from commercial sources on reasonable terms and conditions. | |
| | Capital mobilization/catalytic role | · IFAD helps mobilize (additional) resources either through fundraising or by sending a positive signal allowing the company to access capital that would not have been otherwise available on the market. | |
| | Capital relief and enhancement | · IFAD interventions lead to capital relief for private sector recipients (including FIs), allowing them to expand their operations in a way that would not have been otherwise possible. | |
| | Innovative financing structures and/or instruments | · IFAD provides innovative financing structures that add value by lowering the cost of capital or by better addressing risks and are not available in the market at a reasonable cost. | |

## F. Indicative results framework to measure development results of IFAD's NSOs

9. Drawing on its 40 years of experience in agricultural development and in alignment with its existent policies pertaining to sovereign operations,[28] IFAD will assess the development results of its NSOs based on a list of core indicators (see table 2). These indicators serve as a useful tool for IFAD to quantify the development impact achieved through its NSOs and report to the Executive Board and the public on its contribution to broader country results and the SDGs in general.

10. The indicators are organized along IFAD's three strategic objectives (SOs): (i) increase poor rural people's productive capacities; (ii) increase rural poor

[28] Project Design Guidelines, as of 13 January 2020, annex IV: Technical Guidance Note: Theory of change, logical frameworks and core indicators.

people's benefits from market participation; and (iii) strengthen the environmental sustainability and climate resilience of rural poor people's economic activities.

11. The indicators will serve as a general benchmark to track the development results achieved by IFAD in its NSOs. Given the diverse nature of the NSOs, IFAD will develop a more detailed logical framework for each operation. These logical frameworks will depend on the nature of the intervention will include a selection of the NSO core indicators (table 2).

Table 2
**IFAD NSO core indicators**

| Area of thematic focus | SDG target | No. | Core indicator |
|---|---|---|---|
| SO1: Increase poor rural people's productive capacities | | | |
| Farmers reached | 2.3., 2.4. | 1.1. | Number of smallholder farmers and/or members of cooperatives (farmers' organizations (FOs) that are linked to the private sector recipient as suppliers, buyers, contractors or farming employees during the reporting period |
| Market linkages (value chains) | | 1.2. | Unit count (as applicable) and gross value of production and purchases from value chains over the reporting period |
| Production and farmers' productivity | | 1.3. | Unit count of output volumes and yield (as applicable) and gross value over the reporting period |
| Higher rural employment | 8.3. | 1.4. | Number of new jobs created over the reporting period in SMEs, agribusinesses and/or cooperatives or FOs |
| Improved business performance along the agribusiness value chain | 8.1., 8.2. | 1.5. | For SMEs/agribusinesses: Higher total sales/gross value of sales over the reporting period; percentage of local sourcing; better financial key performance indicators (KPIs).<br>For FIs: Improved agriportfolio; better KPIs |
| SO2: Increase poor rural poor people's benefits from market participation | | | |
| Increased access to finance | 8.3 | 2.1. | For FIs: Number and amount of loans disbursed to SMEs, FOs, and/or cooperatives in the client's company portfolio as well as number of rural clients reached at the end of reporting period<br>For SMEs/agribusinesses: number and amount of loans disbursed |

| | | | |
|---|---|---|---|
| Benefits to sub-borrowers | 8.3 | 2.2. | Terms and conditions to sub-borrowers/final beneficiaries |
| Stronger market participation of women and/or youth and indigenous peoples | 2.3, 8.5 | 2.3. | Number of women, youth and/or indigenous peoples employed as a result of the project over the reporting period |
| Improving products and services | | 2.4. | Number of improved products and services, i.e. improved delivery or access channels, lower costs, higher quality |
| Increased coverage of vulnerable/poor segments of the population | | 2.5. | Percentage of vulnerable/poor people reached |
| SO3: Strengthen the environmental sustainability and climate resilience of poor rural people's economic activities | | | |
| Strengthened resilience to climate change | 2.4., 13.1, 15.1-15.3 | 3.1. | Number of to SMEs, FOs, and/or cooperatives in the client's company portfolio supported in sustainably managing natural resources and climate-related risks, including climate-resilient land management |

