

Document: EB 2020/129/R.23/Add.2  
Agenda: 8(c)  
Date: 6 May 2020  
Distribution: Public  
Original: English

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Investing in rural people

## **Approach Paper: Lending to Subnational Entities in the Context of IFAD's New Business Model**

### **Addendum**

#### **Note to Executive Board representatives**

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Executive Board — 129<sup>th</sup> Session  
Rome, 20-23 April 2020

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**For: Information**

## **I. Comments from Brazil**

1. **Brazil would like to thank IFAD for elaborating this paper, bringing a broad perspective to the possibilities involving lending to subnational entities, and raising important risk factors.**
2. **Specially at this present time of COVID-19, this initiative becomes even more relevant, since projects in which executors are closer to the beneficiaries tend to bring greater and more immediate impacts. In addition, subnational entities have more updated information on the real situation of its population, adding greater value to operations. Therefore, lending to subnational entities could represent an opportunity to increase the number of eligible borrowers while keeping the focus on tackling poverty among small-scale rural producers based on quality data and closer engagement.**
3. **As highlighted in the document, we emphasize that the rules regarding sovereign guarantee remain the same for projects approved both for national and subnational governments. Thus, the financial risks are not increased by this particular matter.**
4. **Brazil would also like to stress the topic of lending to national development banks. We believe that these entities can leverage financing and to enhance the results of the operations. In a moment of scarce resources worldwide, and according to IFAD's new guidelines, leveraging resources for projects is key to increase impact at scale.**
5. **In terms of legal options presented by IFAD to make this proposal feasible, Brazil supports IFAD administration and believes that the best option would be the amendment of the Agreement and its submission to the Governing Council in 2021, since this option gives more legitimacy to the process.**
6. **Finally, we understand that the questions and demands presented by other member states were properly answered in the approach paper and by the Management. At a moment when we need to diversify the investment portfolio of the Fund, we appreciate IFAD's support and straight-forward vision.**

### **Response**

7. We confirm that lending to national development banks could be a suitable option in those countries where such entities enjoy a strong financial track record supported by a credit rating and existing lending from multilateral development banks.

## II. Comments from Argentina

8. **We want to thank the Management for the document. We think that there are still points that require further analysis and work.**
9. **First, it is important to consider what impact could have the lending to subnational entities in IFAD's credit rating. It is likely that if there is a problem with the scheme of guarantees in this type of loans, this could negatively affect the credit rating.**
10. **Second, as the Management indicates, IFAD should engage with subnational entities only with the support of an explicit sovereign guarantee that meets IFAD criteria regarding its enforceability.**
11. **Third, these operations would require legal changes to the Agreement Establishing IFAD or a broad interpretation of Article 11, section 1 (a).**
12. **Fourth, provided the complexity of this type of lending it cannot be standard for all countries. It should take into consideration the particularities of each Member State.**
13. **Fifth, we would like to hear more from the Management on which could be the risk of lending to subnational entities without sovereign guarantees, both for IFAD and for the country to which the subnational entity belongs.**
14. **In conclusion, we ask for further study and consideration of the topic. Future analysis should include the results and impacts of previous IFAD's experience in lending to subnational entities, which according to the document has taken place since the early 1980s. Moreover, emphasis should be put on the impact on the credit rating and the institution's finance.**

### **Response**

15. IFAD Management notes that while there is very limited experience in subnational lending, that experience is mainly positive, as already noted both in the document and in one of our responses to earlier questions from Members, but we are happy to expand as relevant.

We believe that the impact on IFAD's credit rating will not be significant as long as lending to subnationals does not grow exponentially. Also, the individual assessment of any lending request will be key in order to avoid an increase in financial risk. Although the subnational entity credit profile will be assessed in isolation, it is important to note that lending to such entities will be granted only with the support of an explicit guarantee from the State, which will ultimately bear the default risk. Therefore, IFAD will assess the financial conditions of the guarantor and the specific characteristics of the decentralization framework, both from the financial and administrative/legal perspectives. IFAD will also ensure that the terms and conditions of the guarantees are adequate, in line with the elements described in the framework.