

Document: EB 2021/132/R.9/Rev.1
Agenda: 7(a)(i)
Date: 20 April 2021
Distribution: Public
Original: English

E



Borrowed Resource Access Mechanism: Framework for Eligibility and Access to Resources

Executive Board representatives

Focal points:

Technical questions:

Alberto Cogliati
Director
Office of Enterprise Risk Management
Tel.: +39 06 5459 2048
e-mail: a.cogliati@ifad.org

Thomas Eriksson
Director
Operational Policy and Results Division
Tel.: +39 06 5459 2425
e-mail: t.eriksson@ifad.org

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

Benjamin Powell
Director and Treasurer
Treasury Services Division
Tel.: +39 06 5459 2251
e-mail: b.powell@ifad.org

Dispatch of documentation:

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

Executive Board — 132nd Session
Rome, 19-21 April 2021

For: Approval

Recommendation

Taking into consideration the review undertaken by the Working Group on the Performance-Based Allocation System (PBAS), and in line with commitment 40 (Present a proposal for establishment of an access mechanism for borrowed resources to the Executive Board by quarter 2 2021) of the Report of the Consultation on the Twelfth Replenishment of IFAD's Resources (IFAD12 Report), the Audit Committee recommends that the Executive Board approve the following principles for the Borrowed Resource Access Mechanism (BRAM), as set out in further detail in this paper:

- Country selectivity and eligibility;
- Supply of borrowed resources;
- Risk-based country limits;
- Differentiated financing conditions; and
- Demand-based access.

The BRAM will become effective once the relative amendments to the Policies and Criteria for IFAD Financing have entered into force.

I. Background

1. IFAD is seeking to expand its impact to meet the growing challenges of food insecurity, climate change and fragility. As noted in the IFAD12 Report, IFAD is implementing a series of activities under a transformational financial framework reform that will allow it to grow its programme of work, while ensuring financial sustainability and enhanced risk management.
2. The financial framework for IFAD12 will consolidate financial reforms pioneered in IFAD10 and IFAD11 which reflect IFAD's evolution as a development finance institution. Recent reforms constitute the main pillars of IFAD's future financial architecture. The new Debt Sustainability Framework (DSF) reform, the sustainable replenishment baseline, the Capital Adequacy Policy, the revised Liquidity Policy, the Integrated Borrowing Framework (IBF) and the revised approach to determining the resources available for commitment strengthen IFAD's sustainability and financial discipline in a synergistic manner.
3. In line with IFAD's special mandate to leave no one behind, its resources must continue to prioritize the poorest. During IFAD12, 100 per cent of IFAD's core resources¹ – which enable IFAD to provide financing at the most concessional terms – will be devoted to meeting the needs of the poorest countries – low-income countries (LICs) and lower-middle-income countries (LMICs). Additionally, in line with their critical importance as Members of IFAD and development partners, and to extend benefits for the rural poor, upper-middle-income countries (UMICs) will receive from 11 to 20 per cent of IFAD's programme of loans and grants (PoLG) through access to borrowed resources.²
4. The approach for determining the size of IFAD's financing will be adjusted to better support countries' development needs. While the allocation of core resources to LICs and LMICs will continue to be governed by IFAD's PBAS, access to borrowed resources is proposed to be governed by a new mechanism, with principles and eligibility criteria to be agreed by the Executive Board. The combination of these

¹ Core resources are composed of replenishment funds, loan reflows from loans financed by core resources and the grant element of concessional partner loans (CPLs). It should be noted that the CPLs will be allocated as core resources in full. In line with IFAD12 commitments, IFAD will ensure that 55 per cent of core resources are allocated to Africa, including 50 per cent to sub-Saharan Africa. IFAD will also ensure that 25 per cent of core resources are allocated to countries with fragile situations.

² Borrowed resources are the funds that IFAD borrows from any source under the IBF.

two mechanisms would ensure provision of diversified support for countries' changing needs.

5. This paper elaborates the rationale for developing a borrowed resource access mechanism and underlying principles. Through this paper, Management is taking action to deliver on commitment 40 of IFAD12.³ This paper will be presented to the PBAS Working Group, and subsequently to the Audit Committee for review and the Executive Board for approval in April 2021. The BRAM will become effective once the relative amendments to the Policies and Criteria for IFAD Financing have entered into force (see para. 34).