# Comments received and Management's responses

**Canada**

1. **Canada supports IFAD's efforts regarding the implementation of the Private Sector Engagement Strategy and the identified need to engage the private sector directly to increase impact. We support IFAD's focus on complementarity and additionality when deciding which private sector initiatives to support, as this could help reinforce country strategies in agriculture and ensure a focus on long-term solutions. This should be done in coordination with IFAD member states where private sector entities are located to encourage replication and potential spillover to other entities. Although the document refers to the risks involved and the potential ways of mitigating some risks through a due diligence process, we recommend IFAD produce a more detailed process description for conducting due diligence screening on all private sector partners prior to entering into a formal partnership with them.**

**Response:**

*Management thanks Canada for its support to the Private Sector Engagement Strategy and its focus on increasing the impact of IFAD's operations. With regards to the due diligence screening, NSOs will also be subject to an internal review process to assess the reputational, financial, governance, marketing operational, and other key risks associated with each NSO. In addition, environmental and social risks will be identified through a parallel process implemented prior and during the due diligence. A dedicated process is being developed in this respect and is expected to be finalized by the end of the first semester 2020. Meanwhile, management has set clear rules, checks and balances leveraging on practices of sister IFIs to process pilots until the expanded guidelines are finalized.*

2. **We welcome the creation of the Private Sector Trust Fund in order to diversify funding sources and to engage the private sector and foundations as potential donors. Can you provide more information regarding the capacity implications on IFAD personnel in order to manage this fund as the Administrator and Trustee.**

**Response:**

*IFAD has already extensive experience in being the administrator and trustee of the following Trust Fund (TF): the IFAD Trust Fund for the Heavily-Indebted Poor Countries Debt Initiative, the IFAD Fund for Gaza and the West Bank, the IFAD Trust Fund for the After-Service Medical Coverage Scheme (ASMCS TF), the Spanish trust Fund and the ASAP Trust Fund.*

*It is also worth noting that all supplementary funds (SF) are in substance administered like TF. IFAD is acting as administrator to implement projects on behalf of the donors, to reach the agreed objectives. Since its inception, IFAD has signed SF agreements for 1.8 billion. This balance includes, inter alia, SF from Member States and governmental development agencies, European Union, GEF and other entities, etc. As for the private sector, IFAD has experience in UGANDA with the SMADF project and in administering SFs that have been invested in the ABC Fund.*

*IFAD has, therefore, systems and capacity in place for the operational monitoring of the Private Sector TF. Additional capacity requirements will be covered by the Trust Fund management fees and the income the TF is expected to make.*

**Sweden**

3. **Sweden welcomes the proposals in the Framework for non-Sovereign Private Sector Operations. We also welcome IFAD exploring new ways of leveraging financing, incl. the proposed funds in IFAD 2:0.**
**The investment seems to have high potential to accelerate, step up and enhance sustainable rural transformation in the favour of the smallholder farmers and agri-SMEs, which we acknowledge is even more vital now than ever with a world going into a COVID-19 economic and social recession, hitting hard on local food supply chains, food security and economies, especially in fragile and vulnerable countries.**
**In going forward, we need to reboot our way of thinking and start doing things differently and build bridges to empower smallholder farmers and agri-SMEs. In terms of accelerating high impact, we welcome that guarantee instruments (like the ones Sida can provide) will be explored in providing financing and financial services.**
**While we appreciate; i) IFAD clearly spelling out the comparative advantages; ii) the key dimensions in monitoring and supervising, iii) the risk matrix (including mitigation measures), iv) that the Fund is connected to IFAD´s balance sheet, and CAF to detect unexpected losses including following international financial reporting standards; and v) that environmental, climate and social requirements are outlined in the project design, cycle and the legal agreements - we still miss the holistic approach, clearly spelling out the connection and interaction between the financial elements, also in terms of securing the balance between grants and loans in IFAD12 and onwards.**
**Overall, we would appreciate some more explanation on this, and regarding; the expected boosting effects and synergy effects in connection to the proposals of the Agribusiness Capital Fund, ASAP+ and the Private Sector Engagement and the utilization of resources of 25 MUSD (13%) from PoLG in IFAD11.**
**We can understand that a boost is well needed, maybe more in terms of the private sector engagement than ASAP+, as the latter is already established, and climate financing might be is easier to attract. Having said this, we would appreciate IFAD´s elaboration regarding the needed distribution. The trade-off aspects in terms of IFAD11, and the justification of the strategic direction translated into this boost could also be outlined for clarification, also why it is 25 and not 20 MUSD.**
**The overall and complete picture is important also in terms of measuring successful private sector engagements as a part of a larger strategic setting and being able to continually adjust and incorporate lessons learned (para 16, page 4).**
**This proposal lays out great potentials, however, we believe it would benefit from also; i) adding an layer to the analysis of the challenges and risks in connection to the Covid-19 and a world in economic and social recession, and, liked outlined in previous comments (today), to look at the other side of the coin, ii) outline the boosting effects this investment will provide to empower the smallholder farmer and agri-SMEs in need, while strengthening local food supply system/chains and local economies within a regional perspective.**
**In relations to the proposed funds, we would like to underline the importance of taking into account the substitutions risk versus the replenishment. It goes without saying, competing and crowding out among resources must be avoided and therefore the reasoning around this challenge in the light of IFAD12 replenishment would be appreciated. We would furthermore appreciate to get a better understanding of the privileges and requirements to tap into the financing of the Private sector**

