Document: EB 2020/131(R)/R.25/Rev.1
Agenda: 7(h)
Date: 30 December 2020
Distribution: Public
Original: English

E

IFAD
Investing in rural people

Lending to Subnational Entities in the Context of IFAD's New Business Model

Note to Executive Board representatives

Focal points:

Technical questions:

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

Ruth Farrant
Director
Financial Management Services Division
Tel.: +39 06 5459 2281
e-mail: r.farrant@ifad.org

Malek Sahli
Senior Finance Officer
Tel.: +39 06 5459 2545
e-mail: m.sahli@ifad.org

Dispatch of documentation:

Deirdre Mc Grenra
Chief
Institutional Governance and Member Relations
Tel.: +39 06 5459 2374
e-mail: gb@ifad.org

Executive Board — 131st Session
Rome, 7-9 December 2020

For: **Approval**

Contents

Annexes

Executive summary

1. At the 127th session of the Executive Board, Brazil suggested that IFAD consider lending directly to subnational governments and to national development banks (NDBs). The Executive Board agreed to consider this further and Management submitted an initial document for review by the Audit Committee and Executive Board at its 129th session in April 2020. Based on feedback from Members, the present document develops further analysis and seeks the approval of IFAD's governing bodies to offer this tailored form of support to borrowing countries.

2. This document provides an overview of the case for offering subnational financing instruments with sovereign guarantees to subnational governments at state or provincial level, as well as to NDBs. All non-sovereign financing instruments for subnational entities, including NDBs, without a sovereign guarantee are excluded from the scope of this document.

3. There are risks for IFAD in dealing with subnational entities and NDBs in terms of mandates and as regards some financial, legal, operational and governance aspects:

   (i) IFAD will only consider this lending option on the basis of a comprehensive due diligence and credit assessment undertaken in response to a Member State's request to serve its development needs, irrespective of its income category or lending terms category. This option is not linked to IFAD's future borrowing architecture.

   (ii) From a legal point of view, the Agreement Establishing IFAD does not explicitly provide for lending to subnational entities, with or without a sovereign guarantee. Considering the feasibility, demand and risk appetite of its Members, it is proposed to amend the Agreement through the approval of the Governing Council in 2021.

   (iii) An assessment of the financial risk posed by subnational entities, including NDBs, should take into account the borrower's ability to access funds, to issue bonds and to manage its debt efficiently at different maturities, as well as the institutional or political risk, which could be regulatory and/or legal. The enforceability of a sovereign guarantee should be dealt with on a case-by-case basis.

   (iv) Risks relating to governance, monitoring and evaluation should be identified and managed. The subnational entities' operations should be well aligned with the IFAD country strategic opportunities programme (COSOP) and the entities should have the requisite governance structure and institutional resources, as well as sufficient levels of transparency and accountability to permit implementation. Additional risk mitigation is required to deal with non-governmental bodies such as NDBs, even when they have a sovereign guarantee.

4. Management's view is that IFAD should engage with subnational entities, including NDBs, only with the support of an explicit and enforceable sovereign guarantee that meets IFAD's criteria.

5. Moreover, certain criteria should be adopted when dealing with subnational governments. These could include: restricting access to Member States that are eligible for IFAD loans, have a sufficiently strong credit rating and are able to perform the necessary due diligence to provide sovereign guarantees; a penalty, to be agreed by the parties in advance, if a guarantor fails to honour the terms of the guarantee; and IFAD's right to charge additional fees to cover the cost of the due diligence process and the greater risks inherent in the operation.

Recommendation for approval

The Executive Board is invited to:

- Consider and approve this document which introduces the principle of lending to subnational entities, including NDBs, only with the support of an explicit sovereign guarantee that meets IFAD criteria regarding its enforceability and other relevant criteria, including those contained in paragraph 5 above.

Lending to subnational entities in the context of IFAD's new business model

I. Context

1. The Third International Conference on Financing for Development, held in 2015 in Addis Ababa, marked a paradigm shift in development finance. Participants committed to scaling up international cooperation to strengthen the capacities of municipalities and local authorities, and to work towards developing domestic capital markets using blended finance instruments across key development sectors, including those led by subnational entities.

2. With a view to achieving IFAD's mission of reducing rural poverty, tackling food insecurity and mitigating such underlying causes as climate change and fragility, the Fund's vision of its contribution to the achievement of the Sustainable Development Goals was presented to Member States in 2019 in the document IFAD 2.0 The vision encapsulated in that document focuses on building on the enhanced business model rolled out in IFAD11 for a country-level programmatic approach fostering systemic changes and offering tailored support based on countries' different development stages, priorities and needs. The aim is to listen more effectively to countries' voices and develop solutions that are better adapted to local contexts.