II. Rationale for developing a borrowed resource access mechanism

6. There are two main reasons for the introduction of the BRAM: a financial rationale and a development rationale.

Financial rationale

7. The PBAS has been used to allocate IFAD's replenishment and internal resources since 2007. As is the case with the performance-based mechanisms used in other international financial institutions (IFIs), the PBAS maximizes allocations based on need and performance. The PBAS mechanism is therefore designed to address the question of how to allocate a given pot of resources among a predefined group of countries. It assumes intrinsically that the resources to allocate (i.e. the supply) are known and certain and that, to a reasonable extent, the uptake (i.e. the demand) is guaranteed. Indeed, as shown in several documents, albeit with some intra-cycle reallocation, the resources allocated through PBAS have always been fully utilized.
8. As the PBAS does not define or drive a country's financing terms, it is not designed to predict, foresee or guarantee any desired mix of financing (onlending or on-granting) terms. This feature embodies the very nature of the PBAS: it was designed to allocate fairly and transparently replenishment resources that are given in the form of grants to the concessional arm (typically the funds) of development finance institutions (DFIs), and whose size is defined with a high degree of certainty at the end of each replenishment consultation with Members.
9. As evidenced extensively in the IFAD11 and IFAD12 Consultations, IFAD's financial architecture has significantly evolved since the PBAS was introduced. While replenishments will remain the bedrock of IFAD's financing, reliance on borrowed funds will increase further. In addition to liquidity, capital preservation and planning will be a key driver of IFAD's commitment capacity and lending headroom. In IFAD12, borrowing is expected to represent at least 25 per cent of IFAD's resource envelope. Borrowed funds come at a financial cost for the institution from the moment in which they are encashed, hence new financial considerations come into play when an institution starts leveraging at greater levels. Borrowing should be carefully planned in terms of both its size and its use, as well as in terms of the timing of encashment of borrowing and onlending thereof, which should be at financial terms that cover the cost of funds so as not to erode IFAD's capital.
10. None of these key financial considerations are addressed by the PBAS, for the very reason that it is not designed to do so. Such considerations were not as pressing in the past, simply because the size of borrowing was much more contained. However, these are well-known aspects that any financial institution should carefully manage. This is also the reason why no other DFI applies a PBAS-like model for distributing funds sourced through borrowing. The need for the DSF

³ Commitment 40 – Present a proposal for establishment of an access mechanism for borrowed resources to the Executive Board (Q2 2021).

reform is another clear example of how the PBAS does not ensure financially sustainable outcomes.⁴

11. In recognition of all the factors above, the IFAD12 Consultation agreed on commitment 40, which foresees the creation of the BRAM.

Developmental rationale

12. The BRAM allows IFAD to increase the resources available to countries in a position to borrow so that they can scale up proven approaches, or address pockets of poverty in countries where the overall development progress is stronger. The BRAM will provide LICs and LMICs that can absorb additional funds with additional IFAD resources. This will allow successful projects or programmes to be expanded, scaled up or deepened, or complementary investments to be realized. It will also enable UMICs with high levels of inequality and enduring pockets of marginalization and poverty to access IFAD's unique combination of finance and deep experience in catalysing rural transformation.
13. More specifically, countries with both PBAS allocations and BRAM eligibility will be able to access incremental borrowed resources to blend, complement, scale up or fill financing gaps from the ongoing or planned PBAS lending programme. The combination of PBAS and BRAM resources will allow for larger investment projects, or to finance innovative approaches like regional lending in line with the recommendations of the IFAD12 Business Model.
14. Based on the dual rationale described above, Management envisages five pillars or principles for the BRAM: (i) country selectivity and eligibility; (ii) supply of borrowed resources; (iii) risk-based country limits; (iv) differentiated financing conditions; and (v) demand-based access. These principles are elaborated in sections III to VII below.

III. Country selectivity and eligibility

15. **Country selectivity criteria for accessing IFAD's financial resources.** While IFAD's main characteristic is that of universality, since IFAD11 the Fund has applied clear and transparent country selectivity criteria. In IFAD12, criteria (a) to (c) below will apply to all sources of financing, while criterion (d) will apply only to the BRAM. Consequently, in order to access IFAD financial resources, countries will need to comply with the following criteria:⁵
 - (a) **Strategic focus:** A valid country strategy (country strategic opportunities programme [COSOP] or country strategy note) is available early in the cycle to ensure countries have a strategic vision of how to use IFAD resources and are ready to engage in concrete operational discussions;
 - (b) **Absorptive capacity:** All operations in a country that have been effective for more than one year must have disbursed funds at least once in the previous 18 months;
 - (c) **Ownership:** No approved projects are pending signature for more than 12 months; and
 - (d) **Level of indebtedness (BRAM-only):** Borrowed resources will be accessed by eligible LICs and LMICs, as well as UMICs, based on relevant financial criteria. Countries at high risk of or in debt distress will not be eligible to access borrowed resources. Special attention will be given to countries in moderate debt distress to review carefully their exposure to shocks within the overall creditworthiness assessment and their capacity to absorb additional semi-concessional debt. The assessment will take into consideration the Debt

