Document: EB 2021/134/INF.2
Date: 1 December 2021
Distribution: Public
Original: English

E

IFAD
Investing in rural people

Operationalizing the Borrowed Resource Access Mechanism

Executive Board representatives

Focal points:

Technical questions:

Alberto Cogliati
Associate Vice-President and Chief Risk Officer
Office of Enterprise Risk Management
Tel.: +39 06 5459 2048
e-mail: a.cogliati@ifad.org

Nigel Brett
Director
Operational Policy and Results Division
Tel.: +39 06 5459 2516
e-mail: n.brett@ifad.org

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

Gulnara Yunusova
Director and Treasurer
Treasury Services Division
Tel.: +39 06 5459 2251
e-mail: g.yunusova@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 — 134th Session
Rome, 13-16 December 2021

For: **Information**

I. Background

1. At its 132nd session in April 2021, the Executive Board approved the creation of the Borrowed Resource Access Mechanism (BRAM).[1] The BRAM is a key piece in the financial framework for the Twelfth Replenishment of IFAD's Resources (IFAD12). This financial framework consolidates financial reforms pioneered in IFAD10 and IFAD11 that reflect IFAD's evolution as a development finance institution. The Debt Sustainability Framework Reform,[2] the Update to IFAD's Financing Conditions[3] and the elements of pricing for ordinary term loans,[4] 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 (RAC) all strengthen IFAD's sustainability and financial discipline in a synergistic manner.

2. These reforms represent, collectively, the basis that enabled IFAD to obtain a strong credit rating (AA+).[5] This credit rating is enabling the strengthening and diversification of IFAD's resource base. It therefore represents a central piece of the BRAM strategy in that it allows IFAD to access borrowed resources at competitive financing terms to finance the portfolio, including BRAM resources.

3. The development of the BRAM was a consultative process that involved IFAD Member States through the Working Group on the Performance-Based Allocation System (PBAS), and benefited from constructive discussions during the IFAD12 Consultation, with the Audit Committee and the Executive Board and during bilateral meetings. In this spirit, Management has committed to updating the Executive Board on the operationalization of the BRAM. This is the purpose of this paper.

4. The BRAM will be the sole financing mechanism in the programme of loans and grants (PoLG) through which IFAD will provide financing to upper-middle-income countries (UMICs). For IFAD12, Management has committed to making available between 11 and 20 per cent of IFAD's PoLG to UMICs through access to borrowed resources.[6] Eligible low-income and lower-middle-income countries (LICs and LMICs) will also be able to access BRAM resources.

5. As set forth in document EB 2021/132/R.9/Rev.1, the BRAM is built on five pillars: (i) country selectivity and eligibility; (ii) supply of borrowed resources; (iii) risk-based country limits; (iv) differentiated financing conditions; and (v) demand-based access. The following sections are developed around these pillars and elaborate on their operationalization.

II. Country selectivity and eligibility

6. **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. The criteria approved for BRAM-eligible countries are summarized in box 1.

[1] With this, Management delivered on the IFAD12 commitment 40.
[2] EB 2019/128/R.44.
[3] EB 2021/132/R.10/Rev.1.
[4] EB 2021/133/R.12.
[5] AA+ long-term issuer rating from Fitch and S&P.
[6] Borrowed resources are the funds that IFAD borrows from any source under the IBF.

Box 1
IFAD12 selectivity criteria for BRAM-eligible countries

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 BRAM resources, countries will need to comply with the following criteria:[7]

(a) **Strategic focus:** A valid country strategy (country strategic opportunities programme [COSOP] or country strategy note) is available early in the cycle to ensure that 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 sustainability analysis carried out by the International Monetary Fund (IMF), compliance with the IMF external debt limit policy, and IFAD's Non-Concessional Borrowing Policy.

7. The application of the agreed criteria, in addition to a decision taken to maintain IFAD's engagement with approximately 80 countries per cycle, has led to the identification of an indicative list of 52 countries that are BRAM-eligible in IFAD12. Of these, 11 are LICs, 29 are LMICs and 12 are UMICs. In practical terms, the criteria of strategic focus, absorptive capacity and ownership are applied first.[8] The level of indebtedness is then assessed to ensure that countries accessing BRAM resources are not at high risk or in debt distress.