3. IFAD's financial instruments have not yet been fully adapted to evolving circumstances as its sovereign lending operations do not explicitly address countries' needs for decentralized budgetary arrangements, whereas subnational governments and their agencies play an essential role in rural development. As national governments seek to improve their own fiscal and budgetary balances, countries are sometimes urging development agencies to support them directly at the subnational level by, inter alia, lending to subnational entities, with or without sovereign guarantees.

4. During the 127th session of the Executive Board, Brazil called on the Board to consider broadening the scope of IFAD financing by allowing the Fund to lend directly to subnational governments and NDBs (see annex I). This suggestion was based on a consideration of IFAD's proximity to subnational governments, the opportunity to bolster ownership of the funded projects and the prospect of cofinancing leverage that could benefit IFAD and its work with other international financial institutions (IFIs).

5. Management submitted a document for review by the Audit Committee and Executive Board at its 129th session in April 2020. This received positive feedback, accompanied by requests to provide further analysis on IFAD's relevant experience and the potential demand for such funding, as well as greater details concerning risk mitigation measures.

6. The original document has accordingly been updated and submitted to the Audit Committee for review and to the Executive Board for approval, along with related legal amendments to be presented to the Governing Council in February 2021. The

revised document contains an initial assessment of the business opportunities and constraints involved; a review of the institutional, financial, legal, governance, and monitoring and evaluation aspects; and conclusions based on these elements.

II. Business opportunities and constraints in lending to subnational entities

A. Practices of other institutions

7. Several multilateral and bilateral agencies,[1] bilateral donor programmes[2] and private sector foundations[3] have already identified a critical gap in subnational development financing. In recent years, they have been offering loans and credit enhancement instruments directly to subnational entities, along with technical assistance programmes to improve access to finance for infrastructure development. They have also targeted non-traditional development resources to improve cities' development capacity (see annex II).

B. Business opportunities and potential demand

8. The option of lending to subnational entities could position IFAD better to respond to demand for support from its client Member States. Providing financing to subnational governments could bring the Fund closer to its target groups and help to build implementation capacities for local public service delivery. Efficiency in terms of both time and financial resources could be gained by working directly with implementing partners who would otherwise receive funding through a cascade of agreements. This would also create an opportunity to capitalize on the technical and financial implementation capacities of subnational partners — especially as NDBs sometimes have specialized units that support sustainable rural development or finance climate-smart interventions. This could also be an opportunity to participate in larger development programmes that national governments may have delegated to subnational entities and to mobilize cofinancing: the majority of multilateral and bilateral financial institutions provide financing to subnational entities. In some cases, this approach could also entail greater political stability, allowing more time for truly transformative investments.

9. There are three types of financing that IFAD could consider offering to various subnational entities (see annex III):

   (i) A financing instrument for subnational governments (state or provincial), using allocated resources of the country providing the sovereign guarantee;

   (ii) A financing instrument for NDBs using allocated resources of the country providing the sovereign guarantee. In this case, in addition to the assessments undertaken for subnational governments, IFAD would conduct additional appraisals of the institutions' creditworthiness and implementation ability; and

   (iii) Any other financing for subnational entities such as state-owned enterprises and NDBs without a sovereign guarantee, although this option is excluded from the scope of the document.

10. This type of lending could use various replenishment sources, such as core contributions and borrowing.

[1] The International Finance Corporation, the European Bank for Reconstruction and Development (EBRD), the French Development Agency, the United States Agency for International Development (USAID) and the United States International Development Finance Corporation.
[2] UK Aid Direct, Department for International Development, and USAID.
[3] The Rockefeller Foundation, the Bill & Melinda Gates Foundation and the C40 Cities Climate Leadership Group.

Box 1
The case of the Small Industries Development Bank of India and IFAD

At the Small Industries Development Bank of India (SIDBI) Foundation for Micro Credit, IFAD's long-term loan funds served to underpin the bank's long-term debt capitalization, making it easier for it to mobilize funds in the financial market to onlend to microfinance institutions (MFIs). The support helped to meet the ever-increasing demand of the microfinance sector and to leverage future growth. The funds received from IFAD helped the bank lend to partner MFIs at reasonable interest. The collateral-free loans extended to MFIs for onlending to the poor made a major contribution to eliminating poverty and reducing the vulnerability of microfinance clients, particularly women.

Collaboration between IFAD and SIDBI has contributed to the development of a more formal, extensive and effective microfinance sector serving the poor — mainly women — at national, rural and semi-urban level, and to the establishment of an environment conducive to the development of sustainable MFIs.

One of the most important aspects of the programme is the leveraging of IFAD resources. With US$22 million from IFAD, loan funds totalling US$141 million were leveraged for the microfinance sector.

The Government of India provided a sovereign guarantee by signing an agreement with IFAD. SIDBI is repaying the IFAD loan on schedule.

Risks identified during design as well as mitigation measures were included in the programme loan agreement. Being a financial institution, SIDBI comes under the oversight and supervision of India's central bank (Reserve Bank of India).