**Trust Fund, ASAP+ and the ABC fund. This could probably be easily reflected in a PPT slide.**

**Response:**

*For these questions, please refer to answers provided in para 14-22 of document EB 2020/129/R.X. on "Management position on the Comments of Member States on the Utilization of resources under the IFAD Regular Grants Programme for the implementation of the Private Sector Engagement Strategy and other new initiatives."*

4. **Sweden expects high standards in terms of the requirements without exceptions through SECAP, best practice and codes of conduct, promoting the smallholder farmer and rural SME for sustainable and effective agriculture and agribusiness. Overseeing a high set of standards is correlated with a high degree in reputational risks, which we appreciate being mentioned in the paper.**

**Response:**

*Management reiterates its commitment to maintaining high standards in mitigating reputational, social and environmental risks associated with NSOs. On ESG risks, more information on IFAD's new SECAP is provided in the response to question 15 below.*

5. **Also, the paper would benefit from outlining the leveraging aims and boosting aspects of co-financing and co-partnering of host countries in connection to the Private Sector Engagements and the Private Sector Trust Fund.**

**Response:**

*As stated in the Framework, IFAD's partnerships with private sector entities at country level will recognize the primacy of country ownership and buy-in through consultations with the Host Country. The successful implementation of the PSS will, indeed, highly depends on the buy- in from IFAD Member States. Efforts will be, therefore, undertaken to identify as early as the COSOP stage- in consultation with governments of host countries - investment opportunities for international and domestic private sector actors whereby IFAD could play a catalytic role. In addition, IFAD will seek "no objection" from the government as part of any NSO approval process. This close dialogue with the Government of Host Countries is also expected to produce co-financing and co-partnering opportunities, including those linked to IFAD supported projects. This should be ensured through the complementarity principle proposed in the Framework. Examples of co-financing opportunities with the POLG (and therefore with governments of host countries) are also provided in Annex IV of the Framework.*

**Lastly, we would appreciate if IFAD inserts "mitigation and adaption" in para 35; "IFAD will give priority to NSOs targeting fragility-affected countries and those likely to strongly increase the incomes of small producers, while also enhancing job creation, women's empowerment, resilience, mitigation and adaption to climate change and the restoration and conservation of ecosystem services."**

**Response:**

*This comment is well noted and Management will include the reference to mitigation and adaptation in paragraph 35.*

**United States**

6. **We agree with Management's attempts to personalize each interaction, noting that minimal concessionality will be used to determine how best to meet partner needs.**
**While we understand that some may see a need for geographic diversity, as noted in paragraph 22, and we do want to pilot interventions in different settings, we strongly encourage Management to seek out interventions that would produce significant benefits and where IFAD's interventions provide a value-add and not overly emphasize geographic diversity.**

**Response:**

*Agreed. Geographic diversification will not be a key driver or objective of IFAD's interventions. Indeed, IFAD Non Sovereign Private Sector Operations (NSOs) aim at maximizing the Fund's development impact and as such will mainly focus on IFAD's target groups in most vulnerable countries, notably LICs and countries in fragile situations. In addition, the guiding principle behind IFAD's NSOs will be additionality, and the extent to which IFAD's support brings clear value added and helps to address market failures compared to what the market is offering. IFAD will also have a gradual approach and prioritize its pipeline growth in areas where it is expected to have the highest additionality and development impact in areas identified in the Private Sector Engagement Strategy notably job creation, gender equality and women's empowerment, and environmental sustainability.*