⁴ As a consequence, in order to ensure financially sustainable PBAS outcomes, DSF allocations for IFAD12 have been "ring-fenced" in order to predetermine the overall DSF level that IFAD can provide under each replenishment scenario.

⁵ These criteria will be applied in a way that ensures that all LICs have the possibility of accessing fresh resources, in line with the commitment to leave no one behind. Importantly, none of the criteria penalize any group of countries up front and all criteria are actionable: there are clear steps for each country to access financial resources in IFAD12.

Sustainability Assessment carried out by the International Monetary Fund (IMF), compliance with the IMF external debt limit policy, and IFAD's Non-Concessional Borrowing Policy.

16. In line with the agreed graduation pillars, in IFAD12, UMICs should be able to access at least the same share of total resources allocated to them as in IFAD11 (i.e. 11 per cent of the PoLG).

IV. Supply of borrowed resources

17. Guided by the target replenishment and the PoLG scenario agreed and supported by Members, the resources available for commitment (RAC) will be established on a yearly basis in line with the updated methodology introduced for IFAD12.⁶
18. Management will use a funding strategy to plan the use of borrowed resources carefully to allow a smooth distribution of the commitment capacity. Only committed/secured borrowing and planned borrowing, as defined in the RAC methodology, will be considered for financing.

V. Risk-based country limits

19. Unlike the PBAS, the BRAM will not predetermine the size of allocations for countries. Instead, it establishes risk-based ceilings for the maximum amount of resources that each country can access based on demand. This will complement the existing 5 per cent of the PoLG limit for each country. In defining the limits of country exposure in nominal terms and therefore the ceiling volume of BRAM resources, country limits are directly embedded in the Capital Adequacy Policy through the computation of capital consumption of each country, which is derived from the country credit ratings and periodically revised.
20. In order to consider this credit differentiation and in line with the practice at other IFIs, indicative risk-based country limits will be estimated as the prudent exposure to be maintained for each country in relation to its capital consumption (through a minimum credit quality requirement) and the individual country volume within IFAD's overall resources during the cycle.

VI. Differentiated financing conditions

21. The principles contained in the graduation pillars will be respected by the following two concepts:
 - (a) Average financing conditions for IFAD's borrowers will be higher than IFAD's average cost of borrowing. This will ensure financial sustainability for IFAD. There will be no subsidization from core resources.
 - (b) Differentiated financing conditions. Financing conditions will continue to be differentiated based on countries' economic trajectories so that UMICs with a gross national income per capita (GNIpc) above the graduation discussion income threshold pay more than those with a GNIpc below the threshold, and UMICs pay slightly more than LICs and LMICs. Access to higher maturities will be restricted for UMICs to ensure that lower-income countries have higher levels of concessionality. The pricing will ensure IFAD's attractiveness vis-à-vis countries' market financing options.

VII. Demand-based access

22. Once established as described above, eligibility will be communicated to countries. Based on confirmation of interest, projects are developed by governments and IFAD following the same process as at present, and following the same three core principles as for all IFAD-financed operations, namely: alignment with IFAD's mandate, alignment with government priorities and development effectiveness.

⁶ EB 2020/130/R.35.