11. An initial dialogue with potential borrowers suggested that demand would come from five subnational governments and 11 NDBs from nine countries. From this dialogue, it appears that the interested governments consider that lending to subnational entities is mission-critical for IFAD, while stakeholders consider it to be the only cost-effective way to contribute to rural poverty reduction: there are strong disincentives for federal government institutions to provide externally sourced financing.

12. Nonetheless, even for the first type of financing operation (paragraph 9 (i) above), it should be noted that lending to subnational governments might have to be limited or might not be an option at all in countries where autonomous financing activities are restricted by law. For example, in some countries, direct lending to subnational governments might be illegal.

Box 2
The case of Pakistan

In Pakistan, although loans are already being taken out by the provinces, the Federal Government provides the corresponding guarantee and consequently is the signatory to financing agreements.

Box 3
The case of India

In India, borrowing by state governments from external agencies is subject to the approval of the National Government. There is no direct lending to states or subnational bodies; all requests are channelled through the Ministry of Finance, which then deducts the debt payments from the states' resource allocations. For parastatal bodies, the Ministry of Finance provides the sovereign guarantee, but the parastatal agency is responsible for the repayment of the loan. This was the arrangement used for the IFAD National Microfinance Support Programme, which was implemented by the Small Industries Development Bank of India (see box 1).

13. In some other countries, direct lending to subnational governments is restricted and subject to certain conditions and monitoring by the federal or national government.

Box 4
The case of the Philippines

In the Philippines, local governments are supposed to draw at least 60 per cent of their regular annual revenues from local sources. They are allowed to contract loans directly from multilateral financial institutions created under treaties or agreements to which the Philippines is a signatory. In addition, total debt servicing is not to exceed 20 per cent of their regular annual revenues.

III. Risk management, legal implications and safeguards

A. Considerations relating to political oversight and the avoidance of mission drift

14. Subnational debt markets can be a powerful force for national development.[4] In the context of IFAD's evolving business architecture, lending to subnational entities could be an opportunity to increase the number of its eligible borrowers while remaining focused on poverty among small-scale rural producers.

15. Despite the existing and potential demand for this type of operation, Member States and donors might consider that sometimes serving upper-middle-income countries rather than low-income countries raises the possibility of mission drift. However, IFAD would only consider this option: (i) in response to a Member State's request to serve its development needs in a more mature manner, irrespective of its income category or lending terms rating, and (ii) on the basis of a comprehensive due diligence and credit assessment.

B. Financial considerations

16. Regions or states enjoy a certain degree of fiscal autonomy although they are dependent on government transfers and the ability to take on debt. NDBs enjoy more freedom in managing their resources, as they maintain their own independent balance sheets. A national government's control and oversight of businesses may be only partial, depending on the services they provide (e.g. some utility companies run the risk of the rates they charge being changed by the national government).

17. Subnational entities are exposed to two broad types of risk: (i) idiosyncratic risk, depending on the entity's stand-alone economic fundamentals, its fiscal position and/or debt profile, governance and management; and (ii) systemic risk, deriving from the operating environment, which could be captured by the sovereign's own creditworthiness and the degree of market insulation and fiscal autonomy of the subnational entity (including fiscal oversight from the national government).

18. In dealing with subnational entities, the credit risk assessment performed to measure their ability or willingness to service their debt should take into account the borrower's ability to access funds, to issue bonds and to manage its debt efficiently at different maturities, as well as the institutional or political risk, which could be regulatory, currency-related and/or legal.

19. In assessing these risks, there is a distinction to be made depending on the type of support provided by the state or national government. This can take two forms:

    (i) **Implicit support.** Most NDBs are wholly owned by the state. However, some run their commercial operations independently (sometimes with their own rating), and the support they receive from the state may be limited or perceived as only implicit, depending on the entity's strategic importance or role in the country's economy.

    (ii) **Explicit guarantees.** Some subnational entities operate under an unconditional and irrevocable guarantee from the State to support debt obligations or other types of borrowing, as well as other obligations.

20. Dealing with sub-sovereign lending with the support of explicit guarantees is embedded in the current capital adequacy policy, which establishes framework to limit concentration risk in the portfolio. To avoid excessive risk arising from accepting guarantees, a portfolio approach will be adopted, together with a risk

---

[4] Through delegated monitoring by financial intermediaries and through debt placed directly with investors, subnational debt markets account for about 5 per cent of GDP in Argentina and Brazil. See World Bank Policy Research Working Paper No. 2339, *Building Subnational Debt Markets in Developing and Transition Economies: A framework for Analysis, Policy Reform, and Assistance Strategy* (World Bank, 2000).

management perspective. Management has developed indicative operational thresholds for dealing with countries, based on their exposure (loans or guarantees) and credit risk, thus ensuring that capital utilization is regularly and effectively monitored. As far as other technical metrics, the risk management unit follows best international practices (the Basel Capital Accords) and rating agencies' methodologies. Hence the impact on IFAD's credit rating will not be significant as long as lending to subnational entities does not grow exponentially.