III. Supply of borrowed resources

8. The targeted borrowing amount for IFAD12 is guided by the target replenishment and the PoLG scenario agreed with and supported by Member States. The overall three-year targeted amount for the BRAM is US$1.09 billion. The funding plan aims to secure the amount of borrowing needed to enable IFAD to approve such amount during IFAD12.

9. The overall yearly sustainable level of PoLG will continue to be established using the RAC approach on a yearly basis, in line with the updated methodology introduced for IFAD12.[9] For 2022, the overall sustainable PoLG is US$1.167 billion. This amount is derived from updated amounts and projections, and the yearly funding plan.

10. Management is planning a funding strategy with a certain degree of frontloading of borrowing in the first half of IFAD12. This is to give certainty about available resources to be accessed through the BRAM while at the same time allowing for 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.

IV. Risk-based country limits

11. In order to determine the envelope of resources that eligible countries can access through the BRAM, risk-based ceilings are established for the maximum amount of resources that each country can access to meet their needs, bearing in mind the existing ceiling that no country can borrow more than 5 per cent of the PoLG per cycle.[10] In defining the limits of country exposure in nominal terms, and therefore

[7] These criteria are applied in such a way as to ensure 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 penalizes any group of countries up front and all criteria are actionable.
[8] These criteria are applied to identify countries eligible for all IFAD financing sources, including PBAS resources.
[9] EB 2020/130/R.35.
[10] The 5 per cent maximum allocation is calculated based on the total amount of PBAS and BRAM resources. It is therefore, calculated on US$3,375 million.

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's credit ratings and is periodically revised.

12. In order to consider this credit differentiation and in line with the practices at other international financial institutions, 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.

13. In practical terms, the Office of Enterprise Risk Management (RMO) will have a specific role in managing IFAD's operational pipeline. RMO will review the requests received for financing through the BRAM and will assess whether such requests are in line with individual risk-based country limits.

14. Considering that this is the first time IFAD will operate under a demand-based scheme, coupled with the combination of BRAM resources with core resources allocated through PBAS, Management has recognized the need for proactive monitoring of the BRAM portfolio as a whole rather than focusing exclusively on the individual countries within the portfolio. In this sense, two managerial tools are utilized to monitor the adherence to credit risk practices: (i) risk-based country limits; and (ii) indicative portfolio envelopes. These envelopes will be used as a reference for portfolio management purposes, allowing a certain flexibility in individual country limits, but maintaining as an anchor the minimum credit quality requirement for the portfolio.

15. Key elements for operationalizing risk-based country limits have been discussed and approved during 2021 by the corresponding management committees (the Executive Management Committee [EMC] and Financial Risk Management Committee [FRMC]), in accordance with their role in IFAD's governance structure.[11] These elements are summarized in box 2, as follows:

Box 2
Key elements for assessing risk-based country limits

Minimum average rating for the BRAM portfolio. The minimum weighted average rating was established at BB.[12] This minimum level is in line with the current average rating of ordinary loan operations. It aims to ensure repayment of debt from borrowers, safeguard IFAD's preferred creditor status and IFAD's financial sustainability. This is paramount to maintaining IFAD's sound credit rating, which enables the institution to access borrowed resources at competitive financing terms to finance the BRAM portfolio.

Individual risk-based country limits. Based on the amount of borrowed resources and the required average rating for the portfolio, the individual risk-based country limits will indicate the maximum amount of capital consumption allowed for a single country. Risk-based country limits will constitute a key risk management tool to be utilized by RMO for internal monitoring purposes.

Indicative portfolio envelopes. Indicative portfolio envelopes will be utilized as a complementary management tool to assess the BRAM portfolio. They are intended to serve as a management tool to ease the operationalization of the principles for the use of resources under the BRAM and to demonstrate the implications of key trade-offs between policy and financial constraints. These indicative portfolio envelopes result from (i) analysis of the gap (shortfall) in IFAD financing for individual countries when comparing indicative PBAS allocations for IFAD12 with respect to IFAD11 allocations; and (ii) the potential deterioration of the credit outlook of certain countries. The analysis also considered the fact that UMICs are required to channel at least 11 per cent of the total resources with a cap of 20 per cent. Indicative portfolio envelopes will constitute a key portfolio management tool to be utilized by the operational units for planning purposes.

