
Update on the implementation of IFAD's Integrated Borrowing Framework

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Useful references:

IFAD's Integrated Borrowing Framework ([EB 2020/131\(R\)/R.21/Rev.1](#)); and Establishment of IFAD's Euro Medium-Term Note Programme ([EB 2021/133/R.11](#)).

Action: The Executive Board is invited to review the information presented in this update.

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For more information, please visit [IFAD's investors' page](#).

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Background

1. IFAD's Integrated Borrowing Framework (IBF) was approved by the Executive Board in December 2020 in recognition of the growing importance of borrowing in IFAD's resource mobilization mix. The IBF was introduced with the aim of meeting two objectives:
 - **Objective 1: Timely and cost-effective funding.** Ensuring timely access to best-priced borrowed resources in order to fund IFAD's needs in the most efficient manner.
 - **Objective 2: Maintaining adequate liquidity levels to meet growing disbursement needs.** IFAD's undisbursed balance of loans has grown considerably over the last decade. Adequate liquidity should be maintained at all times to ensure IFAD's ability to disburse and play a countercyclical role. The IBF expands the range of tools enabling IFAD to access liquidity needed to disburse development loans funded through borrowing.
2. Under the IBF, as of October 2022, IFAD had secured US\$696 million equivalent, equal to 58 per cent of the Twelfth Replenishment of IFAD's Resources (IFAD12) funding target.
3. The IBF establishes and regulates the following five pillars of IFAD's borrowing activity:
 - A. Eligible lenders;
 - B. Types of borrowing instruments;
 - C. Use of borrowed funds;
 - D. Borrowing governance; and
 - E. Borrowing limits and risk management.
4. Table 1 illustrates the innovations introduced by the IBF.

Table 1

Innovations and updates introduced by the IBF

<i>Pillar</i>	<i>Change</i>	<i>Type of Change</i>
	Introduction of supranational and multilateral institutions, as well as institutional impact investors	Innovation
A. Eligible lenders	Disapplication of additionality rule for borrowing from IFAD Member States and state-supported institutions not through Concessional partner loans	Update from the original Sovereign Borrowing Framework (SBF) provision
B. Types of borrowing instruments	Introduction of bilaterally negotiated bonds, i.e. private placements	Innovation
C. Use of borrowed funds	No change	No change
D. Borrowing governance	No change	No change
E. Borrowing limits and risk management	Computation of debt/equity ratio	Update from the original SBF provision

5. In 2021, after the approval of the IBF, IFAD introduced the following tools to ensure its effective implementation: (i) IFAD's Sustainable Development Finance Framework; (ii) IFAD's investors' webpage; and (iii) IFAD's Euro Medium-Term Note Programme (EMTN).

6. Clear lessons can be drawn at this early stage of IBF implementation. They are an early indication of potential improvements that IFAD and members should consider to boost the effectiveness of the IBF, reduce the funding risk and, ultimately, increase the predictability of IFAD's ability to mobilize resources for development. The remainder of this document presents such lessons in each of the five pillars of the IBF.

I. Eligible lenders

7. **Broadening the eligible lender/investor base has proven both needed and successful.** The main innovation introduced by the IBF in the first pillar of "Eligible lenders" is to allow IFAD to borrow from two new types of lenders/investors: (i) supranational and multilateral institutions; and (ii) institutional impact investors. This was done in recognition of the growing importance of borrowing in IFAD's resource mobilization mix and of the limited availability of sovereign states and state-supported institutions that could lend to IFAD. IFAD has already successfully engaged with both categories, as further detailed below.
8. **Institutional impact investors are important new partners.** As of October 2022, IFAD had secured funding from two institutional investors, namely Folksam AB, a Swedish insurance company, and Dai-ichi Frontier Life, a Japanese insurance company. These investors bought two private placements issued by IFAD totalling US\$150 million. IFAD's Sustainable Development Finance Framework, its investor presentation and its dedicated investor website launched in 2021 served as useful tools for outreach to this new audience.
9. **Market forces remain the main driver of investor appetite.** It clearly emerged during the initial months of 2022 that all investors, including the most vocal environmental, social and governance (ESG) and impact investors, are strongly driven by market conditions when making their investment decisions. While private placements are privately negotiated, they remain largely subject to trends in financial markets, including volatility, foreign exchange rates, interest rate levels and credit spreads.
10. **IFAD's due diligence process for impact investors is robust.** The due diligence process established by the IBF for impact investors, which is conducted jointly by the Financial Operations Department and the External Relations and Governance Department, has worked extremely well. IFAD has been able to source significant information and exclude names that do not meet its standards.
11. **Loans remain an important funding tool.** Concessional partner loans (CPLs) and sovereign loans remain a very important source of funding for IFAD. Financially, they generally have long maturity amortizing structures that are beneficial to the profile of IFAD's liabilities to better match the nature of IFAD's assets. They are also the basis for a long-lasting partnership between IFAD and the lending government/institution that typically allows for areas of collaboration that extend beyond the financial transaction.
12. **Supranational and multilateral institutions were an important addition to the eligible lender base.** In September 2022, IFAD's Executive Board approved the proposal for IFAD to enter into a framework borrowing agreement with the European Investment Bank, a supranational and multilateral institution. This framework agreement will secure a flexible funding source for IFAD that will potentially support IFAD13 as well. Introducing this lender category through the IBF has proved a good decision.
13. **The challenges are related to lengthy negotiation processes and availability.** The challenge with loans is twofold: (i) lengthy negotiation periods that sometimes exceed 12 months; and (ii) the limited availability of the aforementioned types of loans. In IFAD12, only two countries pledged CPLs, compared to three in IFAD11. Sovereign loans (from development agencies and

supranational and multilateral institutions) are generally a very specific instrument that no other development finance institution (DFI) employs as IFAD does. Development banks typically provide loans earmarked for specific projects to ensure compliance with their internal policies and mandate. Since IFAD follows a non-earmarking policy to ensure that such loans fund the totality of its programme of loans and grants, opportunities to raise funding through these loans are rather limited.