21. From a risk point of view, IFAD could engage with subnational governments, including NDBs, but only with the support of an explicit enforceable sovereign guarantee that meets IFAD's criteria. From a legal standpoint, the enforceability of a sovereign guarantee is a complex matter and should be approached on a case-by-case basis (depending on project structure, default history and risk, type of borrower and type of guarantor). IFAD has no precedent for the execution of a sovereign guarantee, and there is no legal framework in place for enforcing one. It could be argued that the possibility of executing a sovereign guarantee may be remote, especially if it exhibits all the features listed in the section below. Nonetheless, a guarantor could bring its case before a local court, and IFAD's immunity could be challenged. The limited experience of other organizations is that the execution of sovereign guarantees is often a matter of political negotiation and may finally depend on willingness to pay. Consequently, this kind of exposure should be considered as riskier than engaging directly with sovereign entities, and the preferred creditor treatment may not be applicable.

22. In other cases, however, such as in Brazil, sovereign guarantees are triggered automatically on the very day that a guaranteed loan falls into default.

23. Sovereign guarantee agreements should explicitly document the obligations assumed by the guarantor and should have the following features:

(i) **Irrevocability.** The guarantee should be legally effective, and the guarantor should be prohibited from terminating the guarantee unilaterally.

(ii) **Unconditionality.** The guarantee should be unconditional, irrespective of the value, genuineness, validity or enforceability of the guaranteed obligations.

(iii) **Timeliness.** The guarantee should provide for the punctual payment of any and all sums falling due under the Loan Agreement, whether at stated maturity, by acceleration or otherwise, and for the punctual performance of all the other obligations of the borrower.

(iv) **An on-demand clause.** The guarantor should be under an obligation to indemnify the beneficiary immediately on demand.

24. The guarantee should cover the entire nominal amount of the underlying loan to the subnational entity and any losses resulting from the non-payment of interest or failure to make any other type of payment.

C. Legal considerations regarding the Agreement Establishing IFAD

25. The Agreement Establishing IFAD[5] does not explicitly provide for lending to subnational entities, either with or without a sovereign guarantee. While the Agreement is silent on this issue, for over 40 years IFAD has consistently reviewed and approved projects involving the provision of financing to subnational entities, NDBs and similar entities. In so doing, Member States have consistently interpreted the Agreement as permitting such lending, following a careful review

[5] Section 1 (b) of article 7 of the Agreement Establishing IFAD states the following: "Financing by the Fund shall be provided only for the benefit of developing States that are Members of the Fund. Such financing may be provided directly to developing Member States or through intergovernmental organizations in which such Members participate or to, or through, private sector organizations and enterprises. In the case of a loan to an intergovernmental organization, the Fund may require suitable governmental or other guarantees."

and approval of each such project by the Executive Board. Furthermore, this practice aligns with the approach of other multilateral development banks (MDBs).

26. The charters of some MDBs (see annex IV for a detailed comparative analysis of the charters of IBRD, IDA, EBRD, IDB and ADB[6]) explicitly allow lending to subnational entities, with or without a sovereign guarantee.

 (i) If, on the basis of a demand and pricing analysis, an evaluation of IFAD's risk appetite, the potential implications of rating discussions (as well as of the political dimension, which should also be considered), and in the light of the ongoing discussions regarding IFAD's risk management framework, Management proposed lending to subnational entities, there would be two legal options (i) amendment of the Agreement, or (ii) confirmation of the implicit interpretation of the Agreement by the Executive Board.

 (ii) The written comments received from the Executive Board Members who expressed their preference all supported the option of preparing an amendment to the Agreement to codify the precedent, to be reviewed by the Executive Board in its December 2020 session, for approval by the Governing Council in February 2021[7].

 (iii) Notwithstanding the proposed amendment to the Agreement, all potential projects within the scope of this paper will be presented to the Executive Board for review and approval. A similar framework and analysis would be applied to other entities as may be assessed and approved from time to time by the Executive Board.

D. Considerations relating to governance, monitoring and evaluation

27. In lending directly to subnational governments and NDBs with a sovereign guarantee, the arrangements and procedures foreseen in the design framework should be applicable in the same way as in transactions with central governments. Nevertheless, certain additional monitoring and evaluation risks would need to be considered, thus requiring a more thorough analysis and due diligence assessment during design — especially if the borrower was a non-governmental body such as an NDB. In addition, the lack of an agreed framework with governments on the enforceability of sovereign guarantees would be of particular concern.

28. The risk of weak alignment with the COSOP should be considered when a project is implemented at subnational level. It would be important to verify the relevance of a subnational lending operation in the country context and its alignment with the COSOP in advance. If ad hoc opportunities were to arise during a COSOP implementation, the related changes should be reflected in the COSOP at the time of the annual or midterm review.