[11] A central element of the proposal related to the governance of the approval of the technical aspects of determining risk-based country limits. In accordance to the newly established Enterprise Risk Management Framework, the FRMC is responsible for monitoring adherence to the credit risk country limits.
[12] Equivalent to Ba2 in Moody's rating scale.

V. Differentiated financing conditions

16. BRAM resources will be offered on ordinary terms. Financing terms have been determined in accordance with the recently approved category differentiation[13] and the proposed update of elements of pricing for ordinary terms,[14] which reflect the graduation principles and related financial pillars. The borrower categories and the financing terms approved for each category are summarized below.

Box 3
Categories and financing terms of ordinary term loans

Category 1 includes LICs and LMICs that are eligible for super highly concessional, highly concessional and blend terms and have access to resources subject to a maximum of 35 years' maturity and a 10-year grace period, with a maximum average repayment maturity of 20 years.

Category 2 includes LMICs not eligible for category 1, borrowers transitioning from blend terms to semi-concessional loans, creditworthy fragile and conflict-affected states, and small state economies that are eligible for borrowing from the International Bank for Reconstruction and Development. Borrowers eligible for this category will have access to resources subject to a maximum of 30 years' maturity and an eight-year grace period, with a maximum average repayment maturity of 18 years.

Category 3 includes UMIC borrowers with a gross national income per capita (GNIpc) below the Graduation Discussion Income (GDI) threshold that do not qualify for an exemption listed within category 2. Borrowers eligible for this category will have access to resources subject to a maximum of 20 years' maturity and a five-year grace period.

Category 4 includes UMICs with a GNIpc above the GDI threshold and lower than the threshold for high-income countries, or those considered eligible for official development assistance. Borrowers eligible for this category will have access to resources subject to a maximum of 18 years' maturity and a three-year grace period.

17. In July 2021, the EMC approved the 2022 lending terms.[15] Using BRAM eligibility criteria, as described in box 1, and the categories described in box 3, IFAD12 countries have been assigned to the above categories based on each borrower's GNIpc and creditworthiness. The application of these criteria has resulted in: 28 borrowers in category 1; 14 borrowers in category 2; four borrowers in category 3; and six borrowers in category 4.

VI. Demand-based access

18. Countries that have been identified through the BRAM eligibility criteria have been formally advised of the possibility of accessing BRAM resources, and dialogue between IFAD Management, regional and country directors and partner countries is currently ongoing. Once interest is confirmed through an expressed demand for financing, projects will be developed by governments and IFAD following the same process as at present, and following the same three core principles applicable for all IFAD-financed operations, namely: alignment with IFAD's mandate, alignment with government priorities and development effectiveness, as described in box 4. Country teams are encouraging governments to plan projects that utilize both PBAS and BRAM resources wherever applicable in order to ensure that projects are of an appropriate size and scale.

[13] EB 2021/132/R.10/Rev.1.
[14] EB 2021/133/R.12.
[15] The 2022 lending terms and their application to individual countries will be shared with the Executive Board at its December session, in part IV of the budget document (EB 2021/134/R.3).

Box 4
Core principles for IFAD-financed operations

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.

Alignment with government priorities. As with 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.

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.

19. As indicated at the Executive Board session in April, IFAD is gathering expressions of interest from Member States to borrow BRAM resources through ongoing discussions with eligible countries, which will facilitate demand and active pipeline management. This exercise is in line 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 in order 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.

VII. Way forward

20. In preparation for IFAD12, Management is taking the necessary practical steps to implement the BRAM. In addition to engaging with partner countries as described above, IFAD has updated its systems to enable the identification of BRAM-financed operations. The design workflow in the Operational Results Management System is being modified in order to include RMO, which will be a new actor engaged in the design process. At the operational level, BRAM-related guidance for IFAD staff has been produced and dedicated sessions with operational staff are being held in order to ensure understanding and ownership of the specificities linked to BRAM financing.

21. Management will closely monitor the BRAM's operationalization in 2022 and report to the Board on its implementation through part IV of the budget document, which will be expanded to include the BRAM in addition to the PBAS.