23. **Alignment with IFAD's mandate.** All operations financed through BRAM resources must be aligned with IFAD's mandate and relevant Sustainable Development Goals; IFAD's strategic objectives as set out in the relevant IFAD Strategic Framework (currently 2016-2025), and the COSOP or country strategy note for the country in question. Projects financed by borrowed resources will be an integral part of the PoLG and therefore subject to all IFAD policies, as well as IFAD12 Consultation commitments and related Results Management Framework. BRAM-financed projects will therefore apply IFAD's targeting policy and incorporate mainstreaming themes and other priorities with ambitions identical to projects financed by core resources.
24. **Alignment with government priorities and demand for financing.** Like projects financed through core resources, projects financed through the BRAM will be aligned with the national context of the partner countries, their institutional framework and relevant ongoing programmes for agriculture and rural development. Regional projects (i.e. regional lending operations) would be eligible for financing should all other commitments be met.
25. **Development effectiveness.** All projects must meet IFAD's standards and follow IFAD's review process to ensure development effectiveness and potential to deliver impact. In addition, all projects will continue to be presented to the Executive Board for approval using existing approval mechanisms.
26. IFAD will use its discussions with Member States and their stated intention to borrow to manage the demand for BRAM resources, aiming to optimize the balance between the two, so that as demand arises it can be satisfied. IFAD's experience over the last several cycles is that demand for resources is spread across each year in a replenishment cycle due to factors such as country context and status of the partnership with IFAD.
27. Should the demand for BRAM resources outstrip the supply, and a prioritization of demand be needed, this will take place based on country-level parameters⁷, ensuring alignment with IFAD12 commitments on resource distribution and particularly the commitment to dedicate a minimum of 11 per cent of the PoLG to UMICs, and ensure geographical/regional balance to respect IFAD's principle of universality. Proposals that do not secure resources in a given year of financing will be reconsidered the following year.

VIII. Risks and mitigation measures

28. **Perception of mission drift.** Members may perceive a risk that the availability of additional resources on semi-concessional terms may encourage countries to finance projects less aligned to IFAD's core mandate of serving the poorest rural populations. To mitigate against this risk, and as explained in section VI, all projects presented for financing through the BRAM or that include BRAM resources must maintain a strong link to IFAD's mandate, speak to IFAD's comparative advantage and be aligned with the IFAD targeting policy, mainstreaming themes and other IFAD12 commitments.
29. **Country limits and credit risk.** As outlined above, indicative risk-based country limits will be estimated and the compliance with this threshold will be monitored for all countries while mitigating concentration risk. This will form a critical part in the process of establishing ceilings for access to BRAM resources.
30. **Increased leverage.** In line with its mandate, IFAD's capitalization has remained stable, showing no internal capacity to generate equity. IFAD's current maximum leverage allowed per the IBF is 35 per cent and any level above that would need to be approved by the Executive Board; Management has, in any case, projected a conservative approach to leverage between now and 2030.

⁷ For example country needs (rural poverty and rural population) and portfolio performance.

31. **Supply of borrowing.** In IFAD12, IFAD expects to borrow approximately US\$1 billion (in addition to CPLs). IFAD has never before undertaken this size of borrowing in a single cycle. Given the outcome of the recent credit rating exercises, Management is confident that IFAD should be able to borrow sufficient resources to fund the BRAM, as forecasted in the IFAD12 scenarios. The implications of IFAD failing to borrow the stipulated volumes would go beyond the BRAM and affect the overall size of IFAD's PoLG.
32. **Demand for borrowed resources.** Various demand studies suggest that there is demand for projects focused on rural transformation. An iterative process of BRAM access can help ensure that the PoLG is delivered in full.
33. **Debt management.** The availability of additional resources on less concessional terms could also present risks related to increasing debt burdens for LICs or LMICs. This will be addressed both by the exclusion of countries with higher levels of debt distress from this funding source and by the careful review of countries in moderate debt distress as noted above.
34. **Organizational readiness.** As BRAM is a new mechanism for IFAD as well as for borrowers of IFAD resources, staff capacity, tools and systems will be developed during the first half of 2021 to enable effective in-country engagement and project development in line with IFAD12 time lines.

IX. Legal considerations

35. The Policies and Criteria for IFAD Financing (PCIF) state that "the resources of the Fund available for financing for developing Member States shall be allocated in accordance with a performance-based allocation system (PBAS) established by the Executive Board. The Executive Board shall report annually to the Governing Council on the implementation of the PBAS." In order to give effect to the BRAM and reflect this new framework both in terms of recognition of the access mechanism and in terms of regular reporting to the Executive Board, the PCIF should be amended. Amendments to the PCIF are within the purview of the Governing Council. This means that the amendments to the PCIF to give effect to the BRAM will be submitted for approval of the Governing Council in February 2022, in time for the start of IFAD12.