29. Any risk concerning the level of robustness of subnational entities in terms of capacities, institutions and incentives for good governance, transparency and accountability should be monitored. That would require the support of adequate human resources and civil service management, as well as sound transparency, accountability and anticorruption arrangements. IFAD will undertake a due diligence process, including an analysis of the client institution's strategy, senior management and board of directors, organizational structure, among other governance aspects guaranteeing standards and industry best practices. The involvement of an institution in capital markets and the presence of a credit rating will also provide information on the extent to which that entity needs to fulfil regulatory and market requirements. Political risk, transparency, and corruption

[6] Respectively, International Bank for Reconstruction and Development, International Development Association, European Bank for Reconstruction and Development, Inter-American Development Bank, Asian Development Bank.
[7] See document EB 2020/131(R)/R.27/Rev.1

indicators in the country, as well as the government's past experience with IFAD projects, will also inform the subnational entity's level of potential risk.

30. Some of the lessons learned from other IFIs indicate that some federal governments prefer to use investment project financing for subnational lending operations since their experience with this instrument is more varied in terms of results/impacts than with other forms of financing. This preference is explained by the fact that, in some contexts, a federal government may have neither the authority nor the capacity to oversee the implementation of the public policy reforms subsumed under such operations, or to verify the quality of the resulting improvements in service delivery. In such cases, a government may therefore place a premium on the IFI's own supervision and implementation support under the investment project financing instrument to satisfy itself of the value added of such operations.

31. There is also a risk that overall project preparation and implementation time and costs could increase, given the greater complexities involved in dealing with subnational entities and their possible lack of previous experience in working with MDBs. These challenges should be mitigated and minimized through repeated engagement in facilitated policy dialogue and coordination efforts with subnational governments, the possible development of long-term partnerships with selected ones and the sharing of experiences across programmes, states and provinces to enhance effectiveness while controlling costs.

E. Considerations relating to lending terms and financing conditions

32. Currently, the Policies and Criteria for IFAD Financing and the set of related lending terms do not consider subnational entities.

33. If the Member States' decision is to pursue this course, a further analysis of the implications for lending terms and the changes needed to related legal texts would be required.

34. Certain criteria would need to be in place in dealing with subnational entities, such as:

    (i) The corresponding national government should buy into the process with IFAD, rather than leave the subnational entity to take the lead and full responsibility.

    (ii) Due diligence, including a credit assessment, should be conducted on a case-by-case basis in line with a defined minimum set of criteria, to address issues related to governance, national laws and regulations, and potential reputational risks. Only Member States meeting those criteria would be allowed to provide sovereign guarantees on loans granted by IFAD to subnational entities under their jurisdiction.

    (iii) A guarantor who failed to fulfil the terms of the guarantee would be subject to previously agreed penalties. These could include, for example, a trigger to accelerate repayments on the entire sovereign portfolio should indemnification not be immediately forthcoming.

    (iv) IFAD would be entitled to charge additional fees to cover the cost of the due diligence process and the greater set of risks involved in the operation.

IV. Conclusions and the way forward

35. Lending to selected subnational entities represents an opportunity for IFAD to extend its spectrum of borrowers, mobilize internal and external cofinancing and tailor its offerings to individual countries' needs and economic trajectories.

36. At the same time, given IFAD's first credit rating exercise, it is important to continue to protect the Fund from financial risk and to maintain related safeguards. It is therefore recommended that, at this stage, IFAD should engage with subnational entities, including NDBs, only with the support of an explicit sovereign guarantee that meets IFAD criteria regarding its enforceability.

Statement by Brazil at the 127th session of the Executive Board

Brief statement for information by Brazil[8]

Outcome:

(i) The Board noted the proposals shared by the representative for Brazil – for consideration at a future session – that IFAD be allowed to: (i) lend directly to subnational governments; and (ii) lend directly to national development banks (NDBs) to stimulate demand for loans and enhance country ownership of IFAD's operations in Brazil and possibly in other countries.

(ii) Members expressed appreciation for the proposals but indicated that there would be a need to consult with their capitals on the matter. Members agreed to Management's proposal to submit a discussion paper at the first session of 2020. Management was asked to include information on the practices of other international financial institutions, the potential impact on credit ratings and the implications for Member States that have no credit rating.

1. The representative for Brazil stated that the discussions held during the session had already demonstrated the need to go beyond business as usual and consider broadening the scope of IFAD financing.

2. Referring to his country's proposals, the representative underscored that, although the two proposals had been made together, they should be viewed independently of each other. First, linkages between IFAD and subnational governments could stimulate demand and bolster their ownership of projects. Second, with respect to NDBs, Brazil saw this as a way of boosting cofinancing, leveraging IFAD's resources and increasing joint efforts with other financial institutions, resulting in more robust and impactful operations.