7. **We note that IFAD intends to commit some of its own resources to non-sovereign private sector operations. Our strong preference is to limit loans or transfers of IFAD's own resources to the new Private Sector Trust Fund. We note that this trust fund could effectively raise funds from external sources and feel that it should not end up being a drain on IFAD's core replenishment contributions.**

**Response:**

*Management would like to emphasize that this proposed allocation from the grant envelope is meant to be a one-off transfer to support the delivery of IFAD few first private sector operations and other initiatives, with the intention to play a catalytic role helping IFAD attract further funding, notably from private sector entities. Indeed, while IFAD has already started fundraising for its private sector operations, this one off allocation from the grant envelope will help it deliver pilot NSOs this year and in 2021which will be key to have an important demonstration effect and to build a track record. This will encourage other investors to join, particularly foundations, Member States, global initiatives (GEF, Green Climate Fund, etc.), impact investors and like-minded agribusiness companies. Hence, the special allocation should be seen as a ''boost'' from IFAD to help mobilize private sector funding as per the Addis Ababa call of action.*
*Note that the ongoing COVID 19 crisis is creating also an opportunity for this allocation to play a countercyclical role and bring strong additionality. Indeed, over the past weeks, IFAD has been approached by social lenders and private investors whose lines of refinancing are being cut. One example for instance is a private*

*sector social lender who has a pipeline of projects that could help preserve the jobs and incomes of over 230,000 small farmers in Zambia (LMIC), Sierra Leone (LIC), Nicaragua (LMIC), Moldova (LMIC) and Kenya (LMIC).*

**8. We agree with Germany's point that loan operations of the Private Sector Trust Fund "should be at least self-sustaining." We also second the point that IFAD should wait to apply riskier instruments such as guarantees and equity investments until potential losses can be covered by non-core funds. Lastly, could Management clarify what was meant to be conveyed in its response to Germany regarding the development of "prudential limits by sector, country, typically at 25% of the portfolio"?**

**Response:**

*In tune with the proposed gradual approach to engage with the private sector, Management will prioritize debt financing over equity investments to maximize the use of capital and avoid, to the extent possible, potential losses that can be more volatile for equity than for debt. Equity investments, either direct or through private equity funds, also require regular valuations compared to amortized instruments (debt), hence there is additional need for back office tools and methodologies. As for guarantees, these are more sophisticated instruments that can be presented in several forms depending of the underlying investment compared to more standardized (and less complex) debt instruments. Guarantees also require constant monitoring to evaluate the probability of its enforcement. Notwithstanding, IFAD may consider the use of equity or risk mitigation measure of there is a strong additionality and development impact, especially if external resources could be mobilized to support the investment such as the case of the ABC Fund investment proposal.*
*To protect IFAD from systemic events, IFAD shall seek to build a private sector portfolio that remains adequately diversified. To that end, IFAD risk management unit will monitor some prudential exposure limits for the private sector to avoid excessive concentration in any particular sector. For sectors, a reference threshold used in the industry is 25% exposure for any particular sector, with the exception of financial sector to account for the inherent diversification that results from lending to financial intermediaries. The 25% limit is also prescribed by regulators (Basel Committee) to precisely avoid concentration risk, which could result in excessive losses and increase in capital consumption. Country limit of 20% is currently comprises in the Capital Adequacy Policy for IFAD's sovereign operations and it will be also followed as reference for IFAD private sector portfolio.*

**9. We also note that Paragraph 46 refers to three risk mitigation instruments, but this section of the Framework Document only refers to two (RSFs and Guarantees). Could Management confirm that there are only two risk mitigation instruments under consideration?**

**Response:**

*The three instruments mentioned in paragraph 46 do not refer to risk mitigation but to the three set of instruments to be deployed under IFAD Private Sector operations, namely: debt, equity and risk-mitigation instrument. Within the risk mitigation instrument, 2 products have been put forward: Guarantees and Risk Sharing Facilities.*