X. Conclusions

36. IFAD is seeking to achieve greater impact while maintaining financial sustainability in a context of rapidly growing needs regarding food insecurity, climate change and fragility. Resource allocation and eligibility constitute a strategic tool to achieve these ambitious goals, and introduce further flexibility for adapting to the emerging needs of IFAD's clients, a core principle of the proposed IFAD12 Business Model.
37. Endorsement of the five principles outlined above will help IFAD strengthen its focus on the poorest of the poor and the most vulnerable countries, while simultaneously making adequate resources available to countries with higher levels of per capita income and those with proposals to utilize additional IFAD resources in synergy with PBAS resources. It will also have the critical benefit of contributing to the financial sustainability of the Fund.
38. The management process for BRAM will be designed and set by IFAD ahead of the start of IFAD12. While the principles described in this document will be abided by at all times, the detailed step-by-step management process is likely to require adjustments over time as IFAD learns from this process. Management is confident that the learning process will be swift, as the process for accessing BRAM resources will be iterative and hence provide opportunities for improvement each time.

39. In addition to its regular reporting on the implementation of the PBAS,⁸ Management will report to the Executive Board on a yearly basis on the BRAM's implementation, including on BRAM funding access by country.
40. Finally, the BRAM mechanism will be reviewed and adjusted as needed to take into account the experience of its implementation in time for the next replenishment cycle (IFAD13).

⁸ Reporting takes place through the progress report on the implementation of the performance-based allocation system, presented to the Executive Board at every December session.

Principles for access to semi-concessional resources in comparable IFIs

Name	International Development Association (IDA) Scale-Up Window (SUW) ⁹	African Development Bank (AfDB) ¹⁰
Concept	<u>Scaling up core allocation</u>	
	<ul style="list-style-type: none"> Additional resources to the country allocations. Available for country-specific and/or regional operations. 	<ul style="list-style-type: none"> Additional resources to the country allocations for eligible African Development Fund (AfDF)-only countries via access to the AfDB sovereign window. Available for country-specific operations (no mention of regional operations).
Country eligibility	<u>No additional debt burden for countries with high risk of debt distress</u>	
	<ul style="list-style-type: none"> Countries subject to a low-income country debt sustainability analysis (LIC-DSA) are eligible only if they are at low or moderate risk of debt distress. Countries not subject to a LIC-DSA are considered on a case-by-case basis. Confirmation of alignment with IDA's Sustainable Development Finance Policy and the IMF Debt Limit Policy (DLP) and through consultation within the World Bank units. Countries have capacity to absorb non-concessional resources. 	<ul style="list-style-type: none"> Countries must have a sustainable debt profile and be classified as having low or moderate risk of debt distress. Countries must have headroom for non-concessional borrowing, as determined by the IMF DSA, and in compliance with the IMF DLP and the World Bank Group Policy on Non-Concessional Debt Accumulation. Countries must have a sustainable macroeconomic position, as determined by a special risk assessment conducted by the AfDB Management. Countries must receive a positive recommendation by the AfDB's Credit Risk Committee, based on AfDB's elaborate risk management framework.
Projects/programme eligibility	<u>Strong development impact</u>	
	<ul style="list-style-type: none"> High-quality and strong development impact. Potential for transformational impact. Alignment with World Bank Group goals and IDA policy priorities. 	<ul style="list-style-type: none"> Economic and social rates of return will be used to ensure that the projects maximize development impact.
Financing conditions	<u>Financing terms</u>	
	<ul style="list-style-type: none"> International Bank for Reconstruction and Development lending terms. 	<ul style="list-style-type: none"> AfDB lending terms.
Allocations	<u>Financing terms</u>	
	<ul style="list-style-type: none"> Regional allocations: Resources from the SUW are allocated to each region in proportion to the share of country allocations assigned to each region, excluding countries at high risk of debt distress. Blend country ratios: To appropriately balance resources between blend countries and other IDA-eligible countries, financing to blend countries is limited to their respective share of country allocations for eligible countries in the region. Country caps: Annual SUW financing to a country should not usually exceed its annual country allocation or one-third of the country's indicative IDA19 country allocation (or whatever is larger). However, caps for small countries are flexible. 	<ul style="list-style-type: none"> Country limits. Cap on the overall envelope for AfDF countries.

⁹ For IDA-eligible countries only, <https://ida.worldbank.org/replenishments/ida19-replenishment/ida19-scale-up-window>.

¹⁰ *Diversifying the Bank's products to provide eligible ADF-only countries access to the ADB Sovereign Window*, AfDB, May 2014.