[8] See document EB 2019/127.

Subnational lending practices of other institutions

1. Support from the International Financial Corporation (IFC) was initiated through the 2003 Subnational Finance Programme – a joint World Bank and IFC programme that provided subnational financing without a sovereign guarantee. The programme aimed to support investments across infrastructure sectors and public services, working through subnational governments, state-owned enterprises, financial intermediaries and public-private partnerships. More recently, IFC has begun to roll out its global Financing Sustainable Cities Initiative, which aims to make cities more competitive by: (i) strengthening institutions and regulations; (ii) improving critical infrastructure and environmental sustainability; (iii) fostering skills and innovation; and (iv) expanding access to finance. The initiative seeks to combine financial and advisory support by working with both subnational governments and private investors. IFC has supported subnational governments and state-owned enterprises through 46 investments totalling US$2.1 billion (2008-2017), most of which was for infrastructure projects. This was equivalent to about 2 per cent of IFC’s total commitments during that period. IFC’s financial support was concentrated in transport, ports, the power sector and water/wastewater. Most of the financing was provided between 2009 and 2014 in countries not served by the International Development Association. While IFC offered a varied range of financing instruments — including senior or subordinated loans in foreign or local currency on a commercial basis, the IFC B Loan syndication programme, partial credit guarantees and long-term capital equity — the majority (78 per cent) of the financing consisted of loans (54 per cent in foreign currency, 24 per cent in local currency). This programme has now been merged with IFC infrastructure financing operations.

2. The major regional MDBs, such as the Asian Development Bank (ADB), Inter-American Development Bank (IDB), the African Development Bank and the Development Bank of Latin America, provide loans to subnational governments (state, provincial and municipal governments and public entities other than central governments) with a sovereign guarantee through the public sector window. Without a sovereign guarantee, the transaction falls under the heading of private sector/non-sovereign operations. Financial details are not usually specified for subnational entities, but in the cases of ADB and IDB, it appears that subnational operations without a sovereign guarantee are not yet frequent. In 2018, of the US$106.0 billion and US$93.4 billion of respective ADB and IDB outstanding loans, the majority (more than 90 per cent) were made to sovereign borrowers (member countries and, with the sovereign guarantee of the relevant member country, to government agencies or other public entities), while only 5.1 per cent and 6.4 per cent were made to privately held, state-owned or subnational entities without a sovereign guarantee.

Definitions of national and subnational entities

1. General government includes three subsectors:

   (i) The national (central/federal) government and related public entities;

   (ii) State or provincial ("federated") governments and related public entities; and

   (iii) Regional and local governments and related public entities.

2. **Central government.** The government of a unitary State, ruling a country that does not give significant power to regional divisions.

3. **Federal government.** The government of a federal State, ruling a country that gives significant power to regional divisions.

4. **Subnational government.** All levels of government (state and regional/local governments) below the national level, regardless of the political, financial and administrative structure of the country. This term therefore encompasses any intermediate (e.g. district, state, regional, provincial) and local governments as well as semi-independent government organizations (e.g. parastatals) at the subnational level.

5. **Regional government.** A group of governments that could be defined as a county, more than one county, one municipality, more than one municipality, a council of governments or more than one council of governments.

6. **Municipality.** A municipal corporation, a city, town, borough, or incorporated village.

7. **National development bank.** A financial institution created by a country's government that provides financing for the purpose of the country's economic development.

8. **State-owned enterprise**. A corporate entity recognized by national law in which the State has significant control through full, majority or significant minority ownership.

Charter provisions on subnational lending of selected multilateral and bilateral creditors