**10. We also have a few requests. First, we request that IFAD includes a specific reference to the new AML-CFT policy in the eligibility section. This is mentioned in more detail in the Risks section later in the document, but**

**we feel that IFAD's objective of "countering the financing of terrorism" should be listed alongside the references to "money laundering" and "anti-corruption"**

**Response:**

*Agreed, the document will be amended to include the reference to the AML-CFT policy in the eligibility section as well as to list "countering the financing of terrorism" in the risks section.*

11. **Second, we request that IFAD Management provide the Executive Board with the full documentation related to the investment screening for each proposal in addition to management's summaries (see paragraph 25). We feel that having access to the full documentation may allow for improved oversight, especially concerning financial, operational, fiduciary, integrity and reputational risks.**

**Response:**

*Similar to the practice of other IFIs and UN agencies working with the private sector, IFAD can only provide publicly available non-sensitive information for a combination of reasons: IFAD may have to sign non-disclosure agreements (confidentiality agreements) with some beneficiaries who will be providing the team with sensitive, non-public information on their financials and their business plans; disclosing this sensitive information will erode trust and confidence in IFAD as a partner of choice for private sector financing. Furthermore, and for the same reasons, the analysis conducted by the IFAD team on the viability or, otherwise of certain aspects of that prospective investee's business model of financials must also remain confidential.*
*Likewise, our proposal to provide management summaries is in line with best practice in other IFIs who do not share investment screening material and technical background work done by management. Instead, the recommendations made by management in the context of the investment proposal to be brought before the Executive Board will be closely informed by the analysis conducted by the team of the financial, operational, fiduciary, integrity and reputational risks – of which a summary will be provided to the Executive Board.*

12. **Third, could Management indicate why the annual financial statements listed in Annex I, Section 14 (to be provided in clause (ii)) are not audited financial statements?**

**Response:**

*Thank you for noticing this oversight. The correct text should read "audited financial statements" and will be corrected.*

**Fourth, the Framework provides that private sector recipients will be assessed on ESG indicators "based on the United Nations Global Compact and other recognized sustainability benchmarks." We recommend being more specific by (i) identifying indicators perhaps as an additional annex, (ii) naming other guidelines (the PSS identifies the 2016 OECD-FAO Guidance for Responsible Supply Chains, the Committee on World Food Security: Principles for Responsible Investment in Agriculture and Food Systems, and CFS: Voluntary Guidelines on Responsible Governance of Tenure of Land, Fisheries and Forests in the Context of National Food Security), or (iii) qualifying the phrase "other recognized sustainability**

**benchmarks" by adding, for example, "internationally", "similarly rigorous" or "[endorsed]/[subscribed to]/[implemented] by …".**

**Response:**

*The framework will be amended to be more specific by adding - Other "internationally" recognised guidelines (e.g sustainability benchmarks suggested by OECD, FAO and the Committee on World Food Security etc. as applicable). Please note that a guidance note corresponding to the revised SECAP 2020 Standard 6 "Financial Intermediaries" (FI) is being developed and will include supporting tools such as model TORs and checklists.*

13. **Fifth, we request that relevant agreements with private sector recipients include representations and covenants to require compliance with IFAD's mandate, IFAD's ESG requirements (including the SECAP), and other policies, UN Business guidelines, and applicable law, and allow IFAD to exit financing arrangements in cases of material non-compliance. We feel that it would be helpful to include this requirement in paragraph 51, particularly in light of the reference to representations and covenants in the following paragraph addressing fraud, corruption, and financial crime risks.**

**Response:**

*Management agree to include wording committing to review the relevant financing arrangements and include, where appropriate, representations and warranties addressing compliance with IFAD's mandate and other applicable policies, relevant UN guidelines or applicable law and which include appropriate early termination clauses applicable to IFAD in cases of material non-compliance. Not all policies and guidelines, or laws or regulations will be applicable in every case, and each NSO will need to be assessed individually.*

14. **We also understand that the SECAP is under review. We hope to see robust Board and public consultation processes and an approach paper that is approved by the Audit Committee/Board (sooner is better, since clearly IFAD staff are moving forward), embodying the principle of "no weakening" or "no dilution" of the existing SECAP; benchmarking against public as well as private standards (since SECAP presumably applies to both public and private sector activities of IFAD); and Board approval of the final SECAP. This would put its process on par with peer institutions (for example, the MDBs, GCF, and GEF).**

**Response:**

*The draft SECAP (2020 version) builds on the core principles of the current SECAP 2017 and includes nine revised Standards which are aligned with international norms and best practice. The revised Standards makes important advances for IFAD in broader coverage of social and emerging issues such as: social inclusion and non-discrimination, gender-based violence, disability, sexual exploitation and abuse, labour and working conditions, stakeholder engagement, and expanded community health and safety provisions including road safety. SECAP 2020 will adopt a four-tier risk classification with proportionate implications for requirements and oversight and will include an environment and social due diligence (ESDD) process for FIs including private sector clients. The proposed guidance note for the new Standard "Financial Intermediaries" will elaborate on the process, roles and responsibilities and include supporting tools. The SECAP process will be flexible and agile so that it can be adjusted to accommodate the different circumstances to the* *project of the various FI types, while ensuring rigor and proportionality. The ongoing emphasis on enhancing convergence with emerging standards of other MDBs and global funds would enable IFAD to take advantage of cofinancing/funding opportunities, take IFAD to another level and prepare the foundation for IFAD 12. The revision of SECAP is based on an inclusive consultative process that involves internal stakeholders. An internal cross-departmental SECAP Review Group (SRG) was established in October 2019 to assist in facilitating, internal coordination, and in providing guidance and feedback during the SECAP revision process and a robust process is place for private sector operations safeguarding. An informal seminar to discuss the draft SECAP 2020 version with EB is scheduled for September 2020 with a full review of the document by the Board in December 2020.*

**15. If the SECAP includes stronger protections than what we approve in this document – for example, for financial intermediaries (FIs) – there should be a way to incorporate those improvements into the non-sovereign/private sector framework.**

**Response:**

*The SECAP is currently being reviewed and once effective will apply also to non-sovereign private sector operations (NSOs). The new SECAP will indeed offer stronger protection, and specific standards related to financial intermediaries will be incorporated. Please be advised that in the NSO Framework, there is some flexibility in the language to ensure that the new SECAP once effective will be applicable to NSOs.*

**16. Related to that, there are a couple of references in Annex VII on FIs to SECAP standards and requirements "as adapted to meet NSO requirements." This should be deleted. Based on the information we have thus far, we feel it is premature to assume that the SECAP standards and requirements will be differentiated for NSOs.**

**Response:**

*SECAP Standards and requirements will cover both sovereign operations and NSOs. NSOs beneficiary recipients will be responsible for adhering to SECAP requirements throughout the project cycle. The SECAP process and requirements will be flexible enough to be adjusted to accommodate the different circumstances/requirements in the project cycle for NSOs. Annex VII is the outcome of a benchmark and comparison to best industry standards to guide NSO operations and the SECAP revision will be building on it as the team ensured that the two workstreams are coherent and consistent.*

**17. There is an important sentence in Annex VII on FIs, which notes that projects with certain impacts will meet the updated SECAP; there is no reference to the current SECAP. We would like confirm that no FI projects will be developed under this Annex using the current SECAP; and that FI sub-project development will await the new SECAP.**

**Response:**

*IFAD will refrain from undertaking any NSO with major impact until revised SECAP is finalized. IFAD is currently in the process of developing the revised SECAP for all its future NSOs. OPR hired a consultant specialized in the design of private sector impact frameworks to lead this process. A workshop was held last week with* *representatives from different IFAD divisions to review the first draft of the revised SECAP. Simultaneously, IFAD is also finalizing its investment approval process for NSOs. The new SECAP will be an integral part of the investment approval process for NSOs. Final drafts for both processes are expected to be completed by end of first quarter 2020 and ready to use for all future NSOs during the second quarter 2020. Meanwhile, IFAD benchmarks private sector recipients against current SECAP and best industry standards (IFC standards).*

**18. We would also like to highlight our interest in making sure that IFAD's disclosure is strong. For example, there are no details on disclosure of due diligence documents for direct investments, or FI sub-projects, although there is a reference in Annex VII to good practice generally.**