II. Types of borrowing instruments

14. **Private placements are a powerful addition to IFAD's funding mix.** The innovation introduced by the IBF in the second pillar of "Types of borrowing instruments" is to allow IFAD to issue private bond placements (or bilaterally negotiated bonds). IFAD has already issued US\$150 million in the form of private placements and is continuing efforts to position itself as an issuer in the markets.
15. **The EMTN is an efficient issuance platform.** In December 2021, after approval by the Executive Board, IFAD established its EMTN, a standardized issuance platform. The two private placements issued in very close succession in June 2022 proved the usefulness of operating under a pre-agreed EMTN platform, since private placements are executed extremely rapidly once agreement on the commercial terms is reached with the investors.
16. **Private placement opportunities shrink significantly in volatile markets.** A clear trend in the first half of 2022 was that extremely volatile markets, rising interest rates and significant strengthening of the United States dollar deterred many traditional private placement investors, particularly in Asia. This was due to both their unwillingness to lock in capital for long maturities and rising hedging costs towards the Japanese yen in particular. Statistics provided by dealers showed how traditional large buyers of ESG private placements were either inactive or focused on short-term liquid issuances. This dynamic is inherent to long-dated private placements; hence, the resulting funding risk cannot be offset as long as IFAD's focus remains on private placements.
17. **Having options and flexibility reduces funding risk.** The only way to mitigate the inherent funding risk in long-dated private placements is to broaden the investor pool and increase IFAD's ability to issue in currencies other than the United States dollar and euro, while entering into cross-currency swaps to hedge the currency risk.

III. Use of borrowed funds

18. **IFAD will continue borrowing to fund its outstanding loans and maintain prudential liquidity levels.** As stated in the IBF, IFAD borrows to ensure timely and effective funding to support the provision of IFAD loans to eligible Member States in line with its mandate and to keep adequate liquidity levels for disbursements.
19. **IFAD must implement a cost pass-through policy for IFAD's own funding cost.** Under the IBF, borrowing is managed with a balance sheet approach, in line with the IFAD Asset and Liability Management Framework. This means that at the balance sheet level, funding costs are fully covered by the interest rate charged on the loan assets financed by borrowed funds, thereby respecting the condition of financial sustainability.
20. The borrowing cost of IFAD's private placements reflects the levels of an institution rated AA+, whereas IFAD still prices its ordinary loans by applying the International Bank for Reconstruction and Development funding spread, which represents the borrowing costs of a AAA-rated institution. As IFAD establishes its own funding curve, a cost pass-through policy of its own borrowing costs becomes necessary to avoid subsidizing borrowing costs through core resources. IFAD is the

only DFI that does not apply a cost pass-through policy on funding costs. A proposal to that effect will be presented to the Executive Board in April 2023.

IV. Borrowing governance

21. **IFAD needs to continue broadening its potential investor pool.** IFAD has so far presented 22 investors and associated transactions to the Executive Board. It should be noted that this does not translate into security of execution. For the reasons explained above, funding windows and investor preferences open and close very quickly, and investors are ready to transact only when and if the market conditions are right, they have available liquidity and the investment opportunity is aligned with their preferences (preferred currency, coupon level, liquidity position, hedging costs, etc.).
22. **Current governance poses challenges.** Pursuant to the IBF, the authority to approve all borrowing proposals lies with the Executive Board. IFAD's governance process, whereby investor names must be pre-approved by the Executive Board, is very unique. It poses clear timing challenges and exposes IFAD to potential losses of emerging opportunities. IFAD's internal due diligence process for new investors is very advanced, and IFAD is the only DFI that undertakes this thorough pre-screening prescribed by the IBF. A change in the current governance process that allows Management to execute transactions with investors within the IBF's established categories and limits and report ex post to the Executive Board would increase IFAD's funding opportunities.

V. Borrowing limits and risk management

23. **IFAD's debt limits were established in 2014.** Lastly, the current debt limits were established in the Sovereign Borrowing Framework in 2014 and have never been revised. The IBF, moreover, introduced a new, more conservative computation for the debt-equity ratio, aligning IFAD with industry best practice and the methodologies followed by credit rating agencies. All else being equal, this new way of computing the ratio increased it by 6.5 per cent (from 18.3 to 24.8 per cent in June 2022). These limits were introduced when IFAD had a far less sophisticated financial and risk management set-up.
24. **IFAD should revise current borrowing limits to implement its gradual leveraging strategy.** As IFAD's hybrid funding structure continues, with a more sophisticated risk framework and tailored access mechanism for borrowed resources, the gradual leveraging strategy should continue to be pursued to sustain the Fund's growth and larger impact. Based on current projections, IFAD would reach the maximum debt-equity limit in the first year of IFAD13. Therefore, a revision of such limits is to be envisaged during IFAD12 to ensure that the Fund enters IFAD13 with adequate funding possibilities.