World Bank	
Charter	**International Bank for Reconstruction and Development (IBRD)** 1. IBRD Articles of Agreement, article III, section 4.[9] 2. IBRD Articles of Agreement, article III, section 4(i).[10] While the Articles of Agreement provide that the member or the central bank or some comparable agency of the member acceptable to the Bank **must provide** this **guarantee**, the Bank requires the **guarantee of the member** for the following reasons: (i) the Bank's desire to have the full faith and credit of the member behind the guarantee; (ii) the fact that Guarantee Agreements contain undertakings that a central bank could not validly undertake or effectively comply with; and (iii) the Bank's desire to create, by the Guarantee Agreement, a contractual relationship under public international law that will not be subject to impairment as a result of restrictions or provisions of the laws of the member. **International Development Association (IDA)** 1. IDA Articles of Agreement, article V, section 2(c).[11] 2. IDA Articles of Agreement, article V, section 2(d).[12]
Policies, rules and operational manuals	**IBRD** 1. **Borrower.** Under its Articles of Agreement, IBRD may lend to: (i) a member country; (ii) a political subdivision of a member; and (iii) any business, industrial or agricultural enterprise in the territories of a member. 2. **Guarantor.** If the member in whose territory the project is located is not itself the borrower, **the member must guarantee** the payment of the principal and interest and other charges on the loan. When a member guarantees a loan, it does so as a principal debtor and not merely as a surety. Thus, IBRD may call directly on the guarantor for payment and is not required to first exhaust its remedies against the borrower. When the member effectively controls the entity in charge of implementing and operating the project, IBRD requires the member to guarantee performance as well as repayment. (Staff should **consult with the Office of the General Counsel [LEG]** for guidance on the application of this paragraph.) **IDA** 1. **Borrower.** Under its Articles of Agreement, IDA may lend to: (i) a member country; (ii) the government of a territory included within IDA's membership; (iii) a political subdivision of any of the foregoing; (iv) a public or private entity in the territories of a member or members; and (v) a public international or regional organization. 2. **Guarantee.** Although IDA **normally does not provide** credits to entities **other than a member country**, if it were to do so, its Articles of Agreement provide that it **may,** at its discretion, **require** a suitable **governmental or other guarantee.** OP 7.00 - Lending Operations: Choice of Borrower and Contractual Agreements: https://policies.worldbank.org/sites/ppf3/PPFDocuments/Forms/DispPage.aspx?docid=1681 Operational Manual: https://policies.worldbank.org/sites/PPF3/Pages/Manuals/Operational%20Manual.aspx 3. **Investment project financing** provides IBRD loans, IDA credit/grant and guarantee financing **to governments** for activities that create the physical/social infrastructure necessary to reduce poverty and promote sustainable development. 4. **Development policy financing** provides IBRD loans, IDA credits/grants and guarantees budget support **to governments or a political subdivision** for a programme of policy and institutional actions to help achieve sustainable development, shared growth and poverty reduction.
Loan Agreements, Guarantee Agreements and General Conditions	1. **Loan Agreement.** For each loan, the Bank and borrower enter into a Loan Agreement that sets forth the amount of the loan or credit and the terms and conditions on which it is made. 2. **Guarantee Agreement.** If IBRD makes a loan to an entity other than the member country concerned, it enters into a Guarantee Agreement with the member, which sets forth the

[9] "The Bank may guarantee, participate in, or make loans to any member or any political sub-division thereof and any business, industrial, and agricultural enterprise in the territories of a member."
[10] "(i) When the member in whose territories the project is located is not itself the borrower, the member or the central bank or some comparable agency of the member which is acceptable to the Bank, fully guarantees the repayment of the principal and the payment of interest and other charges on the loan."
[11] "(c) The Association may provide financing to a member, the government of a territory included within the Association's membership, a political subdivision of any of the foregoing, a public, or private entity in the territories of a member or members, or to a public international or regional organization."
[12] "(d) In the case of a loan to an entity other than a member, the Association may, in its discretion, require a suitable governmental or other guarantee or guarantees."

	member's contractual obligations as guarantor. Additional undertakings made by the guarantor to facilitate the achievement of the loan's purposes are set forth in the Guarantee Agreement. 3. The Loan and Guarantee Agreements incorporate by reference the applicable General Conditions. Since the General Conditions are approved by the Executive Directors, any amendment of their provisions requires **clearance by the LEG** Vice-President, who also decides whether approval by the Executive Directors is also required. The Loan, Guarantee and/or Project Agreements incorporate, as applicable, guidelines **such as** the Guidelines: Procurement under IBRD Loans and IDA Credits; Guidelines: Selection and Employment of Consultants by World Bank Borrowers; and Guidelines for Conversion of Loan Terms for Fixed-Spread Loans.[13]
African Development Bank	
Charter	1. Agreement Establishing the African Development Bank - 2016 edition, article 14, section 1.[14] https://www.afdb.org/en/documents/agreement-establishing-african-development-bank-2016-edition
Policies, rules and operational manuals	1. African Development Bank Group's Policy on Non-sovereign Operations https://www.afdb.org/en/documents/document/policy-on-non-sovereign-operations-109578 2. Revised financial guidelines for sovereign guaranteed loans https://www.afdb.org/en/documents/document/revised-financial-guidelines-for-sovereign-guaranteed-loans-27100
Loan Agreements, Guarantee Agreements and General Conditions	**Section 1.01 Application of General Conditions** (a) These General Conditions set forth the terms and conditions applicable to: (i) any Loan Agreement entered into between the Bank and one or more Regional Member States; (ii) any Guarantee Agreement entered into between the Bank and a Regional Member State in connection with the conclusion of a loan; and (iii) any other agreement to which the Bank is a party and which provides that these General Conditions are applicable. (b) If the Loan Agreement is entered into between a Regional Member State and the Bank, references in these General Conditions to the Guarantor and the Guarantee Agreement shall be disregarded. (c) Additional conditions may be included in the Loan Agreement or the Guarantee Agreement, having regard to the nature of the project. **Section 1.02 Inconsistency with Loan and Guarantee Agreements** If any provision of any Loan Agreement, Guarantee Agreement or any other agreement to which these General Conditions are applicable is inconsistent with a provision of these General Conditions, the provision of the Loan Agreement, the Guarantee Agreement or the other agreement, as the case may be, shall prevail. 1. General Conditions Applicable to the African Development Bank Loan Agreements and Guarantee Agreements (Sovereign Entities) https://www.afdb.org/en/documents/document/general-conditions-applicable-to-the-african-development-bank-loan-agreements-and-guarantee-agreements-sovereign-entities-8149 2. General Conditions Applicable to the African Development Bank Loan Agreements and Guarantee Agreements (Non Sovereign Entities) https://www.afdb.org/en/documents/document/general-conditions-applicable-to-the-african-development-bank-loan-agreements-and-guarantee-agreements-non-sovereign-entities-8151
European Bank for Reconstruction and Development	
Charter	1. Chairman's Report on the Agreement Establishing the European Bank for Reconstruction and Development, article 11.[15] 2. Agreement Establishing the European Bank for Reconstruction and Development, chapter III, article 11, section 3 iii) a).[16] 3. Agreement Establishing the European Bank for Reconstruction and Development, chapter III, article 14.[17]