**Response:**

*This response is related to question 13. Similar to the practice of other IFIs and UN agencies working with the private sector, IFAD can only provide publicly available non-sensitive information. As stated in the NSO Framework (par. 76) "all NSOs will be expected to implement fiduciary and financial management safeguards informed by IFAD's corporate public sector policies and procedures tailored to the requirements of the transaction, for example recognising the confidentiality of the transaction may not permit full public disclosure." Additionally, as in line with best practices, IFAD will disclose d, if relevant, an Environmental and Social Review Summary (ESRS), depending on the E&S risk categorization.*

**19. Lastly, we would like to continue to reiterate that Management must seek Board approval for any new financial instruments. We feel that this should be clearly stated in the Framework and also in the annex on Financial Instruments (Annex II).**

**Response:**

*This is already emphasized in paragraph 85 which states:" Note that all proposed NSO projects will be submitted to the Executive Board for approval." But it will also be included in Annex II.*

**Germany**

**20. We appreciate IFAD responses to our submissions: first by clearly delimiting risk of the trust fund for private sector activities and second by limiting initially the transaction volumes to gather a track record and experience but limiting exposure risks in the beginning.**
**Curious to know: how and whether IFAD decides to use funds from core capital should be transferred to the Trust Fund for private sector exposure as a grant or investment. We ask management to present its considerations in this regard and, where necessary, establish it in an appropriate place in accordance with the decision-making requirements.**

**Response:**

*Given the incipient nature of the non-sovereign operations, the present proposal to use funds from core capital in the form of grant is intended to maximize IFAD's funding catalytic effect. The idea is that early delivery of NSOs thanks to the flexibility and quick availability of resources from the grant envelope will have a strong demonstration effect and attract other investors to join. Secondly, by* *providing a grant compared to an investment, IFAD will assist in the subsequent provision of blended financing with the support of additional resources.*

**21. IFAD should first gain experience with low-risk investments.**

**Response:**

*IFAD will be cautious and prioritize its pipeline growth in areas where it is expected to have the highest additionality and development impact. A gradual approach will also been taken in implementing the instruments identified in the Non Sovereign Private Sector Operations Framework: loans (including direct and indirect lending), equity and risk mitigation (including risk sharing, and guarantees). The needs in the Agri SME market and IFAD target group cut across all of these instruments. In terms of risks, IFAD will be careful and try to start with limited risk but given its mandate and focus on Smallholders, its operations will be risky and this is where its additionality lies. Hence, IFAD approach is to avoid unnecessary risks while making sure that any risks taken are well justified, managed and mitigated.*

**22. As per IFAD Strategy Paper of January 2020 a separate financing window is provided for the private sector strategy under IFAD 12, in which no more than USD 3.5 million should be taken from IFAD replenishment capital. The inclusion of so-called "diaspora investments" is also foreseen. In accordance with these principles, investments in the Fund under IFAD 11 should also be made primarily from additional funds (and, if necessary, also from remittances). Risks can only be taken to the extent that any defaults can be absorbed by the formation of capital buffers from additional recruited resources. We want to be safe, not to directly or indirectly undermine the risk delimitation created by ring-fencing.**

**Response:**

*The 3.5 million which is indicated in the IFAD 12 Strategy Paper refers to the resources that IFAD used to support the establishment of the Agri-Business Capital Fund. Using this limited amount, IFAD successfully incubated a complex structure and crowded in pledges of EUR 50 million in patient first-loss capital from the European Commission, AGRA and the Government of Luxembourg. No indication was given in this document to the amount from IFAD's own resources that would be used for the implementation for the Private Sector Strategy nor for the establishment of the Private Sector Financing Programme (PSFP). But, management made it clear that it has no plan to use IFAD's own capital to invest in such activities.*

*Management is, however, proposing to allocate from the grant envelope a special one time-off contribution to support early delivery of private sector operations. IFAD expects that by injecting this seed funding from the grant envelope for the delivery of pilot NSOs, it will increase its chances to successfully fundraise for this endeavour. The Private Sector Trust Fund will seek and accept contributions and funding from Member States, non- Member States and other non-state actors, including multilateral organizations, philanthropic individuals and foundations, and any other interested entities, including diaspora investments. In terms of risks, to avoid risk contamination in IFAD core capital from private sector operations, any potential loss will be always limited to the amount of capital in the trust fund, which shall always remain sufficient to cover all potential losses derived from the outsourced assets, including extreme stress scenarios.*