[13] See OP/BP 11.00, Procurement, and OP 3.10, Loan Charges, Currencies and Payment Terms of IBRD Loans and IDA Credits.

[14] "In its operations, the Bank may provide or facilitate financing for any regional member**, political subdivision** or any agency thereof or for any institution or undertaking in the territory of any regional member as well as for international or regional agencies or institutions concerned with the development of Africa."

[15] "This Article establishes the ways the Bank shall carry out its purpose and functions, including in relation to regional projects. In describing recipients of Bank financing and assistance, and in setting limits on Bank financing and assistance to **the state sector**."

[16] "The **state sector** includes national and local Governments, their agencies, and enterprises owned or controlled by any of them."

[17] "Where the recipient of loans or guarantees of loans is not itself a member, but is a **state-owned enterprise**, the Bank **may, when it appears desirable**, bearing in mind the different approaches appropriate to public and state-owned enterprises in transition to private ownership and control, **require the member or members** in whose territory the project concerned is to be carried out, or a public agency or any instrumentality of such member or members acceptable to the Bank, **to guarantee** the repayment of the principal and the payment of interest and other fees and charges of the loan in accordance with the terms thereof. The Board of Directors shall review annually the Bank's practice in this matter, paying due attention to the Bank's creditworthiness."

	https://www.ebrd.com/news/publications/institutional-documents/basic-documents-of-the-ebrd.html
Asian Development Bank (ADB)	
Charter	The political subdivision could be an eligible borrower of loans. Please see the Agreement Establishing the Asian Development Bank, chapter III, article 11.[18] Where the recipient of loans or guarantees of loans is not itself a member, the Bank may require that the member guarantees the repayment of the principal and the payment of interest and other charges on the loan in accordance with the terms thereof. Please see the Agreement Establishing the Asian Development Bank, chapter III, article 15, paragraph 2.[19]
Policies, rules and operational manuals	Operations Manual: https://www.adb.org/documents/operations-manual Operations Manual Bank Policies: (i) When making a loan to a **non-member**, a guarantee by the relevant member is the most effective means of protecting ADB's interests. (ii) When ADB makes a loan to an agency, instrumentality, or **political subdivision** of a member, it must examine in detail the borrower's standing in terms of the full faith and credit of the developing member country (DMC) government. To the extent that such standing falls short of the full faith and credit of the DMC government, the fullest protection against default may be possible **only through** securing for the loan **a guarantee from the DMC government**. Operations Manual Bank Policies and Procedures (Non-sovereign operation), A, (2)(iv): To be eligible for ADB **non-sovereign financing**, the proposed recipient must be: (i) **a local government** or **other sub-sovereign entity** (including municipalities and other forms of local government) that can contract and obtain financing independently from the sovereign.
Loan Agreements, Guarantee Agreements and General Conditions	Ordinary Operations Loan Regulations Applicable to Regular Loans Made from ADB's Ordinary Capital Resources (1 January 2017) https://www.adb.org/documents/ordinary-operations-loan-regulations-1-jan-2017

[18] "Subject to the conditions stipulated in this Agreement, the Bank may provide or facilitate financing to any member, or any agency, instrumentality **or political subdivision** thereof, or any entity or enterprise operating in the territory of a member, as well as to international or regional agencies or entities concerned with economic development of the region."
[19] "Where the recipient of loans or guarantees of loans is not itself a member, the Bank may, when it deems it advisable, require that the member in whose territory the project concerned is to be carried out, or a public agency or any instrumentality of that member acceptable to the Bank, guarantee the repayment of the principal and the payment of interest and other charges on the loan in accordance with the terms